

GOVERNANCE OF OPERATIONS AND DECISION-MAKING

Application of the Code and contents of the Corporate Governance Report

Vattenfall applies the Swedish Code of Corporate Governance (“the Code”) and considers it as one of several important sets of governing regulations for external reporting and communication. Information on corporate governance according to the Code for the 2006 financial year is provided below. For information already provided in the Annual Report, reference will be made to the appropriate section.

General information on Group’s Management System

The Group is governed with a focus on value creation and long-term overarching goals and requirements for the Business Groups and Business Units. The Business Groups propose short-term goals for each Business Unit, which are subsequently approved by the CEO and Executive Committee (ExCom).

To ensure that Vattenfall develops in the intended direction and lives up to ethical and legal requirements, the CEO has established a Group Management System (GMS), which also includes a description of how the Group is governed. The GMS is available to all employees on the Group’s intranet. The GMS consists of a number of building blocks (see GMS diagram below). Management is based on Vattenfall’s mission

and vision, the Group-wide Code of Conduct and company philosophy, and on the Group’s policies in key areas. The GMS is documented in governing documents, consisting of Group policies, Group instructions and other documents. The Group policies describe the intentions for action on matters of importance for the Group, while Group instructions provide more detailed and operative control, and lay down mandatory rules.

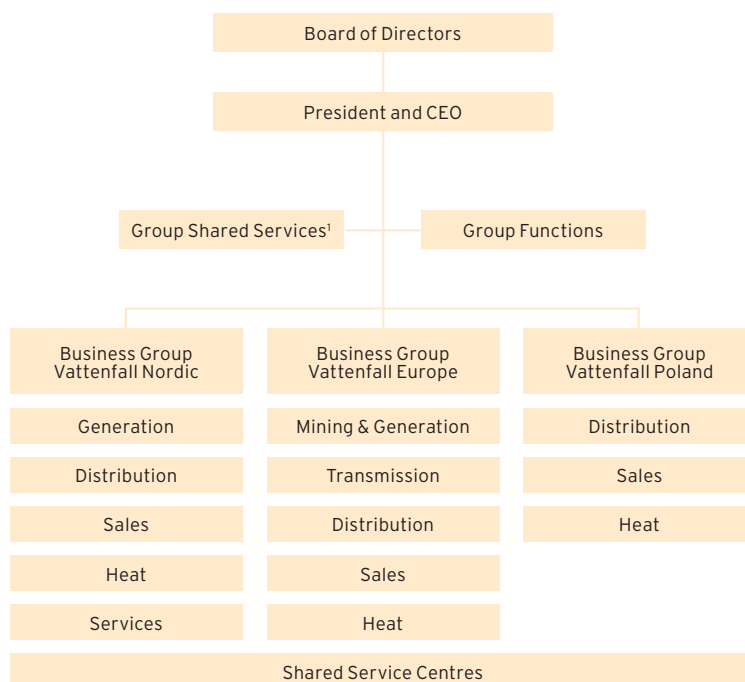
The “Roles and Allocation of Responsibility” instruction defines decision-making bodies and fundamental roles within the Group. The “Principles for Decision-Making and Delegation” is another central instruction that covers delegation from the CEO to the heads of the Business Groups, Group Functions and Group Shared Services. The Group’s management processes for strategic planning, business planning and follow-up are central governance tools for the Executive Group Management (EGM).

The Group functions are responsible for proposing, developing and following up Group policies and instructions. The Vattenfall Group has a Quality Function charged with co-ordinating the GMS. Both the Head of Group Quality Function and the Head of Group Environment must approve all Group policies and instructions prior to final approval. All governing documents are submitted to the EGM for approval.

All activities within Vattenfall are obligated to comply with the GMS governing documents. Consequently, each Business Group has a complementary management system that is adapted to the detailed requirements of its operations. Group Function Internal Audit is responsible for ensuring compliance with the GMS.

Vattenfall’s organisation

Group Management System building blocks



1) Vattenfall Trading Services, Vattenfall Treasury, Vattenfall Insurance and Vattenfall Research and Development AB.

Deviations from the Swedish Code of Corporate Governance

Vattenfall's corporate governance for the 2006 financial year deviates on the following points from the requirements stipulated in the Swedish Code of Corporate Governance:

Code requirements	Description	Comment
1.1.2 Shareholders' initiative rights	Shareholder information on website	Information on the Annual General Meeting is provided on Vattenfall's website. However, because of the ownership structure, this stipulation is not directly applicable.
1.1.3 Notification of general shareholder meetings	Registration by e-mail or the Company's website	Because of Vattenfall's ownership structure, this stipulation is not applicable.
1.4.4 The Chairman's role	Shareholders' right to ask questions at the Annual General Meeting	At the 2006 Annual General Meeting, Vattenfall arranged for an open question/answer session for the general public. In addition, members of Swedish parliament have the right to ask questions in connection with the AGM. However, because of Vattenfall's ownership structure, this stipulation is not directly applicable.
2.1.1 Appointment of nomination committee	Nomination committee criteria	The nomination process conforms to the Swedish state's ownership policy. Information on this process is provided on Vattenfall's website.
2.1.2 Composition of nomination committee	Minimum of three members	The nomination process conforms to the Swedish state's ownership policy. Information on this process is provided on Vattenfall's website.
2.1.3 Publication and information about nomination process	Names of the members of the nomination committee	The nomination process conforms to the Swedish state's ownership policy. Information on this process is provided on Vattenfall's website.
2.2.1 Nomination committee's recommendations for directors and fees	The nomination committee's recommendations for directors, chairman and apportionment of fees	Recommendations are made in the AGM notice. The nomination process conforms to the Swedish state's ownership policy.
2.2.2 Nomination committee's documentation for its recommendations	The nomination committee makes a profile of requirements	The nomination process is in compliance with the Swedish state's ownership policy. Information on this process can be found on Vattenfall's website.
4.2.1 Compensation committee	Committee members shall be independent in relation to the Company	In the Compensation Committee, one committee member, who is not an AGM-elected director, is employed by Vattenfall. This gives the employee representatives an opportunity to participate in the committee.
4.2.3 Share- and share price-related incentive programmes	To be decided by AGM	Not applicable, since Vattenfall is not a listed company.

Organisation and processes

Vattenfall's organisational model is based on the electricity and heat value chains: for electricity – generation, transmission, distribution and sales, and for heat – generation, distribution and sales. The President, who is also the Chief Executive Officer, heads the Group's business operations and administration in accordance with the Swedish Companies Act and the Board's instructions. Reporting and follow-up of the business operations are conducted with full transparency in accounting, control, profitability and value creation.

In terms of management, Vattenfall's operations are broken down into three categories:

- Business operations are handled by Business Groups and their Business Units in defined geographic areas. These are governed as profit centres.
- Group functions that support their respective management teams. These are governed as cost centres.
- Shared Service units, which provide services that support their customers' (internal Business Units and others) efforts to optimise their business operations. Shared Service activities are run on a full cost basis and are governed by internal customers. Shared Service units operate at both the Group (Group Shared Services) and Business Group levels.

A number of management processes that are essential for the Group have been established. Each process is managed by

a process owner, usually a member of the EGM, who is responsible for developing the process. At present, the following Group processes exist:

Process	Process owner
Strategy and business planning	Head of Group Strategies
Reporting and follow-up	Chief Financial Officer
Risk management	Chief Financial Officer
Mergers & acquisitions	Head of Legal Affairs and M&A
Investments	Chief Financial Officer
Communications	Head of Communications
Management planning	Head of Human Resources
Capacity management	Head of Capacity Management

The strategy and business planning process culminates in yearly strategy and business plans. This process includes the analysis and assessment of strategic issues for ongoing evaluation with decisions on selection, formulation and prioritisation made by the EGM. Strategy planning includes the Group's long-term operations as well as its financial performance.

Each year a five-year strategic plan is drafted for decision by Vattenfall's board.

Based on the directives of the strategic plan, the Business Groups and Business Units draw up three-year business plans that are ultimately approved by the ExCom. The business plans for the following calendar year are adopted by the Board.

Governing business ethics

Vattenfall's core values are:

Openness, Effectiveness and Accountability

In 2005 the Board approved Vattenfall's joint-Group Code of Conduct and company philosophy, which stipulate that all employees shall adhere to and work in accordance with Vattenfall's core values, policies and Group instructions. The stipulations of the Code are concretised in other parts of the GMS, such as in instructions for general legal and business-ethics principles, and competition matters. Further information on governing business ethics is provided in Vattenfall's CSR Report, which can be downloaded and ordered from Vattenfall's website: www.vattenfall.com.

The Board's composition and work

The duties and allocation of work in the Board

The Chairman's duties are outlined in both of the Swedish Companies Act and the Board's Rules of Procedure. The Chairman heads the work of the Board and is responsible for ensuring that other board members receive adequate information. The Chairman participates when necessary in important external contacts.

Each year the Board establishes its Rules of Procedure, based on the supporting document for rules of procedure in state owned companies issued by the State Enterprises Division of the Ministry of Enterprise, Energy and Communications. Apart from mandatory items pursuant to the Swedish Companies Act, the Rules of Procedure regulate such things as the Chairman's duties, information to the Board, the form of board meetings, and evaluation of the work of the Board and the CEO.

Matters to be dealt with by the Board are stipulated by the Swedish Companies Act and the Board's Rules of Procedure. The main duties of the Board, apart from appointing the CEO and deputy CEO, are to establish the strategic direction of operations, approve major investments, acquisitions and substantial organisational changes in the Group, and to establish central policies and instructions. In addition, the Board oversees the Company's financial development and has ultimate responsibility for internal control and risk management.

The Board's risk management process

Operational risk management is regulated by Group instructions with a special focus on risks associated with energy and commodity trading, and financial, insurance and credit risks. The Board decides on overall risk limits for the Group in all these areas. Operational risks are followed up on a regular basis and are reported within the respective Business Groups. At each board meeting the Board is informed about the Group's financial position, and any outstanding guarantees and risks are reported. Twice a year the results of earlier decisions on investments are reported on for follow-up. The Board also holds an annual risk management seminar with a more thorough review of the Group's financial and operational risks.

The Chief Financial Officer (CFO) has overall responsibility for the Group's financial activities and risk manage-

ment, and ensures compliance with the Group's policies and instructions in this area. A Group risk committee has been established to support the CFO in these issues with the primary task of ensuring qualitative risk management in the Group by, for example, approving risk management methods, ensuring standardised routines for risk management and risk reporting, and proposing mandates and limits. Since 2003, the Group also conducts an annual environmental risk evaluation which is co-ordinated by the Head of Group Environment. The results of this evaluation are presented to the EGM and Vattenfall's risk committee. Environmental risk management is co-ordinated with other risk management. For more information about Vattenfall's risks and risk management, see pages 66–99 of this annual report and Note 34 to the consolidated accounts.

Composition of the Board of Directors

Vattenfall's board has eight directors elected by the Annual General Meeting (AGM) plus three directors and three deputies elected by the employee organisations. No members of the EGM are board members. Of the board members, three are women and two are foreign citizens. The average age of board members is 54.

At the 2006 AGM, Maarit Aarni-Sirviö, Christer Bådholm, Dag Klackenberg, Peter Lindell, Hans-Olov Olsson, Lone Fønss Schröder and Anders Sundström were re-elected as directors, and Greta Fossum was elected as a new director. The AGM appointed Dag Klackenberg as Chairman of the Board. The employee organisations appointed Carl-Gustaf Angelin, Johnny Bernhardsson and Ronny Ekwall as employee representatives, with their deputies Lars Carlsson, Stig Lindberg and Per-Ove Lööv, respectively. In accordance with the Swedish state's ownership policy, the CEO is no longer a director on the Board. For further information on the Board of Directors, see pages 58–59 of the annual report.

Directors' fees

Directors' fees are set by the AGM. For information on directors' fees for 2006, see Note 44 to the consolidated accounts in the annual report.

Directors' independence

The Swedish state's ownership policy stipulates that nomination of directors is to be made public in accordance with the guidelines of the Code. However, independence in relation to major shareholders is not reported. Of the company's directors, Dag Klackenberg, Maarit Aarni-Sirviö, Christer Bådholm, Greta Fossum, Peter Lindell, Hans-Olov Olsson, Lone Fønss Schröder and Anders Sundström are independent in relation to the company and the EGM.

Appointment of the Board

For enterprises that are wholly owned by the Swedish state, uniform and joint principles for a structured nomination process are applied, which take the place of the Code's rules on the appointment of directors and auditors. The nomination process is run and co-ordinated by the State Enterprises Divi-

sion of the Ministry of Enterprise, Energy and Communications. A work group analyses qualification needs based on the Board's composition, the Company's operations and the current situation. Thereafter, if recruitment needs exist, recruitment work is initiated. Board members are chosen from a broad recruitment base. Nominations are made public in accordance with the Code's guidelines.

Description of the Board's work

Board meetings are conducted largely according to a plan established by the Rules of Procedure. This specifies that seven ordinary meetings are to be held each year. In addition to ordinary meetings, the Board is summoned to further meetings if the need arises. According to the Rules of Procedure, at least one meeting each year must be held at a place other than the head office. In 2006 a meeting was held in Copenhagen. In connection with this, the Board visited local facilities and was provided with more in-depth information about the operations that Vattenfall acquired in Denmark.

The Rules of Procedure stipulate, among other things, that the following items must be included on the agenda once a year:

- The Group's strategic plan
- The Group's total risk exposure
- Safety and environmental issues within the Group's nuclear power operations
- Personnel issues within the Group, including the ability to attract and retain skilled personnel
- Research and development activities within the Group

In addition, the following are reported at each meeting:

- Important business events since the previous meeting, under the item "Business status"
- The Group's financial position

Investments are followed up and analysed by the Board three years after the Board's decision to invest. The Board also holds a number of board seminars each year. At these seminars the Board receives more detailed information about and discusses Vattenfall's long-term development, strategy, competitive scenario and risk management.

The Board had 11 meetings in 2006, including the statutory meeting. Following is a compilation of the meetings and some of the more important items of business that were discussed.

Evaluation of the Board's and CEO's work

The Board evaluates its own work and the CEO's work once a year. This evaluation is headed by the Chairman and is reported to the Board. The most recent evaluation was presented at the board meeting on 26 April 2006 and pertained to the Board's work in 2005. The evaluation of the Board's work in 2006 is ongoing and will be reported at the board meeting in October 2007.

Matters handled by the Board appointed by the 2005 AGM

Meeting date	Focus and important matters discussed
31 January 2006 (extra meeting)	<ul style="list-style-type: none"> • Acquisition matters • Investments in the German network operations
7 February 2006	<ul style="list-style-type: none"> • Year-end report
22 February 2006	<ul style="list-style-type: none"> • Year-end book-closing, annual report and audit report • Credit risk mandate • Management planning and development • Vattenfall's R&D activities • Report on corporate governance and internal control • M&A activities
26 April 2006	<ul style="list-style-type: none"> • Vattenfall's three-month interim report • Evaluation of the Board and CEO • Financial targets for Vattenfall AB • Amendments to the Articles of Association

Matters handled by the Board appointed by the 2006 AGM

Meeting date	Focus and important matters discussed
Statutory board meeting, 27 April 2006	<ul style="list-style-type: none"> • The Board's Rules of Procedure • Members and Rules of Procedure for the Audit Committee • Investments in the German operations
17 May 2006	<ul style="list-style-type: none"> • Finance instructions and instructions for the handling of energy and commodity risks • Follow-up of investments made during the first half of 2003 • Investment in the Uppsala electricity network • Plan for renewable energy • General update of M&A activities • Current M&A activities
26 July 2006	<ul style="list-style-type: none"> • Vattenfall's half-year interim report • Establishment of a compensation committee
31 August 2006	<ul style="list-style-type: none"> • Date for 2007 AGM • Information on the Forsmark nuclear power plant • Payment routines within the Group • Plan for renewable energy and the wind power project • Follow-up of investments made during second half of 2003 • M&A activities • Investments in the German operations • Strategic plan • HR matters within the Group • Report from Audit Committee
24 October 2006	<ul style="list-style-type: none"> • "Curbing Climate Change" initiative • Environmental strategy • Review of the Vattenfall Group's media image locally and internationally • The investment process • Investments in the Danish operations • Information on the Forsmark nuclear power plant • M&A activities
30 October 2006	<ul style="list-style-type: none"> • Vattenfall's nine-month interim report
11 December 2006	<ul style="list-style-type: none"> • Safety and environmental issues surrounding the Group's nuclear power operations • Annual follow-up of investment programme in hydro and nuclear power in the Nordic countries • Investment programme for wind power in the Nordic countries • Current investment activities • Approval of business plans and investment budget for 2007 • Report from Audit Committee • Method for evaluation of the Board's work

Directors' attendance at meetings

	Board appointed by 2005 AGM				Board appointed by 2006 AGM						
	31/01/06	07/02/06	22/02/06	26/04/06	27/04/07	17/05/07	26/07/06	31/08/06	24/10/06	30/10/06	11/12/06
Maarit Aarni-Sirviö	-	X	-	X	X	X	X	X	X	X	X
Christer Bådholm	X	X	X	X	X	X	-	X	X	X	X
Greta Fossum					X	X	X	X	X	X	X
Lars G. Josefsson	X	X	X	X							
Dag Klackenberg	X	X	X	X	X	X	X	X	X	X	X
Peter Lindell	-	X	X	X	X	X	X	X	X	X	X
Hans-Olov Olsson	X	-	-	X	-	X	X	-	X	-	X
Lone Fønss Schrøder	X	-	X	-	X	X	X	-	X	-	X
Anders Sundström	-	X	-	X	X	X	X	X	X	-	X
Carl-Gustaf Angelin	X	X	X	X	X	X	-	X	X	X	X
Johnny Bernhardsson	X	X	X	X	X	X	X	X	X	X	X
Ronny Ekwall	X	X	X	X	X	X	X	X	X	-	X
Lars Carlsson*	X	X	X	X	X	X	X	-	X	X	X
Stig Lindberg*	X	X	X	X	X	-	X	X	X	X	X
Per-Ove Lööv*	X	X	X	X	X	X	X	X	X	X	X

X Present - Not present *) Deputies

Committees**Audit Committee**

The Audit Committee is a board committee tasked with gaining greater knowledge of, insight into and control over the Company's accounting, financial reporting and risk management. The Audit Committee has special responsibility for ensuring application of the Code and for preparing required reports. In conjunction with audits, the Company's auditors report their observations at Audit Committee meetings. No formal decision-making authority has been delegated to the committee, since its members are all directors on the Board.

In 2006 the Board appointed the following members to serve on the Audit Committee: Peter Lindell, Christer Bådholm and Lone Fønss Schrøder, plus deputy board member Per-Ove Lööv from the non-AGM elected board members. With respect to fees paid the committee's members, see Note 44 to the consolidated accounts in the annual report.

The Audit Committee prepares the Board's work as a means of quality-assuring the company's financial reporting. The Board has adopted rules of procedures for the committee. The committee reports its work to the Board by submitting meeting notes to the Board and, when requested, by making presentations at board meetings.

The Audit Committee held four meetings in 2006. The auditors were present at all meetings and presented their observations from the audit of the annual accounts and the review of the six-month accounts. The auditors presented their audit of the annual accounts to the entire board at the board meeting held on 22 February 2006.

Members present at Audit Committee meetings in 2006

	27/01/06	24/04/06	22/08/06	30/11/06
Peter Lindell	X	X	X	X
Christer Bådholm	X	X	X	X
Lone Fønss Schrøder	X	X	-	-
Per-Ove Lööv (employee representative)	X	X	X	X

Nomination Committee

Vattenfall AB has no nomination committee. For more detailed information on the nomination process, see the section "Appointment of the Board" on page 55.

Compensation Committee

In 2006 the Board established a compensation committee to prepare ongoing matters regarding the compensation of senior executives, including matters pertaining to annual salary reviews and other terms of employment for the CEO.

In addition, a going-rate principle is adhered to regarding the salaries and remuneration of all deputy CEOs and heads of the Group functions. The committee reviews current salaries, fixed and variable salaries, and other compensation where applicable, including pension terms, of significance to all such executives. The committee also drafts principles regarding the salary and remuneration.

The following persons were appointed by the Board to serve on the Compensation Committee: Dag Klackenberg, Anders Sundström and Maarit Aarni-Sirviö, plus Johnny Bernhardsson from the non-AGM elected board members. The head of Human Resources and deputy head of Human Resources make presentations at the committee's meetings.

The Compensation Committee has adopted rules of procedure for its work. The committee reports on its work to the Board, whereby the committee chair informs the Board about the committee's decisions. However, the Board as a whole must decide on matters concerning the CEO's employment and decide on the CEO's terms of employment.

The Compensation Committee held one meeting in 2006, on 31 August, at which all the members were present.

Remuneration of senior executives

The Board has approved a programme that complies with the Swedish government's guidelines on remuneration and incentive programmes for senior executives. The programme covers all employees in Sweden and took effect in 2005. Each year Vattenfall's internal auditors perform a review to ensure compliance with these guidelines. The result of this review is reported to the Board.

According to these guidelines, the CEO does not receive any variable salary. Other executives and employees in Sweden do not have higher variable salary than the equivalent of two months' salary a year, or 16.7% of their normal base salary. The normal base salary for certain executives can be decreased by 16.7%, depending on performance. Local practice applies in other countries. As previously, the Group's long-term value creation forms the basis of compensation levels. The Group's targets apply for all employees. Executives' individual performance is also measured, as is the performance of their respective units.

More detailed disclosures about taxable salaries, benefits and pension costs for the Chairman of the Board, company directors, the CEO and other senior executives are provided in Note 44 to the consolidated accounts in the annual report.

Ensuring the quality of financial reporting

In its separate report on internal control (page 55), the Board has reported on the company's internal control structure in the financial reporting routines.

The Audit Committee's work is a part of this control exercised by the Board, where external and internal auditors present their observations to the directors who are members of the Audit Committee. The external auditors presented, among other things, their observations concerning the six-month accounts and the annual accounts at each audit committee meeting in 2006. At these meetings, Vattenfall's internal audit function is represented by its head, who also presents the unit's findings to the Audit Committee. At least two meetings between all board members and the external auditors are planned for 2007.

In conjunction with planning work for the annual audit, discussions are held between the external auditors and the internal audit unit concerning Vattenfall's risk situation.

Auditors

The 2004 Annual General Meeting appointed Ernst & Young AB as auditor, with Authorised Public Accountant Lars Träff as Auditor-in-charge. This appointment applies for a term lasting through the 2008 AGM. Lars Träff has served as Auditor-in-charge since the 1997 AGM. In addition to Vattenfall, Lars Träff has auditing assignments with the following companies, among others: Lantmännen, Swedbank, JM, Observer, Ticket and TV4. Lars Träff has no assignments with companies that affect his independence as an auditor of Vattenfall.

The Swedish National Audit Office has appointed Authorised Public Accountant Per Redemo to serve until the 2008 AGM. He has held this position since 2004. Per Redemo is the appointed auditor for Vattenfall AB, Green Cargo AB, Sveriges Radio AB and Sveriges Utbildningsradio AB, and he is chief auditor for the following authorities/state enterprises: the Swedish Tax Agency, the Swedish National Board of Student Aid (CSN), the Swedish Financial Supervisory Authority and Swedish State Railways. Per Redemo has no assignments for companies that affect his independence as an auditor of Vattenfall.

The auditors are present and report at the Board meeting concerning the annual report and meet with Vattenfall's CEO and CFO on a number of occasions throughout the year. In addition, the auditors maintain ongoing contact and attend meetings of the Board's audit committee. When more extensive consulting is required from the elected auditors, such assignments must first be considered and approved by the Audit Committee. The Group's audit costs are described in more detail in Note 47 to the consolidated accounts and Note 39 to the parent company accounts in the annual report.

Consulting provided by Ernst & Young AB from 2004–2006 pertained primarily to tax and accounting issues.

Audit of the Corporate Governance Report

The Corporate Governance Report and the description below

of the company's internal control of financial reporting have not been reviewed by the company's auditors.

The Board's report on internal control of financial reporting

This report has been prepared in accordance with section 3.7.2 of the Code. It includes a description of the most important internal control routines regarding Vattenfall's financial reporting. In reference to a statement by the Swedish Corporate Governance Board, this description does not include any statement by the Board with respect to how well these routines have worked during the year, and it has not been reviewed by the company's auditors.

Apart from relevant legislation, the framework surrounding the Board consists of the Swedish state's ownership and administration policy and the Code.

In 2005 the Board approved Vattenfall's Group-wide Code of Conduct, which expresses the expectation that all employees agree to adhere to Vattenfall's company philosophy, Code of Conduct, core values, policies and rules.

The formal decision-making structure in the Group is based on the division of responsibility between the Board and CEO, which the Board has established in its Rules of Procedure. The Group's management system is decided on primarily by the EGM and includes, among other things, Group instructions for decision-making, delegation and authorisation, management of subsidiaries, risk management and internal control.

The rules and outcome of the Group's risk assessment and risk management processes are reviewed by the Board each year. The Board has appointed an audit committee tasked with, among other things, assessing the scope and focus of the Group's risk management. The Group's risk management and reporting are co-ordinated by a risk committee that is headed by Vattenfall's CFO.

The Board receives monthly financial reports, and the Parent Company's and Group's financial position are discussed at every board meeting.

Work is currently under way in the Group to complement Vattenfall's management system with a complete description of how its internal control is set up and works with respect to the financial reporting. The management system serves as a platform for internal control for all units within the Group. A process will be developed that will allow for the systematic implementation and documentation of the controls that are performed in various areas in order to ensure the accuracy of the financial reporting. In this work, risks and control requirements in the various business processes will be defined in a uniform manner throughout the Group. The EGM's communication of the importance of satisfactory internal control is an important part of this work. The EGM's internal communication channels consist primarily of the Group's intranet, management conferences, and regular follow-up meetings focusing on financial results.