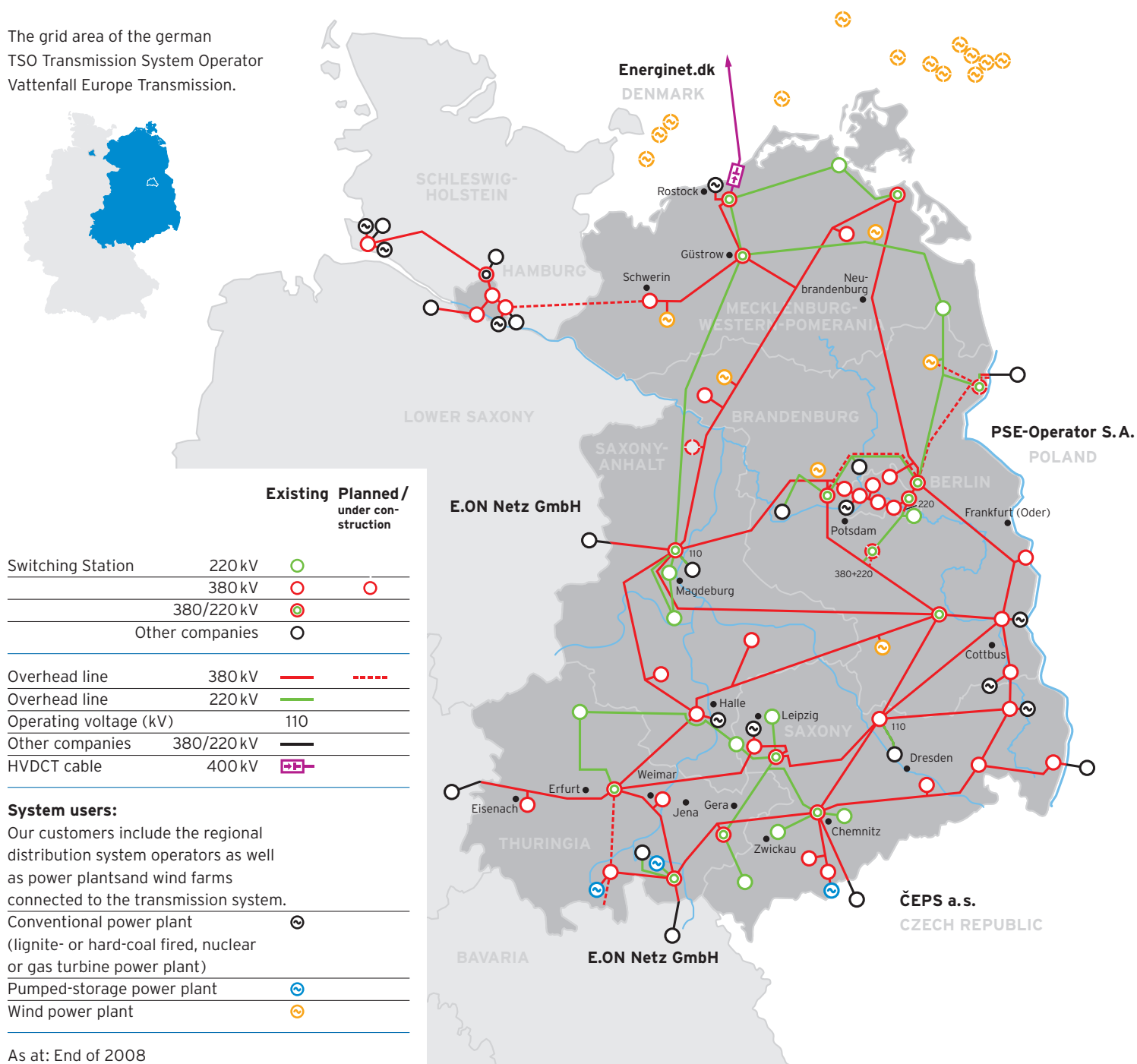


ANNUAL REPORT **2008**

Vattenfall Europe Transmission

THE EXTRA-HIGH VOLTAGE SYSTEM OF VATTENFALL EUROPE TRANSMISSION GMBH

The grid area of the german TSO Transmission System Operator Vattenfall Europe Transmission.



AT A GLANCE

		2008
Sales revenues	€ m	3 631.4
Use-of-system charges	€ m	584.0
Renewable Energies Act / Income and expenses	€ m	2 807.7
Combind Heat and Power Act / Income and expenses	€ m	157.0
Balance sheet total after deduction of the special loss account	€ m	1 786.1
Economic equity	€ m	680.8
Net loss for the year before transfer	€ m	- 92.9
Cash flow from operating activities	€ m	132.1
Fixed assets	€ m	1 192.3
Investments	€ m	108.9
Depreciation	€ m	84.7
Maximum network load	MW	14 167
Electric circuit length	km	9 700
Staff - annual average	Number	512
Staff at 31.12.	Number	516
Personnel expenses	€ m	38.8

ANNUAL REPORT 2008

Vattenfall Europe Transmission



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SUPERVISORY BOARD AND MANAGEMENT

Members of the Supervisory Board

Mats Fagerlund	Member of the Management Board of Vattenfall Europe AG, Berlin - Chairman -
Ulrich Freese*	Vice Chairman of the Mining, Chemical and Energy Industrial Trade Union, Spremberg - Vice Chairman -
Alfred Geißler	Member of the Management Board of Vattenfall Europe AG, Berlin (until 31 December 2008)
Udo Bekker	Member of the Management Board of Vattenfall Europe AG, Berlin (since 01 January 2009)
Florian Guddat*	Foreman for electrical energy equipment
Dr. Hans-Jürgen Meyer	Member of the Management Board of Vattenfall Europe AG, Berlin
Dr. Lutz Pscherer*	Electrical engineer

* Employee representative

Members of the Management

Stefan Dohler	Hamburg, Commercial Division
Hans-Jörg Dorny	Neuenhagen near Berlin, Human Resources Division (since 01 October 2008)
Jürgen Grieger	Rosengarten, Human Resources Division (until 30 September 2008)
Wolfgang Neldner	Berlin, Technical Division

REPORT OF THE SUPERVISORY BOARD 2008

In the past financial year, the Supervisory Board fully assumed the responsibilities assigned to it by the law and the Articles of Association. It oversaw the work of the Management and provided assistance as well as advice. As in previous years, the Supervisory Board was directly involved in all decisions of fundamental importance for the Company.

The Supervisory Board was provided by the Management with written and verbal reports about the Company's business situation, the most important business events as well as the Company's strategy and business plans on a timely basis, in detail and in compliance with legal requirements. In the run-up to meetings, the Supervisory Board received briefing papers in accordance with the agenda. In addition, detailed preliminary discussions were held with the employee representatives.

All management measures requiring Supervisory Board approval as well as other significant business transactions and processes were reviewed by the Supervisory Board and discussed in detail with the Management in three regular meetings.

Through suggestions, critical questions and advice, the Supervisory Board had a monitoring influence on management of the business, and reviewed it with regard to the criteria of lawfulness, propriety and economic efficiency.

Specific matters were also discussed out of meetings. The Management additionally maintained a regular exchange of information and ideas with the Supervisory Board Chairman and Vice Chairman, keeping them informed e.g. on current developments of the business situation, important business transactions and occurrences, and upcoming decisions.

Focal themes of Supervisory Board's deliberations

The topics discussed by the Supervisory Board in its regular deliberations included e.g. the economic and human resources development of the business. In addition, the Supervisory Board supported the Company in meeting its legal obligations, for example

in ensuring connection of the emerging offshore wind farms to the system by establishing a subsidiary, VE BOG, and making it fully operational. The Supervisory Board also oversaw the non-discriminatory exercise of the network business and the implementation of Unbundling requirements, and supported the Management in its cooperation with the regulator Bundesnetzagentur (Federal Network Agency).

Further key topics of the deliberations included the projects for extension of the transmission system, e.g. to allow for the transport of renewable energy-based electricity, support to the Management in the cooperation with other European system operators for further development of the single European energy market, and in collaborating with the relevant authorities and institutions.

Energising of the 80 km overhead line from Halle to Schweinfurt (southwest interconnector), the first section of the European Halle – Schweinfurt priority project, was a particular highlight in this business year.

Annual financial statements

Statutory auditors PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Berlin, had been mandated by the Supervisory Board to audit the 2008 annual financial statements pursuant to a decision taken at the Shareholders' Meeting. The annual financial statements prepared by the Company, including the bookkeeping system, as well as the management report were audited, and as a result given an unqualified audit certificate by the mandated auditor. In connection with the audit of the annual financial statements, the Company's risk early warning system was reviewed and confirmed.

The annual financial statements and the management report for 2008, as well as the statutory auditor's audit report, were made available to all Supervisory Board members in good time. The annual statements were discussed in detail in the presence of, and following a report given by, the statutory auditor in the Supervisory Board meeting on a 05 March 2009.

The annual financial statements and the management report for 2008 were reviewed by the Supervisory Board. No objections are raised against this report and the declarations of the Management contained therein. The Supervisory Board therefore endorses the audit result reached.

**Committee of the Supervisory Board,
and staffing changes**

The Presiding Committee discussed matters concerning the Managing Directors in one meeting. Upon expiration of the 30th day of September 2008, Mr Jürgen Grieger resigned from his position as Managing Director for the Human Resources division of Vattenfall Europe Transmission GmbH. Mr Hans-Jörg Dorny succeeded Mr Grieger on 01 October 2008.

There were no changes in the composition of the Supervisory Board in 2008.

The Supervisory Board expresses its thanks to the Company's Management, the Works Council members and all employees for their work and commitment in financial year 2008.

Berlin, March 2009
On behalf of the Supervisory Board



Mats Fagerlund
(Chairman)

MANAGEMENT REPORT

1. BUSINESS OPERATIONS AND BUSINESS ENVIRONMENT

Vattenfall Europe Transmission GmbH (VE Transmission) operates the transmission system of Vattenfall Europe AG (Vattenfall Europe) at the voltage levels 220 kV and 380 kV. The system extends across the eastern German Federal states, Berlin and Hamburg and has a circuit length of approx. 9,750 km. The Company's customers include the distribution system operators (DSOs) of the regional electricity companies based in the control area of VE Transmission and directly connected to the extra-high voltage system, the operators of power plants, pumped-storage plants and wind farms feeding into the transmission system, large industrial users as well as transit customers, balancing group customers and customers feeding energy into the network under the German Renewable Energies Act (EEG) and the Combined Heat and Power Act (CHP Act).

As a transmission system operator (TSO) responsible for a control area, VE Transmission is in charge of providing the system at maximum safety and security levels, low prices, and in a user-friendly, efficient and environmentally friendly way, as well as for ensuring the overall balance of generation and consumption within the entire electricity system. In doing so, VE Transmission guarantees free access to, and non-discriminatory use of, its transmission system. VE Transmission as an independent legal entity meets the Unbundling requirements by maintaining clear-cut contractual relationships to the other companies of the Vattenfall Europe group. A non-discrimination programme has been published and is being practised.

Due to the central location of its network, VE Transmission has an important function in European electricity trading, connecting:

- the Danish, Polish, Czech and German networks,
- the European mainland to Scandinavia, and
- the interconnection organisations UCTE and NORDEL.

In accordance with the EEG, VE Transmission ensures take-off of all renewable energy-based production

in the control area and its immediate transport, its Germany-wide distribution and the operations to balance variations in feeding in compliance with the requirements.

Since December 2006, VE Transmission has been responsible for connecting offshore wind farms to the system.

The Company sees its main focus in reinforcing and extending the 380 kV long-distance transmission system based on sustainability and high performance.

Against the background of the ongoing political debate about ownership unbundling of the extra-high voltage networks, i. e. their spin-off from the integrated energy utility companies, Vattenfall Europe AG as the sole shareholder of VE Transmission is reviewing a range of options, one being the Company's acquisition by a financially strong investor with a long-term focus. The profit and loss transfer agreement in place between VE Transmission and Vattenfall Europe AG was terminated upon expiration of the 31st day of December 2008. Collaterally to this move, the Company has given itself an own functional and organisational profile according to the requirements the European Union (EU) is certain to formulate for the reorganisation of the Internal Electricity Market. Insourcing of the administrative services previously purchased from the Vattenfall Europe group is one of the features of this profile.

Legal framework of the energy industry

The legal and political setting for the energy business in financial year 2008 saw numerous activities at the European and national levels.

At European level, agreement has been reached about the directives on the internal market in electricity and natural gas, the regulation on conditions for access to the network for cross-border exchanges in electricity, and establishment of a European regulatory agency. The way was paved to creating an "independent transmission and long-distance grid operator" for electricity and natural gas as an alternative that would be unlimited in time and equal to

ownership unbundling. Maintaining the status quo is not regarded as permissible.

Against the backdrop of European and national targets and commitments to climate pollution abatement, the German government had adopted the milestones of a catalogue of 29 activities for an integrated energy and climate programme as early as in August 2007. One of the ways of its implementation will be an amendment to the EEG which became effective on 01 January 2009. It provides for rising remuneration to be paid for onshore wind electricity feed-in and to offshore wind farm operators. For the first time, the EEG allows the deceleration of EEG generation assets to manage electricity feeding in the event of network overloading. A hardship clause provides for indemnification of the plant operators to make up for the resulting revenue shortage, although these costs may currently not be passed on to customers on a nationwide basis. The important horizontal mechanism of physical EEG balancing between the German transmission system operators will remain in place.

With regard to the vertical mechanism of passing on EEG costs, the EEG provides for an authorisation of the government to issue judicial ordinances. Its purpose is to allow – after a transition period has lapsed – only monetary (rather than physical) passing-on of EEG costs by the TSOs to suppliers. Furthermore, it will be possible, by way of a respective ordinance, to commit the TSOs to marketing EEG electricity in an efficient way, and to keeping a common EEG account or entrusting third parties with doing so. Finally, so-called direct marketing of EEG electricity by the plant operators has been provided for.

The Combined Heat and Power Act (KWKG) was modified by a law amending the predecessor act. It serves to interrupt the trend of falling CHP premiums on use-of-system charges observed in previous years by expanding the group of generation plants eligible for subsidies, and by additional subsidizing of investments in district heating systems, from 2009 onwards.

Speedy extension of the transmission system is therefore an urgent necessity and of considerable importance to ensure transportation of the continuously rising EEG electricity volumes from the north-eastern “EEG excess area” to the south-western “EEG demand area” and make more transmission capacity available for the expanding European trading activities. In order to speed up the extension of the grids, a law on the extension of overhead power line connections (EnLAG) has been introduced to the legislative procedure. The essential purpose of the law is to formulate a nationwide demand plan allowing conclusions on whether a given network extension project should be carried out. VE Transmission nevertheless aims to harmonise global requirements with the specific local situation. Compensatory measures are one mechanism serving this purpose. The EnLAG has also identified four pilot projects for buried transmission cables. The grid section relevant for VE Transmission in this context is the stretch of the southwestern interconnector between Altenfeld and Redwitz.

System provision

Internal electric faults caused the destruction of cable terminals at a terminal tower of the partly buried 220 kV Marzahn-Wuhlheide-Thyrow overhead line on Berlin territory on 01 January 2008 and 01 February 2008 which led to some pollution of adjacent properties. The property damage was adjusted, and conversion of the terminal tower initiated. Repairs of the tower will extend into 2009 because of a complicated ownership situation and the nature of the technical adjustments that include additional protective devices.

Operation of the system was ensured by investments and maintenance works in line with the respective requirements. Against the backdrop of ever more challenging requirements being made on the transmission system with a view to long-distance transport of renewable energy and unhindered pan-European electricity trading, the focus of investment activities in 2008 was on network reinforcement and extension works. Among other things, the first sections of the restructured 380 kV switchgear in Vieselbach and Ragow were completed and commissioned.

The erection of the first section of the so-called southwest interconnector from Halle to Schweinfurt, running from the extended Lauchstädt substation near Halle to the Vieselbach substation near Erfurt, was the largest project in 2008. This section was commissioned on 18 December 2008. The licences for the remaining sections of this and other new overhead lines are still outstanding. There is partly little acceptance of new overhead lines on the side of local stakeholders, and there is enormous public resistance against these projects. VE Transmission responds by offering concessions to local players on the one hand, and on the other, by using innovative technologies to manage the inevitable interventions in affected areas and minimise their impact. All in all, this makes both delays and cost increases likely. In the long run, climate pollution abatement (because of throttling of EEG generation units), pan-European trading and the service security of the interconnected EU grid might be compromised.

System control

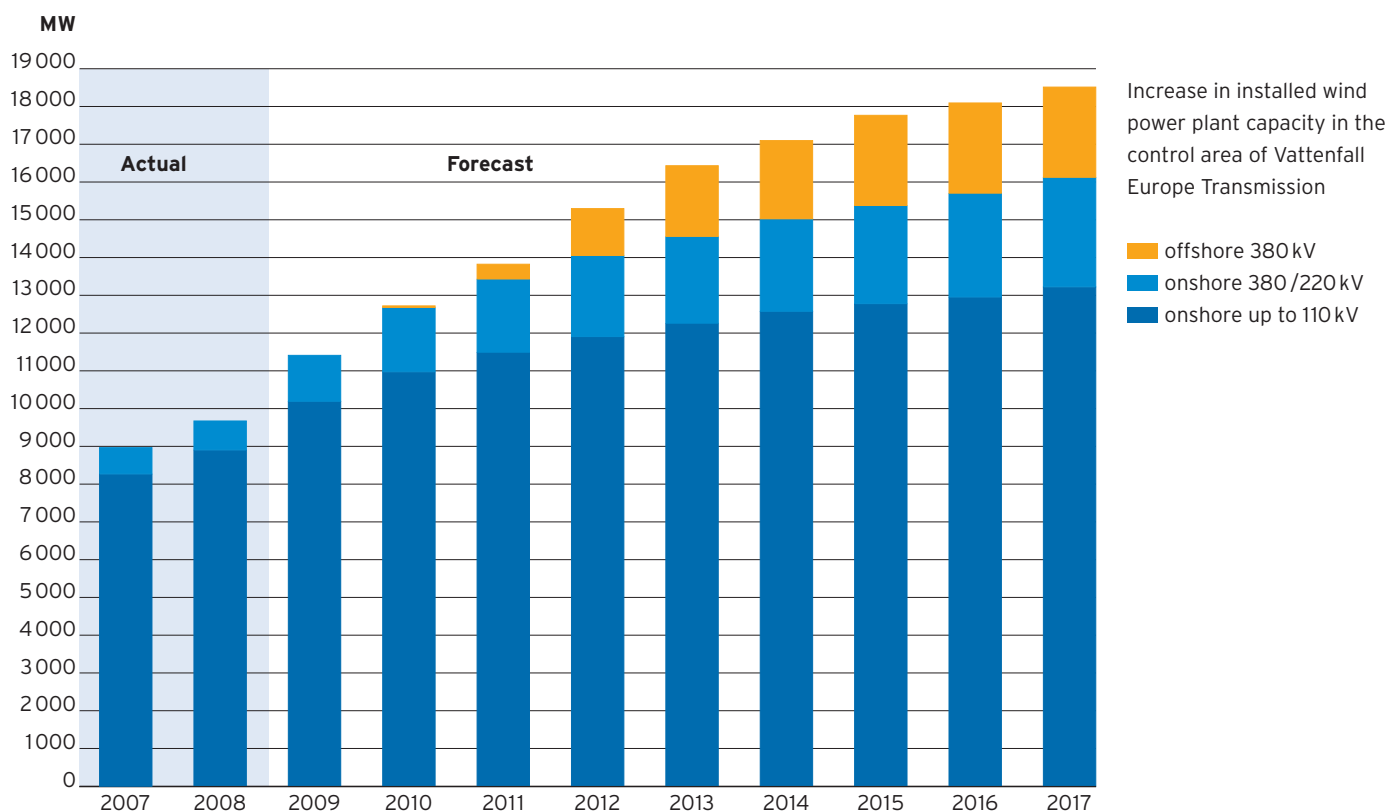
System control in the Company's control area was generally conducted in conformity with the relevant requirements and rules. The control power required was procured via tender procedures. In addition, imbalance power had to be kept available, and an increasing volume of EEG balancing transactions had to be carried out on the basis of market mechanisms, to ensure energy fed-in from EEG units was transported on as required.

The installed capacity of wind power generation in the VE Transmission control area reached 9,680 megawatts (MW) at year-end 2008. The installed wind power had therefore risen 710 MW, or 7.9%, versus the previous year by the end of December 2008. Against this backdrop, the principal challenge was to control the fluctuations in considerably increased wind power feeding such as to consistently guarantee system security. The maximum reached in terms of simultaneous feeding from wind power plants in the VE Transmission control area during the financial year was 8,257 MW (extrapolation) on 20 November 2008. To guarantee safe and secure system operation in the control area of VE Transmission, net-

work- and market-related measures and adjustments according to section 13, clause 1 EnWG ranging even to the point of re-dispatch and – for the first time – regional adjustments according to section 13, clause 2 EnWG had to be resorted to ever more frequently because of the growing discrepancy between high installed wind generation capacity (approx. 41% of wind generation capacity installed in Germany) and low electricity consumption (approx. 18% of all-German consumption) on the one hand, and the failure of network extension projects to keep pace with this on the other hand. Large-scale adjustments according to section 13, subsection 2 EnWG could thereby be avoided.

Various changes occurred in the procurement of system support services as a result of moves to meet requirements of the Energy Industry Act (EnWG) and ordinances pertaining to it. All four German TSOs developed, within a short period of time and in close coordination with their market partners, a procedure for joint procurement of control energy, and implemented it following reconciliation with the regulator Bundesnetzagentur (BNetzA) based on a joint platform for award. To avoid what is called “balancing against each other”, an optimised control concept was put into operation by VE Transmission and two other German TSOs towards the end of 2008. This optimisation helps to avoid up to 97 per cent of the secondary control energy that would, without this system, potentially have been used for opposite control processes in the three control areas involved. This move has allowed tapping into considerable synergies without changing the well-proven control area structures that are so important for service security in the German system.

The first network security conference was held in the VE Transmission control area on 25 and 26 August 2008. This conference focused on trustful collaboration between all system operators and system users, in particular in situations when critical conditions of the electricity system have to be brought under control. Besides carving out the specific features of the security situation and explaining the east German “electricity export area”, reaching a common



understanding of the training needs of operational personnel was a central element of the conference. VE Transmission and the eight distribution system operators directly connected to the transmission system recently signed contracts on support to the TSO by the DSOs in implementing changes according to section 13, subsection 2 EnWG. This means the contractual basis is now in place to give the operating personnel greater certainty to act in critical network situations.

VE Transmission was the first European TSO to successfully undergo the UCTE Compliance Monitoring Audit on 13 and 14 October 2008. This audit reviews compliance with the rules stipulated in the Operation Handbook.

For the purpose of training operating staff, in-house events were held using the training system of providers DuTrain. At the same time, staff of the System Control function took part in the colloquium of the German TSOs at DuTrain's facilities. A bilateral workshop for staff members of the System Control function was held with the Polish TSO in May. September then saw the Company participate in the first supra-regional dispatcher workshop of the Central and Eastern European (CEE) region.

On 11 December 2008, the first development stage of the Cottbus network training centre was commissioned, a facility jointly conceived by VE Transmission and the Cottbus-based technical university Brandenburgische Technische Universität. It will in future be a venue for elaborate safety and security training for operating staff of VE Transmission, the distribution system and power plant operators in the control area as well as neighbouring TSOs.

System use/Regulatory matters

System use in 2008 was invoiced to customers on the basis of use-of-system charges approved by virtue of a BNetzA decision of 10 January 2008 and laid down in a price sheet published by the regulator for the period 01 January to 31 December 2008. In conformity with the BNetzA decision, the pumping electricity take-off by pumped-storage power plants connected to the extra-high voltage system was for the first time included in the costing of use-of-system charges and the Verprobungsrechnung, a verification calculation according to section 20 of the Ordinance on Charges for Access to Electricity Supply Systems (StromNEV). For such take-offs of pumping electricity, an application for approval of an individual use-of-system charge pursuant to section 19, subsection 2, clause 1 StromNEV had already been filed with BNetzA by VE Transmission on 21 December 2007 and supplemented by a statement of reasons dated

16 April 2008. The respective ruling was issued by the regulator on 19 January 2009. The appeal lodged with the Düsseldorf Higher Regional Court (OLG Düsseldorf) against BNetzA's assumption that pumping electricity carries charges was turned down. An appeal on a point of law against this decision of the Düsseldorf Higher Regional Court was filed with the Federal Court of Justice (BGH).

The need to adjust the contracts with customers which resulted from the Energy Industry Act and the ordinances pertaining to it was met by signing further agreements on amendment of use-of-system contracts with distribution system operators.

In the proceedings dealing with the appeal on a point of law with regard to the use-of-system charge for 2006, a BGH decision was pronounced on 14 August 2008. According to it, BGH regarded the so-called "skimming-off of extra revenues" as legally permissible for the period 01 November 2005 to 30 June 2006. A decision in favour of VE Transmission, in contrast, was made by BGH in the same proceedings with regard to the inclusion of advance payments made and assets under construction in the calculations of imputed returns on equity.

On 15 October 2008, a complaint of unconstitutionality against this BGH decision on the so-called "skimming-off of extra revenues" was lodged in due time with the Federal Constitutional Court.

The use-of-system charge for 2009 will be determined on the basis of the revenue cap fixed by BNetzA for the first time. BNetzA opened the public consultation procedure on fixing the revenue cap for VE Transmission by letter of 19 December 2008. This letter to the Company stated an efficiency level of 99.6 per cent. The consultation procedure is still underway.

The consultation letter also stated retraction of the model for application to system support services of the hardship clause according to section 4, subsection 4 of the Ordinance on Incentive Regulation (ARegV). This model had, following reconcilia-

tions between the 6th and 8th Ruling Chambers of the Agency, been sent to the TSOs on 13 November 2008 as a result of lengthy discussions with BNetzA; it had taken the needs of the TSOs at least partly into account. Instead, it is planned to take account of the costs of system support services in view of defining the revenue cap on the basis of case-by-case reviews and decisions.

Following a detailed analysis, the trilateral set of agreements between VE Transmission, a distribution system operator and the latter's special-contract customer was found to be in conformity with the requirements of BNetzA. Should these requirements change, the parties to the agreement will amend the underlying contracts. VE Transmission assumes that this will not lead to any potential future burdens on the Company.

BNetzA continues to hold the view that there are more than minor opportunities for the Company to influence volumes and prices for system support services. According to BNetzA, this implied that effective procedural regulation had to be ruled out in this respect. Effective procedural regulation can, on the other hand, be expected for congestion management and inter-TSO compensation.

In the run-up to the start of incentive regulation due in 2009, a structural adjustment was made at VE Transmission as of 01 December 2008 to the effect that the set of responsibilities of the Regulatory Management function has been enhanced to include – besides management of the regulatory process – commercial regulatory management, a responsibility that had before been assumed by Controlling. The customer-related responsibilities concerning network connection contracts, contract management, network access contracts and strategic network planning have now come to be assisted by a specific legal function in this restructuring process, and have been bundled in a new function called Customer Care/Network Access. This function is advancing the so-called principle of reciprocity that has so far been tested with network connection applications filed by Baltic Sea offshore wind farms, with the aim of adapting it

for use with all customers. The Company interprets this principle as expressing the harmony of licensing, financing and execution among partners relative to the overall project (that may e. g. consist of a wind turbine and its connection to the system).

TSO cooperation and cross-border electricity exchanges

In anticipation of the transposition into national law of the 3rd Energy Package of the EU, the European TSOs have jointly pushed for establishment of the “European Network of Transmission System Operators for Electricity” (ENTSO-E). This new association was established on 19 December 2008. Due to the adequate presence of VE Transmission in the preparatory bodies, the Company has been successful in ensuring that more attention is paid to regional concerns in the interplay of political and technical factors.

The European initiatives for promoting cross-border electricity exchanges and creating regional markets continue to enjoy active support from VE Transmission.

In the CEE region where it is mainly the cross-border overhead lines to the Czech and Polish transmission system operators which are of importance for VE Transmission, the joint process for award of limited transmission capacity by way of coordinated explicit auctions on an annual, monthly and daily basis has continued to be practiced with the adjacent TSOs being involved. In close coordination with the TSOs and the regulators of the region, the investigations into a future load-flow based auction process to further improve the harmonisation of electricity trading activities and system security have continued. The eight TSOs of the region established the Central Allocation Office GmbH (CAO) with its registered office in Freising near Munich on 17 July 2008. This company will be in charge of carrying out load-flow based auctions as of the end of 2009. The IT equipment necessary for this purpose has already been ordered.

In the Northern European (NE) region, a test of the so-called market coupling procedure – a method for allocation of the limited transmission capacity on the Kontek d. c. link between VE Transmission and Danish Energinet.dk – which began in October 2005 – continued into summer 2008. Following notification of approval under antitrust law, the Hamburg-based European Market Coupling Company GmbH (EMCC) was established on 28 August 2008, and market coupling started in September 2008. On 08 October 2008, EMCC in its capacity as auction office decided to temporarily suspend the market coupling procedure at the German-Danish border. This was due to unexpected deviations in load-flow and price calculations between EMCC and the Nord Pool Spot electricity exchange. Resumption of the market coupling procedure at the German-Danish border is scheduled for the first quarter of 2009 as soon as the changes of the EMCC IT system identified as necessary have been implemented. In view of the complexity of the modifications and the necessary comprehensive tests, however, further delays cannot be ruled out. Until the procedure has been resumed, implicit auctions for Kontek are being carried out by Nord Pool Spot.

VE Transmission has also actively participated in the activities of the Central Western European region (CWE) after having signed the Memorandum of Understanding with the Pentalateral Forum. Our focus is here on ensuring system security and structuring the framework for coordinated network extension planning. VE Transmission is contributing its experience from other regions, forming a bridge from west to east.

VE Transmission is among the co-initiators of “TSO Security Cooperation”, a body formed by eleven TSOs in December 2008. A grid security panel and a common IT platform help further increase the level of security in operations.

The bilateral cooperation with the Polish and Czech TSOs was further intensified in the period under review. The requirements for network extensions at the interfaces of the two energy systems were discussed

with the EU coordinators, the Polish and German Ministries of Economics and regulators in two stakeholder meetings. Very important support has thereby been provided to the European priority projects for enhancement of the German-Polish transmission capacity. A cooperation agreement (on integration of renewable energies, market framing, system security etc.) was signed with Belgian TSO Elia in May 2008.

Balancing group management

VE Transmission practises monthly billing of continuous balancing of the control area, and thereby of all (including own) balancing groups. At the end of 2008, approx. 410 balancing groups were managed and billed by VE Transmission for 283 traders, electricity sales organisations and network operators operating in the Company's control area. The two-month period mandated by StromNZV for balancing-group billing has been complied with since September 2007 (beginning with balancing-group billing for July 2007), and final billing after eight months, a schedule considered by BNetzA on a transitional basis, since December 2008 (beginning with balancing-group billing for April 2008). In the course of such final billing, the companies responsible for balancing groups have several opportunities for data clearing with the respective system operators. For each bill, the parties responsible for balancing groups are, on an automated basis, provided with the billing results along with all underlying billing data they need to check the bills.

The market partners have acknowledged the outstanding quality of balancing group billing by VE Transmission, which finds its expression in a low number of bill complaints and good payment discipline.

VE Transmission continues to support the implementation of standardised balancing-group contracts and billing processes as pursued by BNetzA for nationwide application. VE Transmission participated in preparing proposals to BNetzA for this purpose, and in coordinating them between the respective companies. BNetzA postponed a decision to this effect to 2009. VE Transmission has adapted the model balancing-group contract it has so far used to the standard contract based on the outcomes of the

consultation with BNetzA, and has offered it to its market partners for conclusion.

Management of the business under the EEG / CHP Acts

The total volume of EEG electricity absorbed by the system in our control area reached 22.7 TWh in 2008 (previous year: 21.7 TWh). After taking into account the EEG electricity purchased from other TSOs (4.5 TWh) and delivered to them (13.9 TWh), a total 14.2 TWh EEG electricity was delivered to traders and electricity sales organisations operating in the control area based on the provisional EEG quotas. The delivered surplus volumes of 0.9 GWh will be redelivered to VE Transmission as required by the law in the context of the annualised bill for 2008 which will be issued in 2010.

VE Transmission continues to be involved in a discussion with many partners about integration into the system of all energies covered by the EEG, which will in future include biomass-based energy and offshore wind energy. In the interest of climate pollution abatement, VE Transmission aims to take off and transmit every single carbon-free kilowatt-hour.

The amendments to the EEG and the CHP Act became effective on 01 January 2009. The amendments themselves will, from the perspective of the TSO, initially not give rise to any substantial changes in management of these processes. An ordinance provided for by the EEG that will presumably involve considerable modifications of the vertical cost transfer mechanism is not expected to be issued before mid-2009.

VE Transmission is participating in important international, national and regional studies dealing with the integration of renewable energies into the transmission system and its implications for the latter. In particular, the European wind integration study (EWIS) should be mentioned here, a paper complementing the dena II study launched in 2007 and regional studies commissioned by governments of German Federal states. The project "The Harz mountains – A showcase for renewable energy use" was launched in cooperation with renewable energy

generators and other partners. This project investigates the potential for an interaction mechanism between renewable energies and the traditional pumped-storage technology.

Front Office

Being a TSO, VE Transmission has been obliged by the legislator to guarantee service security and network management as well as balance the overall energy situation in its control area and the balancing groups assigned to the TSO. Managing these balancing groups, especially the EEG balancing group, must be based on a transparent, non-discriminatory and market-oriented methodology in conformity with the requirements made by the legislator and regulator BNetzA. To improve its ability to meet these requirements as a TSO having responsibility for balancing groups, VE Transmission has set up a Front Office that ensures the Company's independent access to the energy market. Electricity procurement and marketing solely follow business criteria in the marketplace, subject to the given technical situation of the networks, and are thereby entirely non-discriminatory.

The Front Office is embedded in the organisation of the Energy Management function that also comprises the necessary Middle and Back Offices. The portfolio structure and the processes for managing the business transactions have become well-established and are largely automated as part of the portfolio and billing system of VE Transmission. This warrants full transparency and assessment from a profitability perspective for each and every business transaction. This holistic approach is in conformity with the established regulatory framework and even transcends the developed regulatory requirements in many aspects, making VE Transmission a pioneer in this field. Risk monitoring is based on *mutatis mutandis* application of the requirements issued by the Federal Financial Supervisory Authority (BaFin), performing to a standard that is again much more stringent than the general practice in the industry.

Human resources

On 31 December 2008, VE Transmission had 516 employees and 22 apprentices, with the average age being 44.6 years, and the share of female employees 21 per cent. The percentage of employees on part-time contracts was 0.8 per cent. The Company employed 21 severely handicapped employees and employees with a similar status at year-end, which is equivalent to a share of around 4.1 per cent.

In comparison with the previous year (503 employees and 22 apprentices), the headcount increased by thirteen. This net headcount development is the aggregated result of 33 leavers and 46 joiners.

A university graduate was recruited as trainee in 2008 for long-term qualification.

The 22 apprentices are trained in both technical and commercial occupations. All six apprenticeship graduates of the year 2008 were taken over into full employment on time-limited contracts.

Financial year 2008 saw the preparations for VE Transmission becoming the first German TSO featuring a functionally and organisationally independent structure. These preparations are scheduled for completion in 2009. Following a detailed analysis, it was decided to newly establish 55 positions in order to reliably support all current business processes. The organisational changes required for this purpose, and the related individual personnel measures, were started towards the end of 2008 and will continue in 2009. The staffing procedures for additional resources were largely completed before the end of 2008. Further preparations include the migration of IT systems which will largely detach the IT infrastructure of VE Transmission from the Vattenfall IT landscape in 2009.

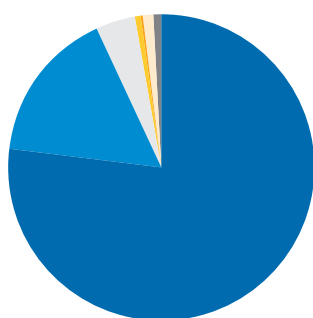
2. BUSINESS SITUATION

Earnings position

In financial year 2008, VE Transmission transported approx. 94 billion kilowatt-hours (kWh) electricity (previous year: 97 billion kWh). The maximum network load was reached at 14,167 MW (previous year: 14,714 MW) on 22 October 2008.

VE Transmission's sales revenues amounted to € 3,631.4 million (previous year: € 3,295.3 million) in financial year 2008. Of this amount, nearly four fifths (€ 2,863.7 million, previous year: € 2,639.3 million) was accounted for by electricity sold under the EEG and CHP Acts, and by system support services provided to other TSOs. These revenues are matched by identical expense items reported under Cost of materials.

Sales revenues from the classic network business rose by around 17 per cent to € 767.7 million (previous year: € 656.0 million). Besides revenues from the sale of EEG imbalance energy, these revenues mainly include network revenues. Vertical network revenues were € 14.8 m down from the previous year, which



Sales Revenues 2008 (in Mio. €)

■ EEG electricity supplies	2 807.7
■ Use-of-system charges	584.0
■ EEG imbalance energy	153.9
■ Electricity supplies CHP Act	17.7
■ Balancing group management	4.6
■ System support services to other TSO	38.3
■ Other sales revenues	25.2
	3 631.4

was, among other things, due to volume, with tariffs merely seeing a marginal increase. An additional charge came from a € 25.4 million reduction of revenues generated with one of our customers, as a result of a correction of use-of-system charges invoiced to the pumped-storage power plants. The revenues from EEG imbalance energy saw a distinct increase of € 119.4 million. These additional revenues compared with € 86.4 million extra expenses under the EEG imbalance process.

A total € 34.5 million (previous year: € 58.0 million) was spent on maintenance of the TSO's assets. In the previous year, expenditures had felt the impact of special measures (e.g. in connection with hurricane Cyril).

Personnel expenses at € 38.8 million (previous year: € 36.3 million) increased predominantly as a result of the regular, collectively bargained pay rise. Depreciation at € 84.7 million (previous year: € 90.0 million) was down from the prior-year level, one of the reasons being the non-scheduled write-off of a transformer in 2007.

Slumping energy prices were the reason why a € 25.7 million provision for contingent losses for future network loss energy expenditure was established. Allocations to this provision are reported under Other operating expenses.

In comparison with the previous year, the negative interest income improved € 3.3 million to € 21.2 million (previous year: € 24.5 m), which is attributable to the development of the Company's overdraft facility during the year under review which was caused by improved funds from operations.

The net loss for the year amounts to € 92.6 million (previous year: € 167.4 million). The loss transferred to shareholder is € 92.6 million (previous year: € 167.7 million).

The previous year's performance was impacted by non-recurring items of considerable importance. Most of the net loss of financial year 2008 is attrib-

table to the failure of transmission tariffs to fully recover the costs of loss energy procurement, furthermore to establishment of the provision for contingent losses, and the deductions on the use-of-system charges invoiced to the pumped-storage power plants.

The Company's performance is largely determined by regulatory requirements. IFRS earnings represent one of the indicators that are of key importance for internal steering of the Company within the Group.

Net assets and financial position

Economic equity in the amount of € 655.8 million has remained unchanged versus last year. The economic equity ratio that includes the equity share of special items and excludes the special loss account increased to 38.1 per cent (previous year: 35.7 per cent). Tangible fixed assets at € 1,192.3 million still accounts for about two thirds of the Company's assets.

Accounts receivable saw a major € 194.3 million decrease in comparison with the previous year, caused mainly by lower receivables from shareholder from the loss transfer. Receivables from management of the EEG business still accounted for the majority of total receivables.

Proceeds from auction revenues collected in the year under review were accrued on the liabilities side of the balance sheet in the amount of € 17.7 million as advance income for measures reducing use-of-system charges in future tariff periods.

The balance sheet total decreased 6.1 per cent versus the prior year.

Most of the € 84.6 million increase in cash flows from operating activities results from the decrease in receivables under the EEG ancillary process. Investing activities caused an outflow of funds of € 105.7 million (previous-year outflow: € 55.2 million). The funds provided by financing activities result from transfer of the loss to shareholder.

Financing of the Company was guaranteed on a short- and long-term basis at all times during the year

2008 based on the intra-group overdraft facility and the loans extended by Vattenfall Europe AG.

Participations

Vattenfall Europe Netcom GmbH (VE Netcom) operates its business in the field of design & build as well as operation of telecommunication systems and networks, and renders telecommunication and other related services. The company generated a net income of € 3.3 million (previous year: € 3.6 million) on sales revenues that increased to € 29.0 million (previous year: € 20.1 million) in financial year 2008. This net income was fully transferred to VE Transmission on the basis of an agreement on profit & loss transfer. VE Netcom had an average 112 (previous year: 85) employees in financial year 2008.

The participation in VE Netcom was sold to Vattenfall Europe as per 31 December 2008. The book profit is € 1.0 million. The net income of the year under review is due to VE Transmission.

Vattenfall Europe Baltic Offshore Grid GmbH is a wholly owned subsidiary of VE Transmission that was established in 2007. The object of this company is to erect, acquire, maintain, operate and operationally manage electricity lines and accessory plant and equipment needed to connect offshore generation units, primarily to be built in the Baltic Sea, to a power transmission or distribution system. The company generated revenues of € 92.1 thousand in its first full financial year.

Furthermore, VE Transmission holds a 12.5% interest in CAO Central Allocation Office GmbH with its registered office in Freising. This company was established on 17 July 2008 with its business purpose being to make congestion management services available for electric transmission grids. VE Transmission also holds a 20 per cent stake in Hamburg-based EMCC European Market Coupling Company GmbH. This company was incorporated on 28 August 2008 with the aim of making congestion management services for electric transmission grids available by way of market coupling, in particular by involving electricity exchanges.

3. IMPORTANT EVENTS POST-ACCOUNTING DATE

VE Transmission filed an opinion paper for the BNetzA public consultation on the revenue cap in due time on 14 January 2009. The Company holds the view that the cost increases that occurred in 2008 in the field of the so-called system support services (control energy, EEG imbalance energy, network loss energy, re-dispatch etc.) have to be taken into full account in defining the revenue cap.

Because of the fact that Ruling Branch 4, the relevant decision-making body of BNetzA, did not grant approval of individual use-of-system charges according to section 19, subsection 2, clause 1 StromNEV for pumping electricity take-off by pumped-storage power plants connected to the extra-high voltage system of VE Transmission until in January 2009, the corresponding income shortfall could not be factored into the use-of-system charges. According to the view of the regulator, the respective income shortfall from 2008 is to be taken account of in 2010, based on a method called cross-period netting.

4. RISK REPORT

In application of the Risk Instruction in place at VE Transmission, the Company's business risks are regularly recorded, assessed and monitored by the respective risk owners on the basis of standardised procedures. The respective value-at-risk figures are calculated working from a scenario-based assessment of risks by their potential amount of loss and probability of occurrence. As the risk monitoring system differentiates between the relevance of the individual risks, and as the respective risk information is integrated into internal reporting, the documentation of risks also helps to ensure rationalised and sustainable management of the Company and its operations.

As far as the risk path is concerned that has to be fixed by BNetzA for the first regulatory period of incentive regulation (2009–2013), some decisions have yet to be made. Key risks inherent in BNetzA fixing the revenue cap include the definition of the

benchmark based on a nationwide comparison of efficiencies with regard to network costs, and the way network-driven costs will be treated. The aim of incentive regulation is to tap into potential for efficiency increases by setting economic incentives; for this purpose, the permissible revenues are decoupled from the costs of the individual companies. For the year 2009, there is a risk of profit deterioration as a result of revenue shortfalls versus the figures currently budgeted in the business plan.

With the inception of incentive regulation, the permissible return on equity will in future be of major importance for the level of network revenues. Insufficient returns on capital employed represent a considerable economic risk for investments – whether previously made or planned for the future – necessary to guarantee service security. The regulator now made a decision on the rate of return on equity for the purpose of calculation of the revenue cap during the first regulatory period, setting the rate of return on equity for new plants at 9.29 per cent before tax, and for inventory plants at 7.56 per cent before tax.

The major risks residing in the energy business result from rising costs of balancing fluctuating renewables-based energy feeding (in particular wind energy), and from the procurement of control power and energy volumes needed to cover network losses. Such cost increases may, on the one hand, result from volume effects – like wind power feeding in excess of the projected volumes – and/or unforeseen increases in market prices.

In order to mitigate the dependency on short-term price swings, the energy expected to be required in 2009 to recover network losses has been procured in the long term through public tendering procedures. Further methods of long-term hedging and control of market risks are being developed. However, not all procurement operations can be hedged on a long-term basis, e.g. because certain procurement procedures are mandatory; for example, the regulator issued detailed directions for the procurement of control energy which have to be used as a basis for joint calls for tenders made by German TSOs. The focus

in this field is therefore on continuous monitoring of the calls for tenders which are, in some cases, made every business day.

As price hikes had been noted in previous years, especially in the market for minute reserve, short-term monitoring of all electricity-price related risks was largely automated as early as in 2006.

A special aspect concerns the legal obligation to assume system responsibility for the transmission of electric energy as the TSOs contribution to a safe, secure and reliable energy supply system. Against the background of the considerable – and further increasing – influence of fluctuating wind power feeding, the focus is here on consistently ensuring the system's balance between generation and consumption.

The risks emanating from extensions of our extra-high voltage network are countered by early and focused public relations work as well as frank discussions with authorities, nature conservation organisations and the local population living in areas close to overhead line runs.

New risks are arising from the erection and operation of power transmission lines required for connection of offshore wind farms in the North and Baltic Seas to the transmission and, if appropriate, distribution system, an obligation laid down in the law. Adverse economic impacts may, for example, result from highly complex new technical processes that have to be followed. In addition, failures to grant licences or approvals, and resulting potential claims for damages on grounds of delayed commissioning, may incur cost increases.

The Company's IT systems and applications are regularly audited and evaluated in application of the existing IT security instructions. In addition, the IT applications were the subject of renewed checks for availability, integrity, data protection and their non-discriminatory nature in 2008.

The more restrictive loan extension practices of the banks recently observed as a result of the financial market crisis may lead to considerable financing difficulties. Presently, upcoming investments are funded through the common Group-wide financing system.

The terms and conditions for some of the goods to be procured in procurement markets have considerably tightened in 2008. Besides to higher prices, this may also lead to longer delivery periods of materials and services. Targeted monitoring of the procurement market and professional asset management are measures taken to contain this risk. As economic activities have seen a global setback in the wake of the financial market crisis, slackening demand may open up opportunities to contract required components at lower prices and, if appropriate, to stockpile them.

The adequacy and effectiveness of the risk management system is regularly audited by the Internal Auditing Department, including for compliance with legal requirements.

The Company's opportunities mainly reside in achieving a firmly established market standing as an independent transmission system operator in a European business environment, and in being a strong and dependable partner to the customers supplied in the control area.

5. FORECAST REPORT

In the interest of guaranteeing the security of supply as required by the relevant EU Directives and the Energy Industry Act (EnWG), VE Transmission will continue to invest in extensions of the networks. In addition, VE Transmission is using its influence to champion unfettered use and development of capacity for electricity storage. The practical implementation of these projects will facilitate directing the super-proportionately high volumes of EEG electricity fed into the system in the VE Transmission control area to regions with less EEG feeding. This will also help to meet the UCTE requirements for safe European grid operation and the stipulations of the German legal framework for safe and secure operation of the control area. Further works for reinforcement and extensions of the networks will be necessitated by the numerous inquiries for connection of conventional power plants and offshore wind farms to the system. Especially the latter are likely to require considerable investment volumes as the Infrastructure Planning Acceleration Act puts VE Transmission under the obligation to install lines hooking up offshore wind farms the construction of which starts before 31 December 2015.

The costs of network operation as such that is, maintenance, human resources, administration and operation are expected to remain largely stable. Only the offshore network costs have been projected to rise in the next few years as the Infrastructure Planning Acceleration Act will be implemented. This applies in particular to the costs to be passed on to the transmission system operators by the subsidiaries of VE Transmission and E.ON Netz GmbH who will operate the offshore systems. The costs of system support services, energy for network losses and EEG imbalance energy continue to be highly exposed to movements in electricity prices and the projected further increase in wind energy feeding, being therefore difficult to forecast since these parameters are very volatile. Across the board, it can be said that the systematically rising costs of EEG imbalance energy and the obligations resulting from the Infrastructure Planning Acceleration Act are likely to trigger further increases in network tariffs.

Based on the most recent price approval for use-of-system charges by BNetzA, the prices for 2009 and following years are planned to be approved under an incentive regulation scheme. The specific features of the TSO (e.g. system responsibility according to section 13 EnWG, maintenance of system stability, management of EEG balancing) have to be taken into account and reflected in proper regulation of the procedure. Based on the legally prescribed risk report that was filed with BNetzA in due time, VE Transmission demands, above all, that a range of specifics found in the east German overall electricity system must be taken into account. Incentive regulation will create the features of the regulatory framework which are essential for the future cost/revenue ratio of the Company and the envisaged market-based returns on capital employed.

Based on the assumption that the above-described legal and regulatory setting will be applicable, the results for the next three financial years are expected to be positive.

The above-mentioned project started in 2008 to create a functionally and organisationally independent VE Transmission is due to be finalized in 2009. Staffing of the positions that have been newly created and are necessary for independent operation is due to be largely completed by the end of the second quarter of 2009. Moreover, VE Transmission will move to its new business location in Eichenstrasse in Berlin. The Company is thereby the first German transmission system operator to adopt a future-oriented structure geared to compliance with all regulatory requirements.

The Management assumes that the review carried out by Vattenfall Europe with regard to potential divestiture of VE Transmission – at least, however, to a structure with a stronger focus on independent operation – will be completed by the end of the first half of 2009. VE Transmission will make its contribution to all corresponding requirements being met in accordance with the requirements under EU law.

VE Transmission will by all means continue to meet its statutory responsibilities for electricity transport in its control area, for the promotion of renewable energies and of the European single market, at a high quality and in particular in the interest of all customers and its European partners, and thereby contribute to availability of a safe and secure electricity supply system. The Company thereby makes a contribution to climate protection and economic development, especially in the eastern German economic area.

Berlin, 10 February 2009
The Management

Three handwritten signatures in blue ink, arranged horizontally. The first signature is on the left, the second in the middle, and the third on the right.

Dohler

Dorny

Neldner

ANNUAL FINANCIAL STATEMENTS OF VATTENFALL EUROPE TRANSMISSION GMBH

Balance sheet as at 31 December 2008 (€ million)

Assets

	Notes	31/12/2008	31/12/2007
Fixed assets	(1)		
Intangible assets		33.5	35.1
Tangible assets		1 157.4	1 133.1
Financial assets		1.4	2.8
		1 192.3	1 171.0
Current assets			
Inventories	(2)	2.9	4.6
Accounts receivable and other assets	(3)	580.5	723.4
Liquid funds	(4)	6.5	-
		589.9	728.0
Prepaid expenses		3.9	4.1
Special loss account		4.2	4.3
		1 790.3	1 907.4

Shareholder's equity and liabilities

	Notes	31/12/2008	31/12/2007
Shareholder's equity	(5)		
Share capital		200.0	200.0
Capital reserve		455.8	455.8
Revenue reserves		0.0	0.0
		655.8	655.8
Special items	(6)	37.6	40.4
Provisions	(7)	427.4	422.3
Liabilities	(8)	480.4	589.3
Deferred income		189.1	199.6
		1790.3	1907.4

Profit and Loss Account (€ million)

	Notes	31/12/2008	31/12/2007
Sales revenues	(9)	3 631.4	3 295.3
Change in inventories		-1.8	3.1
Other internally produced and capitalised assets		2.6	1.0
Other operating income	(10)	183.2	287.4
Cost of materials	(11)	-3 520.9	-3 168.8
Personnel expenses	(12)	-38.8	-36.3
Depreciation	(13)	-84.7	-90.0
Other operating expenses	(14)	-245.8	-438.2
Financial result	(15)	-17.8	-20.9
Result of ordinary activities		-92.6	-167.4
Other taxes		-0.3	-0.3
Loss transferred according to the Profit and Loss Transfer Agreement		+92.9	+167.7
Net loss for the year		-	-

Cash Flow Statement (€ million)

	Notes	31/12/2008	31/12/2007
Result of the period before loss transfer		-92.9	-167.7
Depreciation of fixed assets		84.7	90.0
Increase/decrease in provisions		5.1	-20.0
Loss from disposal of fixed assets		1.1	0.1
Income from disposal of fixed assets		-1.2	-0.2
Other expenses and income not affecting cash		-12.3	85.3
Increase in inventories, trade accounts receivable and other assets		198.5	-78.1
Increase in trade accounts payable and other liabilities		-50.9	138.1
Cash flow from operating activities		132.1	47.5
Proceeds from disposal of intangible and tangible assets		0.4	0.3
Payments for investments in intangible and tangible assets		-108.9	-54.6
Proceeds from construction cost subsidies		0.3	0.1
Proceeds from disposal of financial assets		2.5	0.0
Payments for investments in financial assets		0.0	-1.0
Cash flow from investing activities		-105.7	-55.2
Repayments of financial loans		-59.3	-57.3
Proceeds from loss transfer to shareholder		92.9	167.7
Cash flow from financing activities		33.6	110.4
Net changes in cash funds		60.0	102.7
Cash funds as at 01 January		102.8	0.1
Cash funds as at 31 December		162.8	102.8

Movements in fixed assets (€ million)

	Acquisition and/or production costs				31/12/2008
	01/01/2008	Additions	Book transfers	Disposals	
Intangible assets					
Software, licences, other asset rights	40.5	0.5	0.1	-	41.1
	40.5	0.5	0.1	-	41.1
Tangible assets					
Land, rights equivalent to land and buildings incl. buildings on third-partyland	104.8	1.1	0.2	0.2	105.9
Plant and machinery	2287.6	72.1	50.9	8.3	2402.3
Office equipment and fixtures	53.3	3.8	1.9	0.6	58.4
Advance payments and assets under construction	65.9	31.3	-53.1	-	44.1
	2511.6	108.3	-0.1	9.1	2610.7
Financial assets					
Shares in subsidiaries	2.5	-	-	1.5	1.0
Other loans	0.3	0.1	-	0.0	0.4
	2.8	0.1	-	1.5	1.4
Fixed assets	2554.9	108.9	-	10.6	2653.2

	Depreciation				Book values	
	01/01/2008	Additions	Disposals	31/12/2008	31/12/2008	31/12/2007
	5.4	2.2	-	7.6	33.5	35.1
	5.4	2.2	-	7.6	33.5	35.1
	33.7	2.7	0.0	36.4	69.5	71.1
	1296.8	77.8	7.1	1367.5	1034.8	990.8
	48.0	2.0	0.6	49.4	9.0	5.3
	-	-	-	-	44.1	65.9
	1378.5	82.5	7.7	1453.3	1157.4	1133.1
	-	-	-	-	1.0	2.5
	-	-	-	-	0.4	0.3
	-	-	-	-	1.4	2.8
	1383.9	84.7	7.7	1460.9	1192.3	1171.0

NOTES

GENERAL PRELIMINARY REMARKS

Vattenfall Europe Transmission GmbH (hereinafter called "VE Transmission") is entered in the Commercial Register of the Berlin-Charlottenburg Local Court under register no. HRB 84446.

The Company is included in the consolidated annual financial statements of Vattenfall Europe AG (Vattenfall Europe) with its registered office in Berlin, and in the consolidated annual financial statements of Vattenfall AB with its registered office in Stockholm. The consolidated financial statements prepared by Vattenfall Europe AG cover the smallest group of consolidated companies, and are available in the electronic Federal Gazette (www.ebundesanzeiger.de). The company is entered in the Commercial Register of the Berlin-Charlottenburg Local Court under register no. HRB 86854. According to Sec. 291 of the German Commercial Code (HGB), these annual financial statements exempt VE Transmission from preparing consolidated annual financial statements. The consolidated annual financial statements of Vattenfall AB covering the largest group of consolidated companies are available at Bolagsverket in Sundsvall. The company is there entered under register no. 556036-2138.

A Profit & Loss Transfer Agreement was in place between VE Transmission and Vattenfall Europe in 2008. It was terminated upon expiration of the 31st day of December 2008. The Company was in fiscal unity with Vattenfall Europe in terms of corporate income tax, trade tax and sales tax in financial year 2008.

The annual financial statements of Vattenfall Europe Transmission have been prepared in accordance with the accounting standards of German commercial law and the supplementary provisions of the German GmbH Act regulating limited liability companies. All figures are shown in million euros. Individual items in the balance sheet and in the profit and loss account have been combined to improve the clarity of presentation, and are reported separately in the Notes. The Profit and Loss Account

has been drawn up according to the cost-summary method.

ACCOUNTING AND VALUATION METHODS

Assets

Purchased intangible assets are recorded at acquisition cost and depreciated on a straight-line basis according to their prospective useful lives.

Tangible assets are carried at acquisition or production costs less depreciation. Total operating costs include direct costs and appropriate overheads. Interest on borrowings is not included.

Depreciation of tangible assets is based on the tax regulations. Where permissible under tax law, the method of declining-balance depreciation is used. The transition to the straight-line method is made at the moment where the latter produces higher depreciation amounts.

The official tax depreciation tables for commonly usable assets and sector-specific tax depreciation tables have generally been used to determine the useful lives.

Interests in related companies and participations are reported at acquisition cost or at the lower fair value, with due attention being paid to the requirement to reverse write-downs where the reasons for them no longer exist.

Loans are carried at their nominal value or, where necessary, are discounted as per accounting date.

Unscheduled depreciation is carried at a lower fair value.

Any differences between the permissible valuation under tax law and the permissible valuation under commercial law which are due to special depreciation in accordance with Sec. 4 Development Area Act (FGG) and Sec. 6b Income Tax Act (EStG) are reported under special items with share of reserves.

Financial assets are valued at acquisition cost.

Inventories are valued at acquisition cost, or at their lower value at accounting date, with permissible methods to simplify valuation being applied. Adequate deductions are made to take inventory risks into account which arise from reduced suitability for use.

Other current assets are carried at nominal value or the lower fair value. All identifiable individual risks, as well as the general credit risk, are taken into account by way of adequate deductions.

A Special loss account from formation of provisions is reported on the asset side for provisions which had to be formed because Sec. 249, Subsec. 1, Sentence 1 HGB (German Commercial Code) in connection with Sec. 17 Deutschmark Balance Sheet Act (DMBiG) was applied for the first time in the DM Opening Balance Sheet (DMEB) of VEAG Vereinigte Energiewerke AG as transferor. This Special loss account varies in response to use and release of the underlying DMEB provisions. Any use of provisions will cause depreciation of the Special loss account and hence expenses which are reported in the profit and loss account according to expense types; where DMEB provisions are released, the Special loss account is set off against the provisions with no effect on income.

Shareholder's Equity and Liabilities

Special depreciation under tax law, gains from asset disposals according to Sec. 6b EStG as well as investment grants are disclosed as Special items on the liabilities side. Special depreciation according to the Development Area Act is released - depending on the useful life of the respective asset - during or after the preferential period, while investment grants are released on a straight-line basis in conformity with the respective useful life. Gains from asset disposals are accounted for in the Special item even if they have already been transferred to newly acquired assets. The Special item is released according to the useful life of the respective asset.

Provisions for pensions and similar obligations are, as far as pension commitments with congruent counterinsurance are concerned, carried at the higher value of the going-concern value under tax law and the value of the counterinsurance claim. The remaining pension commitments are valued at their going-concern value. The going-concern value is, according to actuarial principles, determined on the basis of an interest rate for accounting purposes of 6 per cent p.a. The calculations are based on the charts 2005 G published by Prof. Dr. Klaus Heubeck.

Other provisions adequately and sufficiently reflect all identifiable risks and contingent liabilities. Obligations arising from semi-retirement, early retirement and long-service award programmes are valued at cash value according to actuarial principles, using an interest rate for accounting purposes of 5.5 per cent p.a. The calculations are based on the charts 2005 G published by Prof. Dr. Klaus Heubeck. Other long-term provisions are discounted at a rate of 5.5% p.a., provided the respective liabilities contain an interest element. This relates, in particular, to compensation claims put forward by land owners in return for granting easements for the electricity system, for which provisions with no effect on income have been made. Income from congestion management auctions has been accrued on the liabilities side under Other provisions. This income will reduce use-of-system charges, although the respective amounts will not be reimbursed to network customers by way of reduced charges until after two years.

Liabilities are reported at their repayment value.

Construction cost subsidies received are reported as Deferred income. In 2007, this item for the first time includes amounts VE Transmission collected from cross-border congestion management. Such revenues are used for investments in maintenance or extension of connection capacity. This means VE Transmission has to render performance in return for the collected revenues, and reports them on the liabilities side similar to construction cost subsidies.

The construction cost subsidies received are reported on the liabilities side. Construction cost subsidies received until 31 December 2002 are released to income over 20 years, except where a shorter term has been agreed. Construction cost subsidies received as of 01 January 2003 are released to income over the tentative period of use of the respective asset. The horizontal network revenues accrued in 2007 are collected over a period of 30 years as decided by BNetzA with regard to accounting treatment in the context of calculating the use-of-system charges.

Currency Translation

Transactions in foreign currency are valued at the exchange rate applicable at the time the book entry is made. The carrying value takes into account lower exchange rates for accounts receivable and higher rates for accounts payable on accounting date.

NOTES TO THE BALANCE SHEET

(1) Fixed assets

The breakdown of fixed asset items summarised in the balance sheet, and their development in the financial year, are disclosed in the Movements in fixed assets table.

Of the fixed assets, € 0.3 million is encumbered by charges on property.

(2) Inventories (€ million)

	31/12/2008	31/12/2007
Raw materials and supplies	1.2	1.1
Work in progress	1.7	3.5
	2.9	4.6

(3) Receivables and other assets (€ million)

	31/12/2008	31/12/2007
Trade accounts receivable	252.2	425.2
Accounts receivable from related companies	220.0	241.3
of which from shareholder	(180.3)	(106.2)
Other assets	108.3	56.9
	580.5	723.4

Accounts receivable from related companies concern € 52.3 million trade accounts receivable. The accounts receivable from shareholder mainly contain cash deposits made in the scope of short-term cash management.

Under Other assets, € 44.3 million (previous year: € 40.7 million) receivables under the CHP Act are reported.

All accounts receivable have residual maturities of less than one year. Residual maturities of over one year apply to € 11.4 million Other assets (previous year: € 11.2 million).

(4) Liquid funds

Liquid funds includes cash balances with banks.

(5) Shareholder's equity

The Company's € 200 million share capital is fully held by Vattenfall Europe AG, Berlin.

The Other revenue reserves were formed with no effect on income, based on the assignment of title for landed property according to Sec. 36 DMBilG.

(6) Special items (€ million)

	31/12/2008	31/12/2007
Special item with share of reserves		
Value adjustments of fixed assets acc. to Sec. 4 FGG and Sec. 6b EStG	28.2	30.3
Special item for investment subsidies & grants	9.4	10.1
	37.6	40.4

(7) Provisions (€ million)

	31/12/2008	31/12/2007
Provisions for pensions and similar obligations	15.6	14.8
Other provisions		
Outstanding accounts EEG and CHP Act	228.0	271.0
Easements for rights in lines	58.6	56.9
Sundry provisions	125.2	79.6
	427.4	422.3

Sundry provisions mainly includes amounts for risks from reimbursement of use-of-system charges envisaged for future tariff periods, human resources obligations, litigation costs, contamination clean-ups and contingent losses from the procurement of network loss energy.

(8) Liabilities (€ million)

	Maturity up to 1 yr	Maturity 1-5 yrs	Total 31/12/2008	Total 31/12/2007	Prev yr maturity up to 1 yr
Advance payments from customers	7.3	-	7.3	2.3	2.3
Trade accounts payable	64.1	0.7	64.8	58.4	57.9
Liabilities to related companies	68.6	320.0	388.6	507.0	187.0
of which to shareholder	(23.7)	(320.0)	(343.7)	(352.2)	(32.2)
Other liabilities	19.5	0.2	19.7	21.6	21.5
for taxes	(0.7)	(-)	(0.7)	(0.5)	(0.5)
for social security	(0.0)	(-)	(0.0)	(0.0)	(0.0)
	159.5	320.9	480.4	589.3	268.7

Of the liabilities to related companies, € 45.6 million concerns trade accounts (previous year: € 144.9 million), and the remainder consists in Other liabilities. Of the liabilities to the shareholder, € 320.0 million (previous year: € 320.0 million) is accounted for by loans.

The underlying interest rate of the loans was hedged on a long-term basis by swaps with the shareholder. The fair value of the interest swaps at 31 December 2008 was € 15.5 million; the fair value was determined with the help of the discounted cash flow method on the basis of current market data.

Other financial commitments, Contingencies

Other financial commitments as per 31 December 2008 amounted to € 137.0 million (previous year: € 117.9 million) resulting from the order commitment for investments with a residual maturity of up to one year.

For a term of five years, VE Transmission is, according to Sec. 133 of the Act Regulating the Transformation of Companies, jointly and severally liable for liabilities of Vattenfall Europe Distribution Berlin GmbH and Vattenfall Europe Berlin AG & Co. KG incurred before the split-off in 2006.

For a term of five years, VE Transmission is, according to Sec. 133 of the Act Regulating the Transformation of Companies, jointly and severally liable for liabilities of Vattenfall Europe Distribution Hamburg GmbH and Vattenfall Europe Hamburg AG incurred before the split-off in 2006.

VE Transmission is jointly and severally liable together with Vattenfall Europe Distribution Berlin GmbH and Vattenfall Europe Berlin AG & Co. KG for liabilities under the concession agreement with the Berlin Land government.

VE Transmission is jointly and severally liable together with Vattenfall Europe Distribution Hamburg GmbH and Vattenfall Europe Hamburg AG for liabilities under the concession agreement with the Hamburg Land government.

For electricity purchases used for market-based balancing of network losses, VE Transmission entered into € 122.6 million purchasing commitments for 2009.

NOTES TO THE PROFIT AND LOSS ACCOUNT

(9) Sales revenues (€ million)

	2008	2007
EEG electricity supplies	2 807.7	2 571.3
Sales revenues from system support services to other TSOs	38.3	51.1
Electricity supplies according to the CHP Act	17.7	16.9
Revenues balanced by expenses in the same amount	2 863.7	2 639.3
Use-of-system charges	584.0	593.0
EEG imbalance energy	153.9	34.5
Balancing group management	4.6	11.8
Other sales revenues	25.2	16.7
Sales revenues - network business	767.7	656.0
	3 631.4	3 295.3

EEG electricity supplies relates to deliveries of electricity generated from renewable resources to sales organisations and traders supplying final customers in the control area, and supplies to other TSOs in the scope of the burden sharing scheme operated between TSOs to set off the charges resulting from the EEG.

(10) Other operating income (€ million)		
	2008	2007
Allocations under the CHP Act*	157.0	244.5
Income from release of provisions	5.2	17.7
Income from release of special items with share of reserves according to Sec. 4 FGG and Sec. 6b EStG	2.0	2.2
Income from release of special items for investment grants & subsidies	0.7	0.8
Other income	18.3	22.2
	183.2	287.4

*Income is balanced by expenses in the same amount

Other operating income includes € 9.2 million out-of-period income.

(11) Cost of materials (€ million)		
	2008	2007
Expenses for raw materials and supplies and for purchased goods	3 252.1	2 873.7
Expenses for purchased services	268.8	295.1
	3 520.9	3 168.8

Cost of materials is broken down as follows in order to highlight the neutral character of some of the items.

(€ million)		
	2008	2007
EEG electricity purchasing	2 807.7	2 571.3
System support services to other TSOs	38.3	51.1
Electricity purchasing according to the CHP Act	17.7	16.9
Expenses balanced by revenues in the same amount	2 863.7	2 639.3
Expenses - network business	657.2	529.5
	3 520.9	3 168.8

(12) Personnel expenses (€ million)		
	2008	2007
Wages and salaries	31.5	29.7
Social security	5.3	4.7
Pension costs	2.0	1.8
Similar benefits	0.0	0.1
	38.8	36.3

Average number of employees during the year		
	2008	2007
Salaried staff	365	345
Wage-earning staff	147	154
	512	499

In addition, 19 apprentices on average were employed in the financial year (previous year: 20 apprentices).

(13) Depreciation
No non-scheduled depreciation was performed in the financial year.

(14) Other operating expenses (€ million)		
	2008	2007
CHP allocation*	157.0	244.5
Other expenses	88.8	193.7
	245.8	438.2

*Expenses are balanced by income in the same amount

Other expenses mainly includes the contingent losses from the procurement of network loss energy, and allocations to sundry Other provisions.

(15) Financial result (€ million)

	2008	2007
Income from participations	3.4	3.6
Other interest and similar income	1.5	2.3
of which from related companies	(0.9)	(0.2)
Other interest and similar expenses	-22.7	-26.8
of which to related companies	(-14.3)	(-21.7)
	-17.8	-20.9

Income from participations contains the € 3.3 million 2008 profit transferred by Vattenfall Europe Netcom GmbH (VE Netcom).

NOTES TO THE CASH FLOW STATEMENT

The Cash Flow Statement has been prepared in conformity with GAS 2 of the German Accounting Standards Board.

Of the Cash flows from operating activities, € 0.9 million (previous year: € 2.3 million) is due to proceeds from interest. Interest payments amounted to € 16.3 million (previous year: € 23.2 million). Tax payments amounted to € 0.3 million, and are accounted for by property, motor-vehicle and electricity taxes.

SUPPLEMENTARY INFORMATION

Shareholdings

Name and registered office of the company	Interest in capital %	Equity 31/12/2008 € t	Net profit 2008 € t
Vattenfall Europe Baltic Offshore Grid GmbH, Berlin	100.00	1 019.8	- ¹⁾
European Market Coupling Company GmbH, Hamburg	20.00	100.0	- ²⁾
CCentral Allocation Office GmbH, Freising	12.50	100.0	- ²⁾

¹⁾ A profit and loss transfer agreement is in place.

²⁾ Incorporated in 2008; no annual accounts had yet been available at accounting date.

VE Netcom was sold as per 31 December 2008.

EEG and balancing area accounting

In preparing the annual financial statements, expenses and income - and hence accounts receivable and payable - from management of the EEG business process, and from settlement of the balancing groups, were determined on the basis of provisional data provided by third parties, and partly on the basis of forecasts.

A final statement on the level of actually incurred expenses and income from the EEG business cannot be made until the auditor's certificates on the amounts of electricity fed in from renewable energy units have been submitted. With respect to the settlement of balancing groups, VE Transmission depends on having a complete set of data from all balancing groups. These data are not fully available at the time the annual financial statements are prepared, i.e. there are some uncertainties in respect of the amounts of expenses and income in these areas. The corresponding items in the annual financial statements were ascertained on the basis of available data and estimates, and are based on the information available at the time the annual financial statements were prepared.

Impact of valuation measures under tax law

The movements in the special item with share of reserves have improved the HGB result for the year by € 2.1 million. The release of the special item spreads over up to 25 years due to the fixed period of release.

Large-scale transactions according to Sec. 10, Subsec. 2 Energy Industry Act (EnWG)

According to Sec. 10, Subsec. 2 EnWG, large-scale transactions with related or associated companies, or with companies of the same shareholders, have to be disclosed. Outside its operating activities, Vattenfall Europe Transmission GmbH did not enter into any such transactions in financial year 2008, except for the financing transactions stated in the Notes and the sale of VE Netcom to Vattenfall Europe AG.

Information according to Sec. 10, Subsec. 3 EnWG

The annual financial statements of VE Transmission have to be assigned to the activity of electricity transmission.

Members of the Supervisory Board

Mats Fagerlund	Member of the Management Board of Vattenfall Europe AG, Berlin - Chairman -
Ulrich Freese*	Vice Chairman of the Mining, Chemical and Energy Industrial Trade Union, Spremberg - Vice Chairman -
Alfred Geißler	Member of the Management Board of Vattenfall Europe AG, Berlin (until 31 December 2008)
Udo Bekker	Member of the Management Board of Vattenfall Europe AG, Berlin (since 01 January 2009)
Florian Guddat*	Foreman for electrical energy equipment
Dr. Hans-Jürgen Meyer	Member of the Management Board of Vattenfall Europe AG, Berlin
Dr. Lutz Pscherer*	Electrical engineer

* Employee representative

Members of the Management

Stefan Dohler	Hamburg, Commercial Division
Hans-Jörg Dorny	Neuenhagen near Berlin, Human Resources Division (since 01 October 2008)
Jürgen Grieger	Rosengarten, Human Resources Division (until 30 September 2008)
Wolfgang Neldner	Berlin, Technical Division

Expenses for Board members

The drawings of the Management in financial year 2008 amounted to € 701 thousand (previous year: € 751 thousand). One member of the Management is not employed by VE Transmission. Expenses for the Supervisory Board were € 19 thousand (previous year: € 27 thousand).

Loans granted to Board members

Loans granted to Supervisory Board members amounted to € 16 thousand as at 31 December 2008 (previous year: € 19 thousand). The loans are subject to a 5.0 per cent p.a. interest and extend over terms of ten years. A total two thousand euros was re-paid in the reporting year.

Berlin, 10 February 2009
The Management



Dohler



Dorny



Neldner

AUDIT CERTIFICATE

We have audited the annual financial statements - comprising the balance sheet, the profit and loss account, the notes to the financial statements and the cash flow statement - together with the bookkeeping system and the management report of Vattenfall Europe Transmission GmbH, Berlin, for the financial year from 01 January to 31 December 2008. According to section 10, subsection 4 Energy Industry Act (EnWG), the audit also covered performance of the duties of unbundling of the internal accounts according to section 10, subsection 3 EnWG. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law as well as performance of the duties according to section 10, subsection 3 EnWG are the responsibility of the Company's managing directors. Our responsibility is to express an opinion on the annual financial statements together with the bookkeeping system, on the management report and on internal accounting according to section 10, subsection 3 EnWG, on the basis of our audit.

We conducted our audit of the annual financial statements in accordance with Sec. 317 HGB (German Commercial Code) and the German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany - IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with (German) principles of proper accounting and in the management report are detected with reasonable assurance, and that it can be judged with reasonable assurance whether the duties according to section 10, subsection 3 EnWG have been performed in all material aspects. Knowledge of the business activities and the economic and legal environment of the Company, and expectations as to possible misstatements, are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual

financial statements and the management report as well as in internal accounts according to section 10, subsection 3 EnWG are examined primarily on the basis of random sampling within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the managing directors, evaluating the overall presentation of the annual financial statements and management report, as well as expressing an opinion on whether the carrying values and allocation of accounts in internal accounting according to section 10, subsection 3 EnWG are proper and comprehensible, and whether the principle of consistency has been observed. We believe that our audit provides a reasonable basis for our opinion.

Our audit of the annual financial statements together with the bookkeeping system and the management report has not led to any reservations.

In our opinion, based on the findings of our audit, the annual financial statements comply with the legal requirements and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with (German) principles of proper accounting. The management report is consistent with the annual financial statements, and as a whole provides a correct view of the Company's position; it also correctly presents the opportunities and risks of future development.

The audit of performance of the duties of unbundling of internal accounts according to section 10, subsection 3 EnWG has not led to any reservations.

Berlin, 10 February 2009
PricewaterhouseCoopers Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Harald Herrmann,
German Public Auditor

ppa. Sten Kunzmann,
German Public Auditor

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Jürgen Grieger (until 30 September 2008)
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The annual report is also available in German.
When in doubt, the German version is authoritative.

PHOTOGRAPHY

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