Bayer MaterialScience

Certified Mail 7004 2510 0002 4033 9886
Return Receipt Requested

J-6

April 9, 2007

Mr. Dennis Lawyer
Nuclear Materials Safety Branch #2
U.S. Nuclear Regulatory Commission, Region I
475 Allendale Road
King of Prussia, PA 19406-1415

03030292

RE: Radioactive Materials License 06-13053-04
Bayer Pharmaceuticals Corporation - West Haven, CT Facility

Dear Mr. Lawyer:

Bayer MaterialScience LLC
100 Bayer Road
Pittsburgh, PA 15205-9741

Phone: 412 777-2000

Enclosed please find the annual financial assurance documentation to support the corporate guarantee for the following Bayer Pharmaceuticals Corporation radioactive material license holder:

Bayer Pharmaceuticals Corporation
400 Morgan Lane
West Haven, CT 06516
License No. 06-13053-04

Bayer Corporation (Bayer), as the parent company to Bayer Pharmaceuticals Corporation, is providing this financial test update as assurance that funds will be available when needed for required decommissioning activities as specified in 10 CFR Part 30.

On March 26, 2007 Bayer provided notice to the Commission that the audited financial statements for Bayer had been prepared, but would not be approved by the Bayer Board of Directors until early April. In the notice, Bayer indicated that in the event that it is unable to demonstrate that it meets the financial test criteria for guarantors as specified in 10 CFR Part 30, it would fulfill the obligations as the guarantor by establishing an appropriate financial assurance mechanism by April 30, 2007. On April 5, 2007, the audited financial statements for Bayer Corporation were approved and Bayer can now demonstrate that it meets the financial test criteria.

140324

The following items are enclosed:

1) a letter from Willy Scherf, Chief Financial Officer of Bayer Corporation, to the Chief, Nuclear Materials Safety Branch #2;

2) a copy of the 2006 financial statements for Bayer Corporation and independent auditors' report for the statements from Pricewaterhouse Coopers;

3) a special report from Pricewaterhouse Coopers concerning their review of the financial test figures;

4) a letter from Drew Allen of Bayer Pharmaceuticals Corporation, to the Chief, Nuclear Materials Safety Branch #2; and

5) an affidavit signed by Willy Scherf substantiating the need to keep the 2006 financial statements and the independent auditors' report confidential.

If you have any questions or need additional information concerning the financial assurance, please contact me at 412-777-7474.

Sincerely,

Terrence Sullivan
Safety and Environmental Center
Bayer MaterialScience LLC

TOS07008

Attachments

Bayer

April 9, 2007

Chief, Nuclear Materials Safety Branch #2
U.S. Nuclear Regulatory Commission, Region I
475 Allendale Road
King of Prussia, PA 19406-1415

Dear Chief:

I am the chief financial officer of Bayer Corporation, 100 Bayer Road, Pittsburgh, PA 15205, a business corporation organized under the laws of the state of Indiana. This letter is in support of this firm's use of the financial test to demonstrate financial assurance, as specified in 10 CFR Part 30.

Bayer Corporation
100 Bayer Road
Pittsburgh, PA 15205-9741

Phone: 412 777-2000

This firm guarantees, through the parent company guarantee submitted to demonstrate compliance under 10 CFR Part 30, the decommissioning of the following facilities owned or operated by subsidiaries of this firm. The current cost estimates or certified amounts for decommissioning, so guaranteed, are shown for each facility. **See Attachments I, II and III**.

This firm is not required to file a Form 10-K with the U.S. Securities and Exchange Commission for the latest fiscal year.

The fiscal year of this firm ends on December 31. The figures for the following items marked with an asterisk are derived from this firm's independently audited, year-end financial statements and footnotes for the latest completed fiscal year, ended December 31, 2006: **See Attachment IV**. A copy of this firm's most recent financial statements is enclosed.

I hereby certify that the content of this letter is true and correct to the best of my knowledge.

BAYER CORPORATION

Willy Scherf
Chief Financial Officer
Bayer Corporation

ATTACHMENT I
FACILITIES COVERED BY FINANCIAL ASSURANCE

RCRA CLOSURE AND POST-CLOSURE

Facility	Address	EPA ID Number or Permit Number
Baytown	8500 West Bay Road Baytown, TX 77520-9730	TXD 058260977
Institute	Route 25 Institute, WV 25112	WVD 005005509
Kansas City	8400 Hawthorn Road Kansas City, MO 64120-0013	MOD 056389828
New Martinsville	Route 2 North New Martinsville, WV 26155-0500	WVD 056866312
Woodbine*	5954 Harriet's Bluff Road East Woodbine, GA 31569	020-015D(SL)(I)

NRC AND STATE DECOMMISSIONING

Facility	Address	RML Number
Stilwell	17745 S. Metcalf Avenue Stilwell, KS 66085-9104	26-B226-01
West Haven	400 Morgan Lane West Haven, CT 06516	06-13053-04

CORRECTIVE ACTION

Facility	Address	Case Number
Factory Lane Site	5 Factory Lane Middlesex Boro, NJ 08846	G000004483

* RCRA Subtitle D Landfill

ATTACHMENT II
RCRA FINANCIAL OBLIGATIONS

CLOSURE COST ESTIMATES (IN CURRENT $)

Facility	Address	EPA ID Number or Permit Number		Closure Cost
Baytown	8500 West Bay Road Baytown, TX 77520-9730	TXD 058260977	$	636,995
Institute	Route 25 Institute, WV 25112	WVD 005005509		3,506,674
Kansas City	8400 Hawthorn Road Kansas City, MO 64120-0013	MOD 056389828		1,795,997
New Martinsville	Route 2 North New Martinsville, WV 26155-0500	WVD 056866312		1,646,161
Woodbine	5954 Harriet's Bluff Road East Woodbine, GA 31569	020-015D(SL)(I)		211,423
		TOTAL	$	7,797,250

POST-CLOSURE COST ESTIMATES (IN CURRENT $)

Facility	Address	EPA ID Number or Permit Number		Post-Closure Cost
Baytown	8500 West Bay Road Baytown, TX 77520-9730	TXD 058260977	$	1,951,705
Institute	Route 25 Institute, WV 25112	WVD 005005509		7,814,357
New Martinsville	Route 2 North New Martinsville, WV 26155-0500	WVD 056866312		22,239,978
Woodbine	5954 Harriet's Bluff Road East Woodbine, GA 31569	020-015D(SL)(I)		491,842
		TOTAL	$	32,497,882

CORRECTIVE ACTION (C/A) COST ESTIMATES (IN CURRENT $)

Facility	Address	EPA ID Number		C/A Cost
Baytown	8500 West Bay Road Baytown, TX 77520	TXD 058260977	$	5,247,508
		TOTAL	$	5,247,508
		GRAND TOTAL RCRA FINANCIAL OBLIGATIONS	$	45,542,640

ATTACHMENT III
OTHER FINANCIAL OBLIGATIONS

NRC AND STATE DECOMMISSIONING COST ESTIMATES (IN CURRENT $)

Facility	Address	RML Number	Decommissioning Cost
Stilwell	17745 S. Metcalf Avenue Stilwell, KS 66085-9104	26-B226-01	$ 750,000
West Haven	400 Morgan Lane West Haven, CT 06516	06-13053-04	1,125,000
		TOTAL	$ 1,875,000

CORRECTIVE ACTION (C/A) COST ESTIMATES (IN CURRENT $)

Facility	Address	Case Number	C/A Cost
Factory Lane Site	5 Factory Lane Middlesex Boro, NJ 08846	G000004483	$ 9,600,000
		TOTAL	$ 9,600,000

GRAND TOTAL OTHER FINANCIAL OBLIGATIONS	$	11,475,000

ATTACHMENT IV
PARENT COMPANY GUARANTEE FINANCIAL TEST

1.	Current decommissioning cost estimates or certified amounts		
	a. Decommissioning amounts covered by this parent company guarantee	$ 1,125,000	
	b. All decommissioning amounts covered by other NRC or Agreement State parent company guarantees or self-guarantees	$ 750,000	
	c. All amounts covered by parent company guarantees, self-guarantees, or financial tests of other Federal or State agencies (e.g., EPA)	$ 63,142,640	
	TOTAL		$ 65,017,640
2.	Current bond rating of most recent unsecured issuance and name of rating service		A3 [Moody] BBB+ [Standard and Poor's]
3.	Date of issuance of bond:		January 15, 2004
4.	Date of maturity of bond		January 15, 2009
*5.	Tangible net worth** (if any portion of estimates for decommissioning is included in total liabilities on your firm's financial statements, you may add the amount of that portion to this line)		$1,593,369,000
*6.	Total assets in United States (required only if less than 90 percent of firm's assets are located in the United States)		N/A
7.	Is line 5 at least $10 million? (Yes/No)		Yes
8.	Is line 5 at least 6 times line 1? (Yes/No)		Yes
9.	Are at least 90 percent of firm's assets located in the United States? If not, complete line 10. (Yes/No)		Yes
10.	Is line 6 at least 6 times line 1? (Yes/No)		N/A
11.	Is the rating specified on line 2 BBB or better (if issued by Standard & Poor's) or Baa or better (if issued by Moody's)? (Yes/No)		Yes

* Denotes figures derived from financial statements.
** Tangible net worth is defined as net worth minus goodwill, patents, trademarks, and copyrights.

Bayer HealthCare
Pharmaceuticals

Chief, Nuclear Materials Safety Branch #2
U.S. Nuclear Regulatory Commission, Region I
475 Allendale Road
King of Prussia, PA 19406-1415

Dear Chief:

I am the Vice President of Business Planning and Administration for the Global Specialty Business Unit of Bayer Pharmaceuticals Corporation, 400 Morgan Lane, West Haven, CT 06516, a corporation. This letter is in support of using the financial test to demonstrate financial assurance, as specified in 10 CFR Part 30.

I hereby certify that Bayer Pharmaceuticals Corporation is currently a going concern.

This firm is not required to file a Form 10-K with the U.S. Securities and Exchange Commission for the latest fiscal year. The fiscal year of this firm ends on December 31.

I hereby certify that the content of this letter is true and correct to the best of my knowledge.

Sincerely,

Drew C Allen

Drew Allen,
Bayer Pharmaceuticals Corporation

Bayer Pharmaceuticals
Corporation
400 Morgan Lane
West Haven, CT 06516-4175

Phone: 203 812-2000

UNITED STATES NUCLEAR REGULATORY COMMISSION
[NRC License No. 06-13053-04]

AFFIDAVIT OF WILLY SCHERF

I, Willy Scherf, being duly sworn, and on my oath state as follows:

1. I am the Chief Financial Officer of Bayer Corporation ("Bayer"). As part of my employment in this capacity, I have knowledge of Bayer's business operations and finances. I have reviewed the information to be withheld from public disclosure and am authorized to apply for its withholding on behalf of Bayer.

2. The averments contained in this affidavit are personally known to me or contained in business records maintained in the ordinary course of business by Bayer.

3. This Affidavit is made in accordance with 10 CFR 2.390 in connection with the annual financial assurance documentation submitted by Bayer, Bayer's financial statements for the year ended December 31, 2006 and independent auditors' report ("2006 Financial Statements"). Bayer is submitting the 2006 Financial Statements in support of its corporate guarantee of Bayer Pharmaceuticals Corporation, the radioactive material license holder, 400 Morgan Lane, West Haven, CT 06516 [License No. 06-13053-04] and a wholly-owned subsidiary of Bayer.

4. The documents which Bayer request be held from public disclosure by the Nuclear Regulatory Commission ("NRC") are the 2006 Financial Statements which are labeled "CONFIDENTIAL."

5. Each page of the 2006 Financial Statements has been stamped "CONFIDENTIAL" for the following reasons:

a. The information for which Bayer is claiming confidentiality is a business financial trade secret. This information is known only to Bayer and its parent company, Bayer AG of Leverkusen, Germany, and must be kept permanently confidential. It is not routinely made available outside of Bayer;

b. Since Bayer Corporation is not a publicly-traded company and not required to file a Form 10K with the Securities and Exchange Commission, this information is not accessible to the public. Distribution of the financial reports is extremely limited within the corporation with only officers of the corporation receiving copies. Bayer continuously protects the confidentiality of this information; and

c. Disclosure of this information is required by the NRC solely to demonstrate adequate financial capacity to assure appropriate decommissioning for applicable facilities. Nondisclosure of this information will not result in any threat to the health of humans or the environment.

6. Disclosure of the 2006 Financial Statements is likely to cause substantial

harm to the competitive position of Bayer. The information contained in the 2006 Financial Statements is proprietary and held in confidence by Bayer and is not available to the public and could not be properly acquired or duplicated by others. It is for these reasons and as stated in Paragraph 5 above that Bayer requests the 2006 Financial Statements be withheld from public disclosure.

Further Affiant Sayeth Not.

Willy Scherf

COMMONWEALTH OF PENNSYLVANIA)
) SS.
COUNTY OF ALLEGHENY)

On this 9th day of April, 2007 personally appeared before me Willy Scherf, Affiant herein, and after being duly sworn stated that the averments of the foregoing Affidavit are true and correct to the best of his knowledge, information and belief.

COMMONWEALTH OF PENNSYLVANIA
Notarial Seal
Kathryn S. Fritzman, Notary Public
Robinson Twp., Allegheny County
My Commission Expires Feb. 10, 2010
Member, Pennsylvania Association of Notaries

Notary Public

Bayer Corporation and Subsidiaries

Consolidated Financial Statements
December 31, 2006 and 2005

CONFIDENTIAL

Bayer Corporation and Subsidiaries
Index
December 31, 2006 and 2005

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers LLP
600 Grant Street
Pittsburgh PA 15219
Telephone (412) 355 6000

Report of Independent Auditors

To the Stockholder and Board of Directors of
Bayer Corporation

In our opinion, the accompanying consolidated balance sheets and the related statements of operations, stockholder's equity and cash flows present fairly, in all material respects, the financial position of Bayer Corporation and subsidiaries (the "Company") at December 31, 2006 and 2005, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of valuing inventory for its polymer inventories from the average costing method to the last-in, first-out method in 2006.

As discussed in Note 15 to the consolidated financial statements, the Company changed its method of accounting for defined benefit and other postretirement plans upon adoption of Statement of Financial Accounting Standard No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans."

PricewaterhouseCoopers LLP

March 22, 2007

Bayer Corporation and Subsidiaries
Consolidated Balance Sheets
December 31, 2006 and 2005

(dollars in millions)

	2006	2005
Assets		
Current assets		
Cash and cash equivalents	$ 323	$ 17
Receivables		
Trade (less allowances: 2006, $13; 2005, $26)	1,045	976
Affiliates	417	514
Other	274	257
Inventories	1,500	1,552
Deferred income taxes	313	273
Assets of operations held for sale	403	371
Other	54	57
Total current assets	4,329	4,017
Property, plant and equipment, net	2,591	2,670
Other assets		
Goodwill	1,183	1,349
Other intangible assets	619	670
Investments in unconsolidated companies	182	144
Deferred income taxes	682	636
Assets of operations held for sale	755	752
Other	919	657
Total assets	$ 11,260	$ 10,895
Liabilities and Stockholder's Equity		
Current liabilities		
Current portion of long-term debt	$ 461	$ 525
Current portion of capital lease obligations	29	47
Accounts payable		
Trade	545	568
Affiliates	880	844
Liabilities of operations held for sale	155	173
Other	1,746	1,378
Total current liabilities	3,816	3,535
Long-term liabilities		
Long-term debt	1,719	1,961
Long-term capital lease obligations	338	367
Other	1,448	1,535
Total liabilities	7,321	7,398
Commitments and contingencies	-	-
Minority interests	364	420
Stockholder's equity		
Common stock	-	-
Paid-in capital	3,121	3,091
Retained earnings	499	65
Accumulated other comprehensive loss	(45)	(79)
Stockholder's equity	3,575	3,077
Total liabilities and stockholder's equity	$ 11,260	$ 10,895

The accompanying notes are an integral part of these consolidated financial statements.

Bayer Corporation and Subsidiaries
Consolidated Statements of Operations
Years Ended December 31, 2006 and 2005

(dollars in millions)

	2006	2005
Net sales	$ 9,989	$ 9,208
Cost of goods sold	5,977	5,660
Gross profit	4,012	3,548
Operating expenses		
Selling, administration and other - net	2,858	2,450
Research and development	740	629
	3,598	3,079
Income from operations	414	469
Other income (expense)		
Net interest incurred	(200)	(180)
Interest capitalized	6	4
Other - net	68	(19)
Income from continuing operations before income taxes, minority interests and cumulative effect of accounting change	288	274
Benefit for income taxes	11	24
Minority interests	57	(54)
Cumulative effect of accounting change (Note 20)	-	(2)
Income from continuing operations	356	242
Income from discontinued operations (net of tax of $91 and $58 in 2006 and 2005, respectively) (Note 7)	103	138
Net income	$ 459	$ 380

The accompanying notes are an integral part of these consolidated financial statements.

Bayer Corporation and Subsidiaries
Consolidated Statements of Stockholder's Equity
Years Ended December 31, 2006 and 2005

(dollars in millions, except par value and share amounts)

	Common Stock (1)	Additional Paid-In Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Income
Balances, January 1, 2005	$ -	$ 3,085	$ (305)	$ (15)	2,765	
Net income	-	-	380	-	380	$ 380
Currency translation adjustment	-	-	-	(15)	(15)	(15)
Unrealized holding losses	-	-	-	(2)	(2)	(2)
Net gains on derivatives	-	-	-	24	24	24
Minimum pension liability adjustment	-	-	-	(71)	(71)	(71)
Deemed dividend	-	-	(10)	-	(10)	-
Additional capital contribution	-	11	-	-	11	-
Adjustment to gain on sale to related party (Note 4)	-	(5)	-	-	(5)	-
Balances, December 31, 2005	-	3,091	65	(79)	3,077	$ 316
Net income	-	-	459	-	459	$ 459
Currency translation adjustment	-	-	-	19	19	19
Unrealized holding losses	-	-	-	(10)	(10)	(10)
Net losses on derivatives	-	-	-	(21)	(21)	(21)
Change in minimum pension liability	-	-	-	47	47	47
Cumulative effect adjustment due to the adoption of SFAS 158, net of tax	-	-	-	(1)	(1)	(1)
Deemed dividend	-	-	(25)	-	(25)	-
Additional capital contribution	-	30	-	-	30	-
Balances, December 31, 2006	$ -	$ 3,121	$ 499	$ (45) *	$ 3,575	$ 493

(1) Common stock, $1.00 par value, 1,100 shares authorized, 1,003 shares issued and outstanding.

* Comprised of currency translation adjustments of $13, and all of the following items, all of which are net of tax: unrealized holdings gains of $3, net losses on derivative financial instruments of $(3), and pension liability adjustments of $(58), all net of tax.

The accompanying notes are an integral part of these consolidated financial statements.

Bayer Corporation and Subsidiaries
Consolidated Statements of Cash Flows
Years Ended December 31, 2006 and 2005

(dollars in millions)

	2006	2005
Cash flows from operating activities		
Net income	$ 459	$ 380
Adjustments to reconcile net income to net cash provided by operating activities		
Equity in earnings (loss) of unconsolidated companies, net of distributions	(64)	64
Depreciation	427	383
Amortization and other - net	170	221
Loss on sales/impairment/retirement of assets	217	102
Deferred income taxes	(91)	170
Minority interests	(57)	57
Other	37	3
Changes in assets and liabilities, excluding effects of acquisitions and divestitures		
Receivables	(7)	564
Inventories	2	133
Other current assets and non-current assets	(283)	105
Accounts payable	41	(27)
Other current liabilities and long-term liabilities	307	(636)
Net cash provided by operating activities	1,158	1,519
Cash flows from investing activities		
Additions to property, plant and equipment	(388)	(303)
Acquisitions, net of cash acquired	(85)	(33)
Investments in unconsolidated companies	(8)	(8)
Purchases of other assets	(31)	(23)
Loans to affiliates	-	(68)
Proceeds from sales of assets	75	275
Net cash used in investing activities	(437)	(160)
Cash flows from financing activities		
Capital contributions	-	11
Issuances of long-term debt	1,029	1,611
Repayments of long-term debt	(1,397)	(2,926)
Payments on capital lease obligations	(47)	(58)
Net cash used in financing activities	(415)	(1,362)
Net increase (decrease) in cash and cash equivalents	306	(3)
Cash and cash equivalents		
Beginning of year	17	20
End of year	$ 323	$ 17

The accompanying notes are an integral part of these consolidated financial statements.

(dollars in millions)

1. Summary of Significant Accounting Policies

Nature of Operations and Principles of Consolidation
The financial statements include the accounts of Bayer Corporation, a wholly owned subsidiary of Bayer AG, and its majority owned and controlled subsidiaries (the "Company"). The Company is principally engaged in the production, research and marketing of health care, polymer, and agricultural products primarily in the United States. All significant intercompany transactions are eliminated in consolidation.

The Company's investments in unconsolidated companies for which it exercises significant influence, but do not control, are accounted for using the equity method.

The Company also evaluates consolidation of entities under Financial Accounting Standards Board ("FASB") Interpretation No. 46, *Consolidation of Variable Interest Entities* ("FIN 46"). FIN 46 requires management to evaluate whether an entity is a variable interest entity and whether the Company is the primary beneficiary. Consolidation is required if both of these criteria are met. The Company is the primary beneficiary of one variable interest entity which requires consolidation.

The functional currency of the Company's foreign subsidiaries is generally the local currency. Translation gains and losses are included in the consolidated balance sheets as a component of accumulated other comprehensive loss. Where the U.S. dollar is used as the functional currency, foreign currency gains and losses are reflected in net income or net loss.

Net foreign currency transaction gains and losses were a gain of $14 in 2006 and a loss of $20 in 2005.

In connection with the realignment of Bayer AG in the fourth quarter of 2003, the Bayer AG Supervisory Board decided to transfer certain non-core activities of the Polymers and Chemicals subgroups into a separate worldwide company named Lanxess. The Company's activities affected by this decision included the Bayer Chemicals subgroup – with the exception of the Wolff Walsrode business – along with the solid rubber and rubber chemicals operations, including Rhein Chemie, semi-crystalline polymers, ABS/SAN and fibers activities of the former Bayer Polymers subgroup. On January 31, 2005, Bayer AG completed a spin-off of Lanxess AG to then existing Bayer AG shareholders. In preparation for the spin-off of the worldwide Lanxess group, Lanxess Corporation, a subsidiary of Lanxess AG, purchased certain assets and assumed certain liabilities of the Polymer and Chemicals subgroup, as well as certain subsidiaries of the Company on July 1, 2004.

Businesses to be divested are classified in the consolidated financial statements as either discontinued operations or assets and liabilities held for sale. For businesses classified as discontinued operations, the balance sheet amounts and income statement results are reclassified from their historical presentation to assets and liabilities of operations held for sale on the consolidated balance sheets and to discontinued operations in the consolidated statements of operations for all periods presented. The statement of consolidated cash flows is also reclassified for assets held for sale and discontinued operations for all periods presented. Management does

(dollars in millions)

not expect any significant continuing involvement with these businesses following the sales, and these businesses are expected to be disposed of within one year.

Cash Equivalents
Cash equivalents are short-term, highly liquid investments that are purchased with original maturities of three months or less.

Use of Estimates
The preparation of these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and assumptions that affect reported amounts and related disclosures. Specific areas, among others, requiring the application of management's estimates and judgment include assumptions pertaining to creditworthiness of customers and financial institutions, future product volume and pricing estimates, foreign currency exchange rates, interest rates, discount rates, useful lives of assets, investment returns, tax strategies and other external and economic conditions. Actual results could differ from these estimates.

Inventory Valuation
Polymer inventories are stated at the lower of cost or market at December 31, 2006 with cost being determined under the last-in, first-out ("LIFO") method (see Note 2). The cost of other inventories is determined primarily using the average cost method. When necessary, the Company provides allowances to adjust the carrying value of its inventory to its net realizable value, including any costs to sell or dispose. Appropriate consideration is given to obsolescence, excessive inventory levels, product deterioration and other factors in evaluating net realizable value.

Property, Plant, and Equipment
Property, plant, and equipment are carried at cost and depreciation is provided using the straight-line method over the estimated useful lives of the properties. Interest costs, based on the weighted average interest rates of debt, are included in the cost of certain property additions.

The following depreciation periods, based on the estimated useful lives of the respective assets, are applied throughout the Company:

Buildings	20 to 50 years
Plant installations	6 to 20 years
Machinery and equipment	6 to 12 years
Laboratory and research facilities	3 to 5 years
Storage tanks and pipelines	10 to 20 years
Vehicles	4 to 8 years
Computer equipment	3 to 5 years
Furniture and fixtures	4 to 10 years

Goodwill and Other Intangible Assets
The Company adopted Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets*, effective January 1, 2002. Under this standard, goodwill and intangibles with indefinite useful lives are not amortized. Intangible assets with finite useful lives

are amortized generally on a straight-line basis over the periods benefited, with a weighted average useful life of 15 years.

The carrying values of goodwill and other intangible assets with indefinite useful lives are tested at least annually for impairment. If the carrying value of goodwill or an intangible asset exceeds its fair value, an impairment loss is recognized. The evaluation of impairment involves comparing the estimated fair value of the reporting units to the recorded value, including goodwill. The Company primarily uses a discounted cash flow model ("DCF model") to estimate the current fair value of the reporting units. A number of significant assumptions and estimates are involved in the application of the DCF model to forecast operating cash flows, including markets and market share, sales volumes and prices, costs to produce, and working capital changes. Management considers historical experience and all available information at the time the fair values of its reporting units are estimated. However, actual fair values that could be realized in an actual transaction may differ from fair value estimates used to evaluate the impairment of goodwill.

Impairment of Long-Lived Assets
The carrying values of long-lived assets are reviewed by the Company whenever events or changes in circumstances indicate carrying values may not be recoverable, and impairments are recognized if the expected future operating, undiscounted cash flows derived from an asset are less than its carrying value.

Investments
Investments in marketable equity securities are classified as available-for-sale and are reported at fair value with unrealized gains and losses recorded in accumulated other comprehensive loss.

Amortization of Debt Discount
Unamortized debt discount on long-term debt is being amortized over the remaining life of the debt as interest expense.

Financial Instruments
The Company's financial instruments consist primarily of cash and cash equivalents, short-term and long-term notes receivable from related parties, short-term debt with related parties, long-term debt, interest rate swaps, commodity futures, and option contracts. As a policy, the Company does not engage in speculative or leveraged transactions, nor does the Company hold or issue financial instruments for trading purposes.

The Company uses derivative financial instruments for the purpose of hedging currency, commodity price and interest rate exposures, which exist as part of ongoing business operations. It is the policy of the Company to execute such instruments with creditworthy counterparties. All foreign currency forward exchange contracts are denominated in currencies of major industrial countries. The Company carries derivative instruments on the balance sheet at fair value, determined by reference to quoted market prices. Derivative financial instruments are presented as a component of other current or non-current assets or liabilities, based on the instrument's fair value and maturity or the underlying asset or liability related to the hedging instrument. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, if so, the reason for holding it. The cash flows related to derivative instruments are classified in the consolidated statements of cash

flows within operating activities. The amount to be paid or received from interest rate swaps and forward rate agreements is charged or credited to net interest incurred over the lives of the agreements.

Supplemental Cash Flow Information
Income tax payments, net of refunds received, were $132 for 2006. Income tax refunds, net of payments made, were $44 for 2005. Interest payments on borrowings were $151 in 2006 and $162 in 2005.

Revenue Recognition
Revenues from product sales, equipment sales and sales-type leases are recognized when title, ownership, and the risk of loss passes to customers at the time of shipment. Sales-type leases are recorded at the present value of future billings. Where right of return exists, revenues are reduced at the time of sale to reflect expected returns that are estimated based on historical experience. Reserves are also provided at the time of shipment for warranty and installation costs and for recourse obligations related to third-party sales-type leases.

Service and rental income are recognized over the contractual period primarily as services are performed.

Shipping and Handling Costs
Shipping and handling costs that are billed to customers are included in net sales. The related expense included in selling, administration and other – net was $303 in 2006 and $298 in 2005.

Advertising Costs
Advertising costs are expensed as incurred and amounted to $418 in 2006 and $464 in 2005. These costs are included in selling, administration and other – net.

Income Taxes
The provision for income taxes is determined using the asset and liability approach of accounting for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. Under this approach, deferred taxes represent the future tax consequences expected to occur when the reported amounts of assets and liabilities are recovered or paid. The provision for income taxes represents income taxes paid or payable for the current year plus the change in deferred taxes during the year. Deferred taxes result from differences between the financial and tax bases of the Company's assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

(dollars in millions)

Litigation Provisions
The Company records provisions for litigation when the likelihood of an unfavorable outcome is probable and estimates are possible. These litigation provisions include estimated legal fees where appropriate and costs of potential settlements. The amounts recorded are based upon information and cost estimates that are updated at regular intervals, not exceeding three months. However, actual expenditures for legal fees and settlements could differ from the recorded provisions.

Reclassification
Certain amounts in the 2005 consolidated financial statements were reclassified to conform to 2006 presentation.

Recently Issued Accounting Standards
In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS No. 159, permits companies to choose to measure financial instrument and certain other items at fair value. This statement is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of adopting this standard.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R).* SFAS No. 158 requires an employer to recognize the funded status of each of its defined pension and postretirement benefit plans in the balance sheet and has no income statement effect. This requirement is effective for the Company at December 31, 2006. See Note 15 for additional information.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements.* SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that require or permit fair value measurements. This statement is effective on January 1, 2008. Upon adoption, the provisions of SFAS No. 157 are to be applied prospectively with limited exceptions. The adoption of this standard is not expected to have a material impact on the Company's consolidated financial statements.

In July 2006, FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109,* ("FIN 48") was issued. FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return. FIN 48 is effective on January 1, 2007. Management is currently evaluating the impact of adopting this standard.

In April 2006, FASB Staff Position FIN 46 (R) – 6, *Determining the Variability to Be Considered in Applying FASB Interpretation No 46 (R)* was issued. This staff position states that variability should be considered by analyzing the nature of the risks and determining the purpose for which the entity was created. This statement is effective for fiscal years beginning after June 15, 2006. The Company is currently evaluating the impact of adopting this standard.

(dollars in millions)

Effective January 1, 2006, the Company adopted SFAS No. 151, *Inventory Costs – an amendment of ARB No. 43, Chapter 4*, which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) and also requires that the allocation of fixed production overhead be based on the normal capacity of the production facilities. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140.* This statement provides for fair value accounting for any hybrid financial instruments that contain an embedded derivative that otherwise would require bifurcation and clarification of other provisions under SFAS No. 133 and SFAS No. 140. This statement is effective for fiscal years beginning after September 15, 2006. The Company is currently evaluating the impact of adopting this standard.

2. Inventories

Inventories at December 31 consisted of the following:

	2006	2005
Finished goods and work in progress	$ 1,194	$ 1,377
Raw materials and other	343	175
LIFO reserve	(37)	-
Inventories	$ 1,500	$ 1,552

For its polymer inventory valuations, the Company changed its method of valuing inventory from the average-cost method to LIFO effective January 1, 2006. The Company believes the LIFO method of inventory costing better reflects the cost of doing business and will provide more meaningful information. The Company will look to adopt LIFO for its remaining businesses if business conditions reflect that this would provide more meaningful results based upon the existing business conditions. The Company has determined that it is impracticable to determine the cumulative effect of applying this change retrospectively for 2005. Approximately 28% of total inventories at December 31, 2006 were valued on a LIFO basis.

3. Business Combinations and Investments

During 2006, the Company completed two acquisitions at a cost of $85. The most significant of these transactions was the acquisition of the capital stock of Metrika, Inc. for $72. The allocation resulted in goodwill of approximately $20.

In December 2006, two dormant U.S. subsidiaries of Bayer AG were merged into the Company. These transactions resulted in the acquisition of a deferred tax asset of $1 and the extinguishment of affiliate payables to these subsidiaries of $29. These transactions were treated as capital contributions.

(dollars in millions)

In 2005, the Company completed two acquisitions at a cost of $33 including the purchase of certain assets and assumption of liabilities, which now comprise the Company's subsidiary, BaySystems Inc., which was valued at $24.

During 2005, the Company acquired the remaining 40% ownership interest of Genoptera LLC, and as consideration, the Company will potentially pay royalty fees on future sales of certain products. No value was assigned to this transaction and the Company impaired $6 of intangible assets.

The following table provides a summary of assets and liabilities arising from acquisitions based on preliminary and/or final purchase price allocations:

	2006	2005
Current assets	$ 5	$ 12
Property, plant and equipment - net	7	4
Goodwill	25	33
Other intangible assets	51	10
Other noncurrent assets	18	(22)
Current liabilities	21	5

In 2005, the Company completed the evaluation and allocation of the purchase price for the acquisition of Bayer Roche LLC and as a result, increased goodwill and reduced other noncurrent assets by $22, which is reflected in the above table for 2005.

4. Sale of Businesses to Related Party

On July 1, 2004, Lanxess Corporation, a subsidiary of Lanxess AG, purchased certain assets and assumed certain liabilities of the Polymers and Chemicals subgroups, as well as certain subsidiaries of the Company. At that time, Lanxess AG was a wholly owned subsidiary of Bayer AG. This related party sale was performed in contemplation of Bayer AG's January 31, 2005 spin-off of Lanxess AG to then existing Bayer AG shareholders. In connection with the sale, the Company received $212 in cash and had $379 of notes receivable from Lanxess Corporation. These notes were subsequently repaid. Net assets transferred to Lanxess Corporation totaled $534. The resulting pre-tax gain of $45, and related tax benefit of $12, on the related party transaction were recorded in additional paid-in capital as gain from sale to related parties. The tax benefit primarily related to differences in the book and tax bases of subsidiaries disposed, which includes certain immaterial corrections to prior year amounts.

As of June 2005, the after-tax gain of $57 was reduced to $52 due to a reallocation of the sales proceeds for tax purposes, as a result of the finalization of the purchase price allocation. This resulted in higher capital losses attributable to the sale of subsidiaries. As a result of uncertainty regarding the Company's ability to utilize capital loss carry forwards, the Company recorded a valuation allowance of $5 as it is not likely that this loss carry forward will be utilized.

(dollars in millions)

5. Goodwill and Other Intangible Assets

Changes to goodwill and other intangible assets for 2006 and 2005 were as follows:

	Goodwill	Other Intangibles
Balances at December 31, 2004, net of accumulated amortization	$ 1,316	$ 764
Additions during the period	11	10
Amortization expense	-	(83)
Impairments	-	(21)
Purchase price reallocation	22	-
Balances at December 31, 2005, net of accumulated amortization	$ 1,349	$ 670
Additions during the period	24	52
Amortization expense	-	(84)
Impairments	(190)	(19)
Balances at December 31, 2006, net of accumulated amortization	$ 1,183	$ 619

The following activity occurred in 2006:

The Company recorded an impairment charge of $190 for goodwill associated with its CropScience business. This has been reported as a component of selling, administration and other-net. The Company's CropScience business experienced lower than expected operating profits and cash flows due to increased competition. This trend is expected to continue into the future. Furthermore, in 2006, this business initiated major restructuring efforts that are expected to require significant cash outlays in 2007 and 2008. The cost of, and the expected future benefits, from this action were incorporated into the projected future operating results. As a result of this trend and restructuring efforts, the projected operating results and cash flows for the CropScience business have been reduced.

The Company acquired Metrika Inc., resulting in increased goodwill of $20. Additionally, the Company made one small acquisition and a small divestiture, resulting in a net increase to goodwill of $4. In connection with these acquisitions, the Company also recorded an increase in other intangibles of $52, primarily related to patents and customer and distributor relationships associated with the Metrika acquisition.

The Company recorded $19 of impairment charges for certain remaining pharmaceutical marketing rights due to continuously declining future cash flows resulting from increased competition.

(dollars in millions)

The following activity occurred in 2005:

The Company completed the evaluation and allocation of the purchase price for the Bayer Roche LLC acquisition and as a result, increased goodwill by $22.

The 2005 increase in intangibles resulted mainly from the purchase of certain assets and assumption of liabilities, which now comprise the Company's subsidiary BaySystems. The Company also acquired the remaining interest of its 60% owned subsidiary, Genoptera LLC. In conjunction with this acquisition, $6 of intangible assets were impaired. In addition, the Company recorded $15 of impairment charges for certain pharmaceutical marketing rights due to a decline in future cash flows resulting from lower projected sales levels.

Other intangible assets, net of accumulated amortization, consist of the following:

	2006	2005
Patents	$ 1	$ 2
Trademarks	167	201
Marketing rights	53	71
Production and other rights	398	396
	$ 619	$ 670

Estimated aggregate amortization expense for other intangible assets for each of the five succeeding years is as follows:

2007	$ 94
2008	81
2009	73
2010	71
2011	69

6. Property, Plant and Equipment

Property, plant and equipment consisted of the following:

	2006	2005
Land	$ 108	$ 107
Buildings and leasehold improvements	1,745	1,723
Machinery and equipment	4,303	4,132
Construction in progress	345	266
Gross property, plant and equipment	6,501	6,228
Less: Accumulated depreciation	3,910	3,558
Net property, plant and equipment	$ 2,591	$ 2,670

(dollars in millions)

Depreciation expense was $411 and $350 for the years ended December 31, 2006 and 2005, respectively. Included in depreciation expense for 2006 is $26 related to the change in the estimated future life of facilities that will be vacated and disposed of as part of restructuring programs. See Note 12.

7. Discontinued Operations and Assets Held for Sale

In 2006, Bayer AG committed to a plan to divest its worldwide Diagnostics division ("DS") and the Wolff Walsrode business. The sale of DS was completed in January 2007, which resulted in a gain of approximately $2,000. The sale of Wolff Walsrode is expected to close in the first half of 2007.

The financial information for all periods has been presented to reflect these businesses as assets of operations for sale and liabilities of operations held for sale in the consolidated balance sheets and as discontinued operations on the consolidated statements of operations. Also included in income from discontinued operations for 2006 is tax expense of $36, related to a deferred tax liability as a result of a basis difference in a foreign subsidiary that will be realized due to this divestiture.

The following table details selected financial information for the businesses included within discontinued operations.

	2006	2005
Net sales	$ 1,326	$ 1,373
Income from operations	191	192
Income before income taxes	194	196
Provision for taxes	91	58
Income from discontinued operations	103	138

The major classes of assets and liabilities of operations held for sales in the consolidated balance sheets are as follows:

	2006	2005
Assets		
Receivables	$ 205	$ 187
Inventories	189	164
Other current assets	9	20
Property, plant and equipment, net	131	107
Goodwill	41	41
Other intangible assets	502	533
Other	81	71
Total assets of operations held for sale	$ 1,158	$ 1,123
Liabilities		
Accounts payable	21	17
Other	134	156
Total liabilities of operations held for sale	$ 155	$ 173

(dollars in millions)

8. Disposition of the Plasma Business

During the fourth quarter of 2003, Bayer AG committed to a plan to divest the worldwide Plasma business of its Biological Products Division. In accordance with this decision, the Company classified its U.S. Plasma business as held for sale and recorded an impairment loss of $400.

At December 31, 2004, the Company remeasured its impairment loss based on a preliminary sales agreement with NPS BioTherapeutics, Inc. ("NPS"). As a result, an additional $102 in impairment loss was recorded in 2004 to bring the cumulative loss on the disposition to $502.

On March 31, 2005, Bayer AG completed the disposition of this business to NPS. Proceeds from the sale were $304. Subject to any final working capital adjustments, the transaction generated a preliminary loss on the disposition of $7, after considering previously recorded impairment losses. Subsequently in 2005, the Company recorded additional losses of $53 related to working capital adjustments and inventory that was below that specified in the purchase and sale agreement. Of this amount, $40 was paid to NPS in 2005. The final sales agreement provides that the Company will receive a 10% equity interest in the newly formed company, could potentially receive contingent consideration based on the performance of the entity, and would have various supply, distribution and service agreements with the new entity.

During 2005, the Company reached a settlement agreement related to the contingent consideration and received a payment of $27. Additionally, the Company's ownership interest was diluted to 8.52% due to a capital contribution to NPS by a third party. The Company also received dividends of $6 on its retained equity interest.

During 2006, the Company received a second settlement payment of $7 related to the contingent consideration. Further, the Company received dividends of $2 on its retained equity interest and subsequently sold its 8.52% equity interest for $22, resulting in a gain on disposition of $7.

In 2007, the Company reached a settlement related to the remaining $13 in working capital and inventory adjustments. This was settled for $9 and was paid in March 2007.

The final cumulative loss on the disposition was $521, net of the gains recorded for the sale of its equity interest and consideration received.

9. Equity Investments in Affiliates

The Company has investments in affiliates that are accounted for on the equity method. The following table presents summarized financial information on a combined 100% basis of the principal companies. Amounts presented include the accounts of the following equity affiliates: Bayer Inc. (26.86%), BayOne Urethane Systems LLC (50%) and Exatec LLC (50%).

(dollars in millions)

	2006	2005
Total assets	$ 941	$ 811
Net sales	858	896
Gross profit	286	262
Net income	255	38

The Company recorded income of $64 and $4 for its share of earnings of all unconsolidated equity method affiliates for the years ended December 31, 2006 and 2005, respectively. The Company's equity in the earnings or losses of such affiliates is included in other income-net in the Company's Consolidated Statement of Operations.

BayOne Urethane Systems LLC made cash distributions to the Company in the amount of $3 and $4 in 2006 and 2005, respectively. Bayer Inc. made cash distributions to the Company in the amount of $68 in 2005. There were no cash distributions from Bayer Inc. in 2006. The Company made cash contributions to Exatec LLC in the amount of $7 and $6 in 2006 and 2005, respectively.

10. Related Party Transactions

Revenues and receivables from related parties primarily reflect sales of products and services to Bayer AG and other affiliates. Generally, transactions are conducted under long-term contractual arrangements. Total revenues generated by sales and service transactions with related parties were $2,458 and $2,062 in 2006 and 2005, respectively. Included as a component of net sales is $157 in 2006 and $97 in 2005, are research and development and other costs billed to affiliates. Total receivables from related parties were $938 and $818 at December 31, 2006 and 2005, respectively.

Accounts payable to related parties reflect the purchase of products and services from Bayer AG and other related affiliates. Purchases from related parties totaled $1,869 and $1,122 in 2006 and 2005, respectively. Interest expense from related parties totaled $51 and $59 in 2006 and 2005, respectively.

During 2006, the Company transferred a $25 pension asset to a subsidiary of Bayer AG. This transfer was treated as a deemed dividend.

Additionally, in December 2006, two dormant U.S. subsidiaries of Bayer AG were merged into the Company. These transactions resulted in the acquisition of a deferred tax asset of $1 and the extinguishment of affiliate payables to these subsidiaries of $29. These transactions were treated as capital contributions.

During 2005, the Company accrued $9 for environmental contingencies related to legacy Aventis S.A. environmental sites. Based on the Aventis purchase and sale agreement, management believes that such amounts are indemnified by Aventis S.A. However, Bayer AG management has indicated that it will not reimburse the Company for the U.S. related environmental liabilities. The additional accrual had no impact on the Company's 2005 net income, as the amount was recorded as a deemed dividend in the consolidated statement of stockholder's equity. There were no additional accruals recorded in 2006 related to this environmental liability.

(dollars in millions)

In connection with legal proceedings in which the Company and Bayer AG are co-defendents, the parties may share in the overall costs of such defense, including any outcome of such proceedings. Management believes that costs incurred by the Company are representative of those that the Company would incur on a stand-alone basis.

In connection with certain of the rubber-related and urethane-related price fixing proceedings, it is the present intention of Bayer AG to assume the financial responsibility for fines, costs and potential civil liability associated with or arising therefrom. In 2005, Bayer AG established provisions relating to agreements or agreements in principle to settle a number of rubber-related and urethane-related civil antitrust actions which were then pending in the United States and elsewhere. It was determined by Bayer AG that $18 of the total projected costs of €285 for these settlements were allocable to the Company and therefore, have been reflected in other – net in 2005.

In 2006 and 2005, the Company did not record any charge with respect to the agreement in principle to settle the class action civil litigation associated with polyether polyols, methylene diphenyl diisocyanate ("MDI") and toluene diisocyanate ("TDI"), and their related systems, as described in Note 21. It is the present intention of Bayer AG, as between Bayer AG and the Company, to assume the financial responsibility for payment of this settlement.

In connection with the legal fees and settlement costs incurred in connection with the PPA litigation, Bayer AG maintains the global insurance policy covering these exposures. Bayer AG confirmed insurance coverage to the Company of up to $240. Remaining insurance receivables of $13 and $25 related to these matters are included within other current receivables in 2006 and 2005, respectively. Amounts in excess of the insurance coverage have been expensed accordingly.

11. Strategic Agreement with Schering-Plough

In September 2004, the Company announced that it entered into a strategic agreement with Schering-Plough Corporation ("S-P"). Commencing in October 2004, in the United States and Puerto Rico, S-P began to market, sell and distribute the Company's primary care products including Avelox® (moxifloxacin HCl) and Cipro® (ciprofloxacin HCl) under an exclusive license agreement. The Company will receive royalties from S-P based on product sales. The Company recorded royalties of $65 and $135 in 2006 and 2005, respectively, as a component of net sales.

As part of the U.S. integration, the Company reduced its workforce by 1,357 employees and will perform other restructuring activities. In connection with the workforce reduction and other restructuring activities, S-P agreed to pay the Company $20, which is fixed regardless of the actual restructuring costs incurred by the Company. Actual costs associated with this integration of $41 were incurred by the Company through 2005. The Company is amortizing this amount as a reduction of selling, administration and other – net over the life of the agreement.

Concurrent to the agreement between the Company and S-P in the United States, Bayer AG negotiated a similar arrangement in Japan. In Japan, following regulatory approval, Bayer began to co-market S-P's cholesterol absorption inhibitor Zetia® (ezetimibe). This agreement was finalized in July 2005. Upon finalization of the agreement in Japan, the Company received a payment from

(dollars in millions)

S-P of $120, for the agreement in the United States, and Bayer AG paid $120 to S-P, for the agreement in Japan.

Upon finalization of the global agreement in 2005 and in accordance with Accounting Principles Board ("APB") No. 29, *Accounting for Nonmonetary Transactions*, the Company recognized in the consolidated statement of financial position $129 of deferred revenue and a capital contribution of $11. The amount of deferred revenue was based upon the fair value of the Zetia® marketing rights intangible asset recorded by Bayer AG. Therefore, the amount of cash received by the Company in excess of $129 is considered a capital contribution. The $129 of deferred revenue will be amortized over the life of the U.S. drug rights license agreement in the United States of approximately 13 years. As a result, the Company has recognized revenue of $8 and $5 in 2006 and 2005, respectively which are reflected as a component of net sales.

Also, Bayer AG and the Company will support the promotion of certain S-P oncology products in the United States and key European markets for a defined period of time. Under the agreement, the Company will serve as a subcontracted sales force for S-P's oncology sales group and will receive a fixed fee of $12 per year to be paid quarterly in arrears for a three-year period in exchange for marketing S-P's oncology products and the use of its sales force. In 2006 and 2005, the Company received $12 and $15, respectively, of the fixed fee and is amortizing this amount over a thirty-month period. In 2006 and 2005, the Company recognized $16 and $8, respectively, as a component of net sales, of income related to the promotion of the oncology products. However, as this is a worldwide agreement, the Company allocated $8 and $2 of this income to Bayer AG through a reduction of the amount recognized in 2006 and 2005, respectively.

In addition, there was a business integration and transition period from the effective date through mid-2005. In 2005, the Company billed S-P $1, for transition services provided to Schering which was recorded as a reduction of marketing expenses.

Also commencing in October 2004, S-P undertook the Company's responsibilities for U.S. commercialization activities related to the drug Levitra® (vardenafil HCl), under the Company's co-promotion agreement with GlaxoSmithKline PLC. In 2006 and 2005, the Company recognized $127 and $126, respectively, of income related to the sales of Levitra® and paid co-promotion fees to GlaxoSmithKline PLC of $82 and $64 in 2006 and 2005, respectively.

In 2005, the Company expensed and paid to S-P a one-time payment of $18 to resolve and settle claims arising from products referred to in the agreement as "Tail Products."

In 2006, the Company S-P entered into additional agreements that amended aspects of the original agreement related to the monitoring of inventory levels maintained by S-P. As a result of this, the Company recorded expense of $3 related to short-dated inventory as a result of this amendment.

12. Restructuring and Asset Impairment Charges

The Company has undertaken numerous restructuring programs in the past few years. All amounts noted below are pre-tax.

(dollars in millions)

Restructuring Programs

Polymer Facility Rationalizations – In 2000, the Company initiated an overall program to integrate and restructure operations. As part of this program, the Company shut down a production unit in the New Martinsville, WV plant. In 2002, the Company's coatings business announced it would close its plant in Hicksville, NY by the end of 2002. Accruals related to these programs were $3 at December 31, 2004, primarily related to future demolition costs. The Company recorded an additional demolition accrual of $2 during 2006. Cash payments of $3 and $1 were incurred in 2006 and 2005, respectively. The remaining accrual of $1 primarily relates to the New Martinsville, WV plant, and is anticipated to be paid in 2007. Pre-demolition occurred at the end of 2006.

Site Restructuring – In 2006, the Company decided to transform its New Martinsville site into an industrial park. In connection with this transformation, the closure of the MDI unit and the related infrastructure will take place throughout 2007 and 2008. In 2006, the Company recorded a severance accrual of $6. These costs are reflected as selling, administration and other-net.

Polymers Reorganization – The polymers business initiated a reorganization program in 2002 to realign the business. As a result, in 2004, the associated restructuring accrual was $12, related to remaining severance payments. The Company recorded additional severance accruals of $2 in 2005, due to a continuation of this program and reversed $1 in 2006. These costs are reflected either in cost of goods sold or selling, administration and other–net, depending upon the function restructured. Payments were $2 and $11 in 2006 and 2005, respectively. This program is completed and there is no remaining accrual.

Institute Facility – In 2003, the Company announced that it would close its polyols facility in Institute, WV during the first half of 2004 and reduce its workforce as part of an overall program to consolidate production sites. The Company recorded a restructuring accrual for this action of $11 at December 31, 2004, of which $8 was for future severance costs and $3 for future payments related to penalty clauses under an abandoned service contract. An additional $4 was recorded in 2005, a component of cost of goods sold, related to actions taken during this period. Of these amounts, the Company paid $5 and $9 in both 2006 and 2005, and expects to pay the remainder of $1 in 2007.

CropScience Site Consolidation – In 2004, the Company announced the closure of three sites (Montvale, NJ, Plano, TX and Birmingham, AL) and the relocation of the administration of a CropScience business to the headquarters in Raleigh, NC. As a result, the Company recorded restructuring accruals for severance of $4 and future lease costs of $2. In 2005, the Company recorded an additional $3 of expense, primarily due to additional costs associated with vacating a leased facility. These costs are reflected either in cost of goods sold or selling, administration and other–net depending upon the function restructured. The Company paid $3 in both 2006 and 2005 associated with this program, with the remainder of $3 to be paid throughout 2007.

CropScience Reorganization – In 2002, the Company initiated integration and restructuring programs related to the Aventis acquisition. Due to continuation of reductions in workforce at December 31, 2004, the Company recorded an accrual of $1. An additional severance accrual of $1 and $6, respectively, were recorded in 2006 and 2005 and $1 has been reversed. These costs are

(dollars in millions)

reflected either in cost of goods sold or selling, administration and other-net depending upon the function restructured. Payments of $4 and $2 were recorded against these accruals in 2006 and 2005, respectively. The remainder of the accrual of $1 at December 31, 2006 is expected to be paid in 2007.

CropScience, Project New – In 2006, CropScience headquarters in Germany announced restructuring measures to reduce 1,500 positions worldwide by the end of 2009. North America is to be the largest single region affected. In 2006, the Company recorded an accrual of $21 for future severance payments. These costs are reflected in selling, administration and other-net. The Company paid $4 against this accrual in 2006 with the remainder of $17 to be paid out through 2009.

Diabetes Care Headquarter Relocation – In 2005, the Company announced that during 2006 it would relocate its diabetes care headquarters from Elkhart, IN to Tarrytown, NY and reduce its workforce by 60 positions. In 2005, the Company accrued $9 and reversed $2 in 2006 for future severance payments for those people in positions to be terminated. These costs were recorded as a component of selling, administration and other–net. Payments of $1 occurred in 2006 with the remainder of $6 to be paid in 2007.

Schering-Plough – At December 31, 2004, the Company's restructuring accrual of $47 related to the S-P transaction, primarily consisted of employee termination and severance costs related to workforce reductions of 1,357 employees and lease termination costs. In 2005, the Company reduced this restructuring accrual by $9 due to efforts to reduce lease termination costs and lower than anticipated severance costs. This income was recorded as a component of selling, administration and other–net. The Company made cash payments of $4 and $32 in 2006 and 2005, respectively and anticipates the remaining costs of $2 to be paid in 2007.

West-Haven Site Closure – Following the acquisition by Bayer AG of Schering AG in June 2006 (operated as Berlex in the United States), it was announced in November 2006 that the West Haven site would be closed and functions relocated to another site. It is management's intention to relocate 435 positions, and the remaining 431 employees will be terminated. The Company accrued $22 for severance and $1 for retention bonuses. These costs are expected to be paid in 2007.

Plasma Workforce Reduction – As part of the plasma business divestiture in March 2005, the Company expensed and paid $3 related to severance for workforce reductions. This cost was recorded as a component of selling, administration and other–net.

Elkhart Closure – At December 31, 2004, the Company maintained restructuring accruals in the Consumer Care Division of $1 primarily for severance related to the closure of a facility in Elkhart, IN. The majority of these amounts were paid in 2005. The remainder of the accrual was reversed in 2006.

Corporate – The Company maintained restructuring accruals of $13 at December 31, 2004 related to future severance payments related to workforce reductions subsequent to the Lanxess spin-off. In addition, due to the divestiture of DS, it was determined that the Company's information technology department needs to be downsized. The Company provided $1 for these severance

(dollars in millions)

costs in 2006. These costs were recorded as a component of selling, administration and other–net. Cash payments charged against the accruals were $3 and $9 in 2006 and 2005, respectively. The accrual of $2 at December 31, 2006 is anticipated to be paid in 2007.

Shared Services – Severance costs recorded in 2006 and 2005, related primarily to workforce reductions resulting from the shift of certain administrative functions to a shared center in Europe, were $1 combined for the two years, were recorded either in cost of goods sold or selling, administration and other-net depending upon the function restructure and are expected to be paid out in 2007.

DS Workforce Reductions – In prior years, DS initiated several restructuring projects for streamlining the Diagnostics workforce in the US and reorganizing it into the Diagnostics division and Diabetes Care division. In 2005, DS announced a downsizing of its business through the reduction of 60 positions within this group. At December 31, 2004 the restructuring accrual for all above mentioned programs was $4, primarily related to severance. In 2005, an additional severance accrual of $4 was recorded related to this program as a component of selling, administration and other – net. Cash payments related to these programs were $3 in both 2006 and 2005. The Company reduced the accrual for the outsourcing in 2005 by $1 due to lower overall severance payments. The remaining accrual at December 31, 2006 of $1 is expected to be paid in 2007.

DS VGI Restructuring – At December 31, 2004, the Company maintained a restructuring accrual of $5 related primarily to the 2003 closure of the leased Atlanta, GA facility. In 2006, an additional expense of $2 was recorded due to higher than expected future lease payments. Cash payments in 2006 and 2005 were $1 and $2. The remaining accrual represents future lease payments of $4 and is expected to be paid in 2007.

The following table summarizes the restructuring programs discussed above, except for the DS restructuring programs, which are included in liabilities of operations held for sale (see note 7).

	Severance	Lease Termination Costs and Other	Total
2005			
Accrual - December 31, 2004	$ 75	$ 21	$ 96
Restructuring Charges	28	14	42
Cash Payments	(69)	(12)	(81)
Other	(2)	(10)	(12)
Accrual - December 31, 2005	**$ 32**	**$ 13**	**$ 45**
2006			
Restructuring Charges	$ 55	$ 3	$ 58
Cash Payments	(24)	(6)	(30)
Other	(5)	-	(5)
Accrual - December 31, 2006	**$ 58**	**$ 10**	**$ 68**

(dollars in millions)

Asset Impairments

New Martinsville Plant Rationalization – In May 2005, the Company announced it would close its TDI plant at New Martinsville, WV effective immediately. The Company identified fixed assets with a net book value of $11 that would no longer be utilized as a result of this closure. As a result, the Company recorded an accelerated depreciation charge due to a change in useful life of $11 in 2006 related to these assets as a component of cost of goods sold. In 2006, management determined that an additional $1 of fixed assets would no longer be utilized and as a result, this was charged to expense. These assets were dismantled and scrapped in June 2006. Dismantling costs were expensed as incurred.

In 2006, the Company announced that it decided to transform its New Martinsville site into an industrial park. In connection with this transformation, the closure of the MDI unit and the related infrastructure will take place throughout 2007 and 2008. Fixed assets of $21 net book value were identified to be of no further use as a result of this closure. The Company recorded accelerated depreciation of $8 in 2006, which was recorded as a component of selling, administration and other – net, and expects to recognize an additional charge of $14 in 2007. In addition, the Company recognized an asset retirement obligation ("ARO") of $10, of which $3 had been depreciated in 2006 and recorded as part of selling, administration and other – net.

Diabetes Care Headquarter Relocation – In connection with this program, the Company began to accelerate depreciation expense associated with the book value of assets that would no longer be used as a result of this relocation. The Company recognized $11 and $4 in 2006 and 2005, respectively, related to this change in useful life, which was recorded as a component of selling, administration and other – net. No further expense is expected.

Pharma Facilities – In 2005, the Company wrote-down the carrying value of former manufacturing and warehouse facilities to their net realizable value through recognizing a $15 charge, which is reflected in selling, administration and other – net, due to a pending offer to sell these buildings. The reduction in carrying value was based on estimated sale proceeds for the facilities.

West Haven Administrative and Research Facilities – In connection with the announced closure of the West Haven administrative and research facilities, the Company began to accelerate depreciation expense associated with the book value of assets that would no longer be used as a result of this closure. The Company recognized $7 of accelerated depreciation expense in 2007.

Polymer Expansion Project – In 2006, the Company recorded a $39 charge to other expense related to the abandonment of expansion projects associated with its polymers business. An alternative option has been explored and determined to be more feasible than continuing the subsequently abandoned project.

Viadur Intangible – Based on a discounted future cash flow projection, the Company recorded a $20 and $19 impairment charge during 2006 and 2005, respectively, as a component of selling, administration and other – net. This charge is a result of competitive forces in the end markets causing a reduction in the projected future sales of this product.

(dollars in millions)

13. Long-Term Debt and Capital Lease Obligations

Long-term debt at December 31 consisted of the following:

	2006	2005
U.S. note issues (a)	$ 792	$ 795
Affiliates (b)	789	925
Eurobond debt (c)	606	543
Commercial paper (d)	-	205
Other	-	27
Unamortized discount - net	(7)	(9)
	2,180	2,486
Less: Current portion	461	525
Long-term debt	$ 1,719	$ 1,961

(a) Interest rates at December 31, 2006 of 6.20% to 7.13%; due in 2008, 2015 and 2028 in the amounts of $250, $200 and $350, respectively.

(b) Interest rates at December 31, 2006 of 5.29% to 6.50%; due in 2007 and 2011 in the amounts of $461 and $328, respectively.

(c) Interest rate at December 31, 2006 of 3.75%; due in 2009 in the amount of $606.

(d) No commercial paper was outstanding at December 31, 2006 as previously outstanding amounts were repaid in 2006. See Note 14 for termination of related interest rate swaps.

The aggregate annual amounts of long-term debt maturities as of December 31, 2006 were as follows:

2007	$ 461
2008	251
2009	603
2010	-
2011	328
After 2011	537
	$ 2,180

At December 31, 2006, the Company, together with Bayer AG, had an available and unused €3,500 ($4,610) syndicated revolving commercial paper backstop facility which expires on March 31, 2011. In addition, the Company had $165 and $4,000 in various uncommitted credit lines with third parties and related parties, respectively, available at the same date.

At December 31, 2006, the Company was party to interest rate swap agreements with financial institutions effectively establishing variable interest rates on aggregate net notional amounts of fixed rate debt of $636 and $486 in 2006 and 2005, respectively. Under the agreements, the

(dollars in millions)

Company will make interest payments at floating rates based on interest rates indexed to LIBOR and receive interest on the same notional amounts at an average fixed rate of 4.7%. The average maturity is 7.4 years.

At December 31, 2006, the Company was party to a cross-currency interest rate swap agreement effectively converting Euro-denominated, fixed rate interest payments on a notional amount of € 460 ($606 and $543 in 2006 and 2005, respectively) into U.S. dollar-denominated, fixed rate interest payments. Under this agreement, the Company will make interest payments in U.S. dollars at a fixed rate of 3.63% and receive interest payments in Euros at a fixed rate of 3.75%, until maturity in 2009.

Certain of the long-term debt and capital lease obligations of the Company are guaranteed by Bayer AG.

Capital Lease Obligations
During 2001, the Company entered into a capital lease transaction for certain equipment at its Baytown, TX facility which expires in 2013. During 2002, the Company's Puerto Rico subsidiary entered into a capital lease transaction for its Guaynabo, PR facility which expires in 2012.

Total capital lease obligations of the Company at December 31 consisted of the following:

	2006	2005
Total	$ 367	$ 414
Less: Current portion	29	47
Long-term lease obligations	$ 338	$ 367

Minimum future lease payments and present value of the net minimum lease payments under the capital leases existing at December 31, 2006 were as follows:

2007	$ 45
2008	23
2009	27
2010	26
2011	23
After 2011	326
Total minimum lease payments	470
Less: Imputed interest	103
Present value of net minimum lease payments	$ 367

Included in the above minimum lease payments are amounts for which the Company has recorded a receivable from Lanxess of $41 and $47 as of December 31, 2006 and 2005, respectively, related to a sub-lease of a portion of the capital lease at the Baytown, TX facility.

(dollars in millions)

Property, plant and equipment related to capital leases at December 31 consisted of the following:

	2006	2005
Property, plant and equipment	$ 705	$ 715
Accumulated depreciation	(572)	(563)
Property, plant and equipment - net	$ 133	$ 152

14. Financial Instruments

Currency Rate Hedging
The Company has historically entered into foreign exchange forward contracts to hedge various currency exposures relating to assets and liabilities denominated in foreign currency.

At December 31, 2006, the Company was party to a foreign exchange forward contract with a third party designated as a cash flow hedge of an underlying Euro-denominated debt obligation. Both the forward contract and the underlying debt obligation mature in 2009. To the extent effective, changes in the fair value of the forward contract are deferred in accumulated other comprehensive loss ("AOCL") and subsequently reclassified to earnings as foreign exchange gains and losses are recognized on the underlying debt obligation. The forward contract was recorded as a financial instrument whose fair value was an asset of $35 and a liability of $11 at December 31, 2006 and 2005, respectively. For the ineffective portion of the cash flow hedge, income of $2 and expense of $2 was recognized in earnings for the years ended December 31, 2006 and 2005, respectively.

At December 31, 2006, the Company was party to foreign exchange forward contracts with Bayer AG designated as cash flow hedges of anticipated foreign currency denominated sale transactions with other Bayer legal entities in Canada and Europe. To the extent effective, changes in the fair value of these intercompany forward contracts are initially deferred in AOCL and subsequently recognized in earnings when the underlying transactions occur with third parties. The open forward contracts were recorded as financial instrument assets and liabilities with fair values of $2 and $3 and of $6 and $1 at December 31, 2006 and 2005, respectively. There was no ineffectiveness associated with these cash flow hedges for the years ended December 31, 2006 and 2005.

Interest Rate Hedging
The Company enters into interest rate swap agreements as a hedge to reduce interest rate risks inherent in the Company's debt portfolio.

At December 31, 2006, the Company was party to interest rate swap agreements which mature in 2012 and 2016 and effectively convert $286 and $150, respectively, of its fixed rate debt to floating rate debt. At December 31, 2005, the Company was party only to the interest rate swap agreements that mature in 2012. All these interest rate swaps were not designated for hedge accounting and were recorded as a financial instrument liability with a value of $10 and $6 at December 31, 2006 and 2005, respectively. Expense of $4 and $6 was recognized in earnings for the change in fair value for the years ended December 31, 2006 and 2005, respectively.

(dollars in millions)

At December 31, 2006, the Company was party to interest rate swap agreements which mature in 2015 and effectively convert $200 of its fixed rate debt to floating rate debt. These interest rate swaps were designated as fair value hedges. As such, the swaps are carried at fair value. Changes in the fair value of both the swaps and the underlying debt are recognized in earnings, the net of which is zero. The interest rate swaps were recorded as a financial instrument liability with a fair value of $8 and $5 at December 31, 2006 and 2005, respectively.

During 2005, the Company terminated interest rate swap agreements to effectively convert $425 of commercial paper floating rate debt to fixed rate debt. These interest rate swaps were designated as cash flow hedges. To the extent effective, changes in the fair value of these swaps were initially deferred in AOCL and subsequently recognized in earnings when the underlying transaction occurred.

At the time of termination, the interest rate swaps were recorded as financial instrument liabilities at a fair value of $34 with a related deferred loss in AOCL of $25 (net of tax). This loss was to be amortized over the remaining life of the individual swaps to the extent that the hedged transactions remained probable of occurrence. Subsequent to the interest rate swap termination, the level of underlying commercial paper floating rate debt declined from $425 to a managed level of $250 at December 31, 2005. As a result, $4 of the deferred loss in AOCL was recognized in earnings for the year ended December 31, 2005. In 2006, the Company decided to no longer manage the level of outstanding commercial paper and therefore the remaining deferred loss of $21 was recognized in earnings.

Commodity Price Risk Management
The Company enters into commodity futures contracts to hedge a portion of its exposure to price fluctuations on anticipated natural gas transactions. At December 31, 2006 and 2005, the Company had commodity contracts outstanding totaling a notional amount of $99 and $116, respectively, with expiration dates through 2008 and 2007, respectively.

To the extent that contracts designated as cash flow hedges are effective in hedging the Company's exposure to price changes, changes in the fair values of the contracts are deferred in AOCL and reclassified to inventory as the natural gas is purchased.

The fair value of the contracts was a liability of $26 and an asset of $29 at December 31, 2006 and 2005, respectively. Changes in the fair value of the contracts not designated as cash flow hedges and the amount of ineffectiveness of contracts designated as cash flow hedges were recognized in earnings. The amount recorded in earnings for the years ended December 31, 2006 and 2005 was a loss of $15 and a gain of $11, respectively.

Investments
The Company has certain investments which consist of equity interests in publicly traded companies where the ownership percentage is less than 20%. At December 31, 2006 and 2005, these investments classified as available-for-sale had an adjusted cost basis of $11 and $10, respectively, and a carrying value equal to their fair value of $15 and $32, respectively. In 2005, pre-tax non-operating charges of $1 were recognized to record an other than temporary impairment to the fair value of certain of the investments. The original cost basis of such investments has been written down and a reclassification adjustment net of taxes has been reflected in AOCL. The

remaining unrealized holding gains and losses for the changes in fair value have continued to be deferred in AOCL, net of tax. No similar adjustments were recorded in 2006.

Debt
The fair value of the Company's debt is estimated based on rates available to the Company at the reporting date for similar debt of the same remaining maturities.

At December 31, 2006 and 2005, the carrying value of debt was $2,180 and $2,486, respectively. The fair value of debt was approximately $2,238 and $2,535, respectively, at December 31, 2006 and 2005.

Other Financial Instruments
The carrying amount approximates the estimated fair value for all other financial instruments.

Credit Risk
The Company is exposed to credit loss in the event of nonperformance by counterparties on the above instruments. Although nonperformance is possible, the Company does not anticipate nonperformance by any of the counterparties. Additionally, the Company's geographic orientation in diverse businesses with a large number of customers and suppliers minimizes concentrations of credit risk. At December 31, 2006, the Company had no significant concentration of credit risk.

15. Pension and Other Post-Employment Benefits

The Company has various noncontributory defined benefit pension plans covering substantially all U.S. employees that generally provide for monthly pension payments to eligible employees upon retirement. The Company also provides certain health care and life insurance benefits for most U.S. retirees. The Company uses a December 31 measurement date for its plans.

In August 2005, the Company announced that defined benefit pension plans sponsored by the Company, excluding certain plans where participants are covered under collective bargaining agreements, would freeze accrued benefits as of December 31, 2005. In place of continuing benefit accruals under the affected defined benefit plans, the provisions of the Company's defined contribution savings plan ("DC Plan") were changed such that beginning January 1, 2006, the Company will contribute 5% of eligible compensation, as defined by the plan provisions, to the DC Plan. Employees may qualify for an additional contributions of 0 to 10% based upon their age and years of service as of December 31, 2005. Certain other employees qualify for an additional 5% to 7% due to employee rank. These contributions are in addition to those made under the 401(k) provisions of the DC Plan, which call for a company match of up to 4% when an employee contributes 6% of their eligible earnings.

This change freezes the accrual of benefits effective December 31, 2005 under the affected plans. The plan amendments are a curtailment event as the change eliminates accrual of defined benefits for future services for substantially all employees under these plans. This action resulted in a reduction of the pension benefit obligation for the qualified defined benefit plans of $344, a reduction in unrecognized actuarial losses of $323, and the recognition of $21 as a curtailment gain. For the Company's non-qualified defined benefit pension plans, this event is considered to be

(dollars in millions)

a negative plan amendment. Therefore, the reduction in the pension benefit obligation of $19, associated with the non-qualified plans, was reflected as a reduction of prior service cost.

On September 29, 2006, SFAS No. 158 was issued, which requires, among other things, the recognition of the funded status of each defined pension plan and post employment benefit plans on the balance sheet. Each over funded plan is recognized as an asset and each under funded plan is recognized as a liability. The initial impact of the standard due to unrecognized prior service costs or credits and net actuarial gains or losses as well as subsequent changes in the funded status is recognized as a component of AOCL in stockholders' equity. Additional minimum pension liabilities ("AML") and related intangible assets are also derecognized upon adoption of the new standard. The Company adopted SFAS No. 158 as of December 31, 2006. The following table summarizes the effect of the required changes in the AML as of December 31, 2006 prior to the adoption of SFAS No. 158 as well as the impact of the initial adoption of SFAS No. 158.

Change due to the AML and adoption of SFAS No. 158 at December 31, 2006:

	Prior to AML and SFAS No. 158 Adjustments	AML	SFAS No. 158 and AML Adjustments	Post AML and SFAS No. 158 Adjustments
Prepaid benefit costs	$ 29	$ -	$ 36	$ 65
Accrued benefit costs	(386)	76	60	(250)
Other post employment benefits	(428)	-	(97)	(525)
AOCL (before tax)	170	(76)	1	95
Deferred tax asset	(66)	29	-	(37)
AOCL (after tax)	$ 104	$ (47)	$ 1	$ 58

The amounts in accumulated other comprehensive loss that are expected to be recognized as components of net periodic benefit cost (benefit) during the next fiscal year are as follows:

	Pensions	Other Post - Employment Benefits	Total
Prior service (benefit)	$ (1)	$ (15)	$ (16)
Net loss	4	19	23

(dollars in millions)

The following table sets forth the changes in benefit obligations, plan assets, and the funded status for the Company's defined benefit pension and other post-employment benefit plans:

	Pensions		Other Post-Employment Benefits	
	2006	2005	2006	2005
Projected benefit obligation at January 1	$ 2,766	$ 2,959	$ 906	$ 879
Service cost	19	97	25	33
Interest cost	154	164	51	53
Plan amendments, acquisitions and dispositions	-	(18)	-	3
Curtailments	1	(363)	(23)	(12)
Actuarial (gain)/loss	(17)	87	75	1
Benefits paid	(154)	(160)	(46)	(51)
Projected benefit obligation at December 31	$ 2,769	$ 2,766	$ 988	$ 906
Plan assets at January 1	$ 2,390	$ 2,325	$ 417	$ 383
Actual return on assets	326	133	56	26
Company contributions	22	92	36	59
Benefits paid	(154)	(160)	(46)	(51)
Plan assets at December 31	$ 2,584	$ 2,390	$ 463	$ 417
Funded status	$ (185)	$ (376)	$ (525)	$ (489)
Unrecognized prior service benefit	-	(1)	-	(223)
Unrecognized net actuarial loss	-	156	-	306
Net accrued cost	$ (185)	$ (221)	$ (525)	$ (406)

Amounts recognized in the statement of financial position consist of:

	Pensions		Other Post-Employment Benefits	
	2006	2005	2006	2005
Prepaid benefit cost	$ 65	$ 26	$ -	$ -
Accrued benefit cost	(250)	(350)	(525)	(406)
Accumulated other comprehensive loss	-	103	-	-
Net amount recognized	$ (185)	$ (221)	$ (525)	$ (406)

(dollars in millions)

Amounts recognized in AOCL consist of:

	Pensions		Other Post-Employment Benefits	
	2006	2005	2006	2005
Prior service benefit	$ (1)	$ -	$ (203)	$ -
Net actuarial (gain)/loss	(1)	-	300	-
Net amount recognized before tax effect	$ (2)	$ -	$ 97	$ -

The accumulated benefit obligation for all defined benefit pension plans was $2,749 and $2,747 at December 31, 2006, and 2005, respectively.

Included in the above information are pension plans with accumulated benefit obligations exceeding the fair value of plan assets at December 31:

	2006	2005
Projected benefit obligation	$ 629	$ 2,649
Accumulated benefit obligation	629	2,649
Fair value of plan assets	386	2,282

The following assumptions were primarily used to determine the benefit obligations at December 31:

	Pensions		Other Post-Employment Benefits	
	2006	2005	2006	2005
Discount rate	6.00%	5.72%	6.00%	5.72%
Rate of compensation increase	4.25%	4.25%	N/A	N/A

The weighted average health care cost trend rate assumed in 2007 was 11%, gradually declining to 5% by the year 2014. A one percentage point change in assumed health care cost trend rates would have the following effects:

	1-Percentage Point Increase	1-Percentage Point Decrease
Increase (decrease) in the aggregate of service and cost components	$ 2	$ (2)
Increase (decrease) in the benefit obligation	77	(71)

(dollars in millions)

The following assumptions were primarily used to determine net periodic cost for the years ended December 31:

	Pensions		Other Post-Employment Benefits	
	2006	2005	2006	2005
Discount rate	5.72%	6.00%	5.72%	6.00%
Expected return on assets	8.25%	8.25%	8.25%	8.25%
Rate of compensation increase	4.25%	4.25%	N/A	N/A

Net periodic cost includes the following:

	Pensions		Other Post-Employment Benefits	
	2006	2005	2006	2005
Service cost	$ 19	$ 97	$ 25	$ 33
Interest cost	154	164	51	53
Expected return on assets	(191)	(190)	(34)	(32)
Curtailment loss (gain)	1	(21)	-	(4)
Amortization of prior service cost (benefit)	-	3	(20)	(20)
Amortization of actuarial losses	5	9	18	20
Net periodic (benefit) cost	$ (12)	$ 62	$ 40	$ 50

The weighted average asset allocations for both the pension and other post-employment benefit plans at December 31, 2006 and 2005, and target allocations for 2007, by asset category, are as follows:

	Plan Assets at December 31,		Target %
Asset Category	2006	2005	2007
Equity securities	57%	56%	53%
Debt securities	35%	35%	35%
Other	8%	9%	12%
	100%	100%	100%

The basic goal underlying the pension and post-employment plan investment policy is to ensure that the assets of the plans, along with expected plan sponsor contributions, will be invested in a prudent manner to meet the obligations of the plan as those obligations come due. Investment practices must comply with the requirements of the Employee Retirement Income Security Act of 1974, as amended, and any other applicable laws and regulations.

Numerous asset classes with differing expected rates of return, return volatility, and correlations are utilized to reduce risk by providing diversification. Debt securities comprise a significant

(dollars in millions)

portion of the portfolio due to their plan-liability-matching characteristics and to address the plans' cash flow requirements. Other securities primarily consist of investments in partnerships that hold investments in private companies. Additionally, diversification of investments within each asset class is utilized to further reduce the impact of losses in single investments. The use of derivative instruments is permitted where appropriate and necessary for achieving overall investment policy objectives.

Additionally in 2006, the Company announced the disposition of DS and Wolff Walsrode business, as well as several workforce reductions and site consolidation projects. These actions eliminated a related portion of the accrual of benefits under defined benefit plans and the retiree medical plan. This resulted in an increase in pension benefit obligations of $1 and a reduction of the retiree medical obligation of $23, which reduced unrecognized actuarial losses by $23 and reduced prior service benefit by $41. However, the recognition of the reduction of prior service benefit of $41 was deferred as a significant reduction in headcount will not occur until 2007 when DS is sold and the West Haven employees leave the Company.

Effective with the sale of the Plasma business on March 31, 2005, employees associated with this business no longer participate in the Company's defined benefit plans. This action eliminated a related portion of the accrual of benefits under defined benefit plans and the retiree medical plan. This action resulted in a reduction of pension benefit obligations of $27 and the retiree medical obligation of $12. These reductions in benefit obligations reduced unrecognized actuarial loss in their entirety.

The Company does not expect to make any contributions to its defined benefit pension plans and to its other post-employment plan trusts in 2007.

The Company expects to make the following estimated future benefit payments to its pension and other post-employment plans:

Year	Pension Benefits	Other Post-Employment Benefits
2007	$ 132	$ 52
2008	136	55
2009	143	58
2010	151	63
2011	158	67
Years 2012 - 2016	907	376

The Company and certain of its subsidiaries also have defined contribution retirement savings plans available to most U.S. employees. Company contributions recognized as expense amounted to $164 in 2006 and $44 in 2005.

Prior period adjustments of $20 were recorded in 2006 due to computational errors in accounting for medical costs for employees receiving long-term disability benefits and adjustments to pension accruals. These costs are reflected in cost of goods sold, selling, administration and other-net and

research and development. The Company has concluded that recording those adjustments are not material to any period presented.

Share Incentive Plan
In 2002, the Company offered certain members of Company senior management the opportunity to participate in a Share Incentive Plan where the employee placed Bayer AG shares of their own in a special deposit account. A determination is made on an individual basis as to the maximum number of shares each participant may deposit; the participant receives one warrant for every 5 shares deposited. No similar plans were offered subsequently.

The deposited shares were "restricted" for three years and could not be sold or transferred during that time. Thereafter, in 2005, a two-year exercise period began. During this period, the participant may exercise their warrants. The exercise period expires in 2007.

Any unexercised warrants expire at the end of this two-year period. To determine whether the participant is eligible to exercise their warrants, and, if so, the cash he or she receives upon exercise, there are two performance criteria applied based on the absolute and relative performance of Bayer AG stock. If the minimum criteria are not met, the participant receives no benefit under the program. As of December 31, 2005, 1,257 warrants were in the exercise period, however, because neither minimum criterion was met, the warrants were not exercisable. In 2005, the Company recognized no expense related to the program, as the minimum requirements were not met and were not expected to be achieved. At various times during 2006, minimum criteria were met and 449 warrants were exercised with payments to the participants at a cost to the Company of $0.4. In 2006, 76 warrants were forfeited due to employee termination. The Company accrued $1 as the estimated additional cost to the Company for the value of the 732 outstanding warrants at December 31, 2006.

Aspire Plan
Effective January 1, 2005, the Company launched two new long-term incentive compensation plans (the "Aspire plan") for certain employees in the United States. Both plans provide awards based upon a percentage of the employee's salary ("target award") adjusted for the Bayer AG share price performance. One plan further adjusts the awards based upon the performance of the Bayer AG share price relative to the DJ EuroStoxx 50 Index. The award adjustments can range from 0% to 150% or 175% of the target award based upon participant rank and the aforementioned performance criteria. Performance criteria are established and fixed at the beginning of an award period.

Awards commence at the beginning of each year and are earned over a three-year period, with cliff vesting at the end of an award period. Beginning January 1, 2005, there were two transition award periods, a one-year period running through December 31, 2005 and a two-year period running through December 31, 2006. All awards are settled in cash. No awards are settled in shares of Bayer AG. Payment of awards occurs in the year subsequent to when the award vests. Awards may be deferred, at the sole election of the participant, for up to two years subsequent to the award date. All deferred awards are also paid in cash.

The Company recognizes the cost of these awards at the fair value of the liability incurred. The liability for the Aspire plan is remeasured at each balance sheet date to its fair value, with all

(dollars in millions)

changes recognized immediately in earnings. The total cost of all outstanding awards for 2006 and 2005 was $48 and $39, respectively, including expense for the fair value adjustment of $18 and $8, respectively.

The Company uses a Monte-Carlo model to project the Bayer AG share price performance, and its performance relative to the DJ EuroStoxx 50 Index, for recording the awards at fair value. In addition to the plan provisions and the range of award adjustments, the following table sets for the assumptions were used to develop the fair value of the outstanding awards at December 31:

	2006	2005
Bayer AG stock price - beginning of period	€ 34.41	€ 23.05
EuroStoxx 50 Index - beginning of period	3,520	2,914
Bayer AG stock price - end of period	€ 40.79	€ 34.41
EuroStoxx 50 Index - end of period	4,102	3,520
Expected dividend yield	2.3%	2.0%
Expected volatility	21.5%	24.6%
Risk-free interest rate	3.8%	2.8%

16. Income Taxes

The components of income from continuing operations before income taxes and minority interests and income tax expense (benefit) attributable thereto for the years ended December 31, 2006 and 2005 were as follows:

	2006	2005
Income from continuing operations before income taxes and minority interests		
United States	$ 284	$ 278
Foreign	4	(4)
	$ 288	$ 274
Income tax expense (benefit)		
Current		
Federal	$ 110	$ (209)
State	28	12
Foreign	2	-
	140	(197)
Deferred		
Federal	(146)	163
State	(5)	10
Foreign	-	-
Net income tax benefit	$ (11)	$ (24)

(dollars in millions)

The net expense for income taxes in 2006 and 2005 differed from amounts computed by applying the U.S. statutory income tax rate to income from continuing operations before income taxes and minority interests as follows:

	2006	2005
Computed expense for income taxes	$ 101	$ 97
Changes resulting from		
Tax credits	(8)	(4)
State income taxes, net of federal income tax benefit	68	12
Effects of foreign operations, net of foreign tax credits	14	(3)
Net (excludable income) nondeductible expenses	(9)	1
Adjustments to prior years' taxes	(32)	12
Adjustments to tax reserves	10	(130)
Decrease in valuation allowance	(155)	(9)
Net income tax benefit	$ (11)	$ (24)

Net deferred income taxes at December 31 consisted of the following:

	2006	2005
Deferred tax assets		
State tax loss and credit carryforwards (expiring in 2007 through 2026)	$ 205	$ 281
Foreign tax and other credit carryforwards ($6 expiring in 2012 through 2014, $18 do not expire)	23	186
Other loss carryforwards expiring in 2010 through 2026	199	66
Environmental related	35	36
Inventory	14	23
Employee benefits and compensation	419	417
Other liabilities and accruals	353	435
Other	68	88
Valuation allowances		
Federal	-	(78)
State	(93)	(212)
Total deferred tax assets	1,223	1,242
Deferred tax liabilities		
Property, plant, equipment and intangibles	(228)	(333)
Net deferred tax assets	$ 995	$ 909

Net prior period adjustments to both current and deferred taxes of $11 and $27 were recorded in 2006 and 2005, respectively due to computational errors in both accounting estimates for income taxes and income tax returns. The Company has concluded that recording those adjustments are not material to any period presented.

(dollars in millions)

In assessing the realizability of deferred tax assets, the Company considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. Based on the results of this assessment, the Company has provided a partial valuation allowance on state net operating loss carry forwards and state tax credits at December 31, 2006. At December 31, 2005, the Company provided a partial valuation allowance on state net operating loss carry forwards, state tax credits, capital loss carry forwards, foreign tax credit carry forwards and charitable contribution carry forwards. The change in valuation allowance in 2006 is attributable to current and projected future years' utilization of attributes. If changes occur in the assumptions underlying the Company's projected realization, the valuation allowance may need to be adjusted in the future.

Certain of the income tax returns of the Company and for the Company's subsidiaries are currently under examination by the Internal Revenue Service ("IRS") and various state tax authorities (collectively, the "tax authorities"). In many cases, these audits result in the examining tax authority issuing proposed assessments. The Company believes that its tax positions comply with applicable tax law and when necessary, has defended its positions and intends to continue to do so. The Company believes it has adequately provided for the probable outcome related to these matters. Reserves for the resolution of probable tax assessments where cash payment is expected are included in other long-term liabilities.

In November 2004, as part of its audit of 1992 through 1997, the Appeals division of the IRS substantially completed its review of the Company's transfer pricing transactions with Bayer AG and offered a verbal, nonbinding settlement to the Company. The Company recorded the effect of the settlement upon receipt of the written settlement from the IRS in December 2005. The issue was settled for less than the amount reserved, which resulted in a decrease in income tax expense in 2005 in the amount of $144.

At December 31, 2006 it is the Company's intention to indefinitely reinvest foreign undistributed earnings and, accordingly, no deferred tax liability has been recorded for such earnings. Undistributed earnings of certain consolidated foreign subsidiaries at December 31, 2006 amounted to $2

17. Operating Leases

Leased properties include manufacturing plants, warehouses, offices, and equipment. Such leases expire at various dates through 2020.

(dollars in millions)

Rental expense under operating leases was $44 in 2006 and $56 in 2005. Future minimum rental commitments under non-cancelable operating leases existing at December 31, 2006 were as follows:

2007	$ 49
2008	42
2009	38
2010	32
2011	27
After 2011	25
	$ 213

18. Other Liabilities

Other current liabilities at December 31 consisted of the following:

	2006	2005
Accrued interest	$ 58	$ 52
Accrued salaries and wages	25	69
Accrued self-insurance and legal claims	306	175
Accrued restructuring costs	41	44
Accruals related to future benefit payments to employees	297	174
Accrued taxes other than income taxes	71	73
Accrued sales promotions	372	357
Deferred service contract revenue	28	59
Other	548	375
	$ 1,746	$ 1,378

Other long-term liabilities at December 31 consisted of the following:

	2006	2005
Accruals related to future benefit payments to employees	$ 937	$ 984
Accrued environmental costs	114	88
Deferred service contract revenue	160	107
Other	237	356
	$ 1,448	$ 1,535

(dollars in millions)

19. Geographic Information

External revenues based on country of destination are as follows:

	2006	2005
United States	$ 7,212	$ 6,954
Germany	600	422
Italy	391	361
Canada	353	350
Other foreign countries	1,433	1,121
	$ 9,989	$ 9,208

20. Asset Retirement Obligations

Effective January 1, 2005, the Company adopted FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations*. Upon addition of this standard, the Company recognized the cumulative effect including liabilities at fair value of $5 at January 1, 2005 for asset retirement obligations ("AROs"). This consisted primarily of costs associated with asbestos removal, radioactive decontamination, PCB removal and disposal, waste water treatment and landfills. These costs reflect the legal obligations associated with the normal operation of the Company's facilities. Additionally, the Company capitalized asset retirement costs by increasing the carrying amount of related long-lived assets, primarily machinery and equipment, and recorded associated accumulated depreciation from the time the original assets were placed into service. At January 1, 2005, the Company increased by $1 property, plant and equipment – net.

In addition to the AROs discussed above, Bayer may have other obligations in the event of a permanent shutdown of a facility. However, these events are not determinable and, therefore, the associated AROs are not reasonably estimable and liabilities cannot be established.

The changes in the carrying amount of AROs for the year ended December 31, 2006 follow:

	Total
Accrual - December. 31, 2005	$ 5
Accretion Expense	1
Payments	(1)
Liabilities Incurred	11
Accrual - December 31, 2006	$ 16

The $11 of additional obligations recorded in 2006 resulted primarily from the announced decision to transform the New Martinsville site into an industrial park. The liabilities consist primarily of asbestos removal and decontamination costs.

(dollars in millions)

21. Commitments and Contingencies

Purchase Commitments and Other Contingencies
At December 31, 2006, outstanding purchase commitments for assets and research, and certain other contingencies amounted to approximately $463.

Letters of Credit
The Company had outstanding letters of credit aggregating approximately $32 at December 31, 2006. These letters of credit are maintained primarily as security for performance on certain of the Company's insurance arrangements and litigation matters.

Self Insurance
The Company is generally self-insured for automobile, general, employer's and product liability up to certain per occurrence and aggregate retention levels for each policy year, with excess liability coverage in place beyond the self insured retention levels. An estimate of the cost of settling existing claims is included in accrued liabilities.

Indemnifications
In connection with previous sales of assets and businesses, the Company has indemnified respective buyers against certain liabilities that may arise in connection with the sales transactions and business activities prior to the ultimate closing of the sale. The term of these indemnifications which typically pertain to environmental and legal liabilities can be indefinite. If the indemnified party were to incur a liability or have a liability increase as a result of a successful claim, pursuant to the terms of the indemnification, the Company would be required to reimburse the buyer. The maximum amount of future payments can be unlimited. Although it is reasonably possible that future payments may exceed amounts accrued, due to the nature of the indemnified items, it is not possible to make a reasonable estimate for the maximum potential exposure or the range of exposure under such indemnifications. No assets are held as collateral and no specific recourse provisions exist related to these guarantees.

Legal Proceedings
The Company is involved in a number of legal proceedings. As an active participant in a wide range of life sciences and chemical activities, the Company may in the ordinary course of business become involved in proceedings relating to such matters as product liability, competition and antitrust, patent validity and infringement, tax assessments, and past waste disposal practices and release of chemicals into the environment.

The following discussion, although not an exhaustive list of claims or proceedings in which the Company is involved, nevertheless describes what the Company believes to be the most significant of those claims and proceedings. Subsequent developments in any pending matter, as well as additional claims that may arise from time to time, including additional claims similar to those described below, could become significant to the Company. References to the Company include claims or proceedings to which the Company and/or one or more of its subsidiaries is a party. The claims or proceedings described also may involve, and in some cases may principally involve, Bayer AG or other non-consolidated affiliates of the Company. Claims or proceedings significant to the Company might not be significant to Bayer AG taken as a whole, and claims or proceedings

(dollars in millions)

significant to Bayer AG or other non-consolidated affiliates of the Company might not be significant to the Company.

The Company cannot predict with certainty the outcome of any proceedings in which it is or may become involved. An adverse decision in a lawsuit seeking damages from the Company, or the Company's decision to settle certain cases, could result in monetary payments to the plaintiff and other costs and expenses. If the Company loses a case in which it seeks to enforce its patent rights or in which it has been accused of infringing another company's patent rights, it will sustain a loss of future revenue if it no longer can sell the product covered by the patent or command prices for the affected products that reflect the exclusivity conferred by the patent. While payments and other costs and expenses the Company might have to bear as a result of these actions are covered by insurance in some circumstances, the coverage under some of these insurance policies has (as indicated below) been exhausted, and other payments may not be covered by insurance policies in full or at all. Accordingly, each of the legal proceedings described in the following discussion could be significant to the Company, and the payments, costs and expenses above those already incurred or accrued could have a material adverse effect on the results of operations, financial position or cash flows.

Product liability proceedings

Cerivastatin litigation
In August 2001, Bayer AG and the Company voluntarily ceased marketing the anticholesterol product cerivastatin (marketed in the United States and Canada under the trade name Baycol) in response to reports of serious side effects in some patients. Claims for compensation have been made against Bayer AG and the Company. Many lawsuits were filed, primarily in the United States and Canada. It is possible that additional lawsuits may be filed in the United States and elsewhere.

As of February 12, 2007, approximately 1,810 lawsuits remain pending in the United States in both federal and state courts against the Company, including putative class actions. At one time, more than 14,000 lawsuits were pending.

The actions in the United States have been based primarily on theories of product liability, consumer fraud, predatory pricing and unjust enrichment. These lawsuits seek remedies including compensatory and punitive damages, disgorgement of funds received from the marketing and sale of Baycol and the establishment of a trust fund to finance the medical monitoring of former Baycol users. Five U.S. cases have been tried to date to final judgment, all of which resulted in verdicts in the Company's favor.

Cases remain pending in the federal district court in Minnesota and in multiple states. All cases are on behalf of individual plaintiffs, except in Oklahoma and Illinois, where class actions on behalf of multiple plaintiffs have been approved. Additional cases seeking class certification remain pending. Certification of a class is unrelated to a determination of the Company's liability.

In January 2004, the Company received a subpoena for documents principally relating to Baycol from the Defense Criminal Investigative Service of the U.S. Department of Defense Inspector General followed by a related subpoena issued by the U.S. Attorney for New Jersey in February 2006. The U.S. Attorney for New Jersey subsequently advised the Company that it did not need to

(dollars in millions)

respond to this subpoena. Prior to the withdrawal of Baycol, the Company had a contract with the Department to provide it with a supply of Baycol. The investigation is a joint Department of Defense/Food and Drug Administration inquiry relating to Baycol. The Company is not aware of any charges or complaints filed in connection with this inquiry. The Company believes it acted responsibly and fulfilled its responsibilities to the U.S. government, and has cooperated in the investigation, including by providing the information requested. Local governmental authorities in several European countries also initiated criminal proceedings in connection with the withdrawal of Baycol. The majority of these proceedings have been dismissed.

Since April 2004, the Company also has received civil investigative demands from 30 states seeking documents regarding the marketing of Baycol. In January 2007, the Company agreed, without any admission of fault, to pay a total of $8 to settle civil allegations made by the attorneys general of these 30 states that the Company failed to adequately disclose to consumers safety risks associated with Baycol. The Company also entered into a consent decree wherein it agreed to publicly register Company-sponsored clinical studies for its products approved for marketing in the United States in accordance with the International Committee of Medical Journal Editors guidelines and to post information regarding those studies on the Internet.

Litigation in other countries. As of February 12, 2007, approximately 60 actions remain pending against the Company and/or other Bayer AG companies in other countries, including class actions in Canada for residents of all Canadian provinces, except for Québec, who claim personal injury from Baycol other than rhabdomyolysis. In November 2006, these class actions were consolidated and will proceed in Manitoba. Separately, in 2004, settlement agreements were entered into covering Canadian residents who allegedly contracted rhabdomyolysis. The deadline for filing claims under the 2004 settlement agreements lapsed in November 2006.

Impact of cerivastatin litigation on the Company. Without acknowledging any liability, during 2006 the Company settled an additional 69 cases worldwide resulting in agreements to pay settlements of approximately $12. In the United States, approximately 4,000 additional cases were dismissed without payment during 2006. To date, the Company has settled a total of 3,152 cases worldwide as of February 12, 2007, resulting in aggregate settlement payments of approximately $1,159. The Company will continue, on a voluntary basis and without concession of liability, to offer fair compensation to people who experienced serious side effects while taking cerivastatin. After more than five years of litigation, the Company is currently aware of fewer than 20 cases in the United States that in its opinion hold a potential for settlement, although the Company cannot rule out the possibility that additional cases involving serious side effects from cerivastatin may come to the Company's attention. In cases where an examination of the facts indicates that cerivastatin played no part in the patient's medical situation, or where a settlement is not achieved, the Company will continue to defend itself vigorously. The Company believes it has meritorious defenses in these actions.

Following a 2003 agreement reached with the majority of the insurers in the cerivastatin litigation, Bayer began establishing provisions reflecting an excess of expected payments including defense costs over the expected insurance coverage. Additional charges of $22 and $44 to the Company's operating result were recorded in 2005 and 2006, respectively, each in respect of settlements already concluded or expected to be concluded and anticipated defense costs.

(dollars in millions)

Due to the considerable uncertainty associated with the cerivastatin litigation, it is currently not possible to estimate the potential liability. Since the existing insurance coverage is exhausted, the Company could incur further costs that are not covered by the provisions already established. The Company will regularly review the necessity of further provisions and related charges to the operating result as the cerivastatin litigation proceeds.

The Company co-promoted Baycol with SmithKline Beecham Corporation. SmithKline Beecham Corporation and the Company have signed an allocation agreement under which SmithKline Beecham has agreed to pay five percent of all settlements and compensatory damage judgments arising out of actions based on the sale or distribution of Baycol in the United States, with each party responsible for paying its own attorneys' fees.

HIV-related actions
Since the 1980's, the Company, as well as other fractionators of plasma products, has been involved in lawsuits alleging that hemophiliacs became infected with the human immunodeficiency virus ("HIV") and/or the hepatitis C virus ("HCV") by using allegedly infected clotting factor concentrates derived from human plasma. All of the early HIV-related cases have been resolved except for two which remain pending in Argentina and three which are pending in Japan. In October 2006, an additional HIV-related case was filed in Taiwan. In 2003, a putative class action against the Company and other manufacturers was filed in the United States on behalf of U.S. residents claiming compensation for HCV infections and non-U.S. residents claiming compensation for HIV and/or HCV infections. The court denied the plaintiffs' motion to certify a class. Since 2003, U.S. and non-U.S. residents filed additional cases involving multiple plaintiffs against the Company and other manufacturers, claiming compensation for HIV and/or HCV infections allegedly acquired through blood plasma products manufactured in the United States. All of these matters have been filed in or transferred to federal district court in Illinois for coordinated proceedings. In January 2006, the court granted defendants' motion, on the basis of forum non conveniens, to dismiss the claims of the eight residents of the United Kingdom who are plaintiffs in one of the cases. Plaintiffs appealed this ruling, and we are awaiting the decision of the United States Court of Appeals for the Seventh Circuit.

The Company believes that it has meritorious defenses in the HIV/HCV litigation and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability and the Company has and will regularly consider the need to establish provisions as the proceedings continue.

Phenylpropanolamine ("PPA") litigation
In late 2000, the Company voluntarily discontinued marketing over-the-counter cough and cold remedies containing the decongestant PPA in the United States in response to a recommendation from the FDA that manufacturers voluntarily discontinue marketing products containing PPA. The FDA issued this recommendation after one epidemiological study suggested a possible association between PPA and hemorrhagic stroke.

As of February 12, 2007, 79 lawsuits remained pending in U.S. federal and state courts against the Company. To date, three state cases have proceeded to trial. Two have resulted in defense verdicts for the Company. In one case, the plaintiff was awarded damages of $0.4. This case was settled in July 2005 while on appeal.

The Company believes it has meritorious defenses in these actions and intends to continue to defend itself vigorously. As of February 12, 2007, the Company had settled 383 cases resulting in payments of approximately $57, without acknowledging any liability. The Company will continue, on a voluntary basis and without concession of liability, to offer fair compensation to people who suffered hemorrhagic stroke while taking the Company's product containing PPA. The Company recorded a charge to the operating result in the amount of $73 in 2005. In 2006, this amount was reduced by $15 due to an anticipated reduction in future PPA-related litigation charges. Such charges were for settlements already concluded or expected to be concluded, and defense costs which exceed the amount of existing insurance coverage.

Isocyanate litigation
The Company is a defendant in three Alabama state court isocyanate cases. Collectively the cases involve the claims of more than 1,600 plaintiffs who allege personal injuries (primarily respiratory) caused by exposure to diphenylmethane diisocyanate ("MDI") from products supplied by the Company and other co-defendants. The products were used in underground coal mines in Alabama where the plaintiffs worked. The Company's co-defendants include two other MDI manufacturers, several distributors and contracting companies that used MDI-containing products in those mines. Plaintiffs assert claims of negligence, wantonness, outrage, failure to warn, misrepresentation, concealment, breach of warranties and conspiracy. Punitive damages are sought. In April 2006, the trial court entered an order sanctioning the Company for allegedly failing to properly respond to discovery, and entered a default judgment holding the Company liable for damages if proven at trial. Following an appeal by the Company, the Alabama Supreme Court in July 2006 directed the trial court to vacate its orders, and those orders subsequently were vacated.

The Company is a defendant in a purported class action filed in federal district court in Alabama. The Company's co-defendants include isocyanate trade associations, MDI manufacturers, several distributors and contracting companies that used MDI-containing products in the underground coal mines where plaintiffs worked. The case was filed by fifteen (15) individual plaintiffs on behalf of themselves and a class of all similarly situated coal miners in the United States seeking redress for alleged personal injuries, declaratory and injunctive relief as a result of their alleged exposure. Plaintiffs likewise allege that they are entitled to medical monitoring for injuries that may manifest themselves in the future as a result of past MDI exposure.

The Company believes it has meritorious defenses in these actions and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Antitrust proceedings

Proceedings involving former rubber-related lines of business
Government investigations. Bayer AG and certain subsidiaries, including the Company, are or have been the subject of criminal and civil investigations conducted by the Antitrust Division of the U.S. Department of Justice ("DOJ"), the Directorate General for Competition of the European Commission ("EC"), and the Canadian Competition Bureau ("CCB") (collectively, the "Competition Authorities"). The Competition Authorities are or were investigating potential violations of their respective antitrust or competition laws involving certain of Bayer's former

rubber-related lines of business.

Since September 2002, the DOJ has undertaken criminal grand jury investigations of potential antitrust violations involving Bayer's former rubber chemicals, ethylene propylene diene monomer ("EPDM") synthetic rubber, and acrylonitrile butadiene rubber ("NBR") synthetic rubber lines of business. To settle charges related to allegations that its former rubber chemicals business unit engaged in anti-competitive activities between 1995 and 2001, Bayer AG pleaded guilty and paid a fine of $66. To settle charges related to allegations that its former NBR business unit engaged in anti-competitive activities between May and December 2002, Bayer AG pleaded guilty and paid a fine of $4.7. The two agreements resolve all criminal charges against Bayer AG and the Company in the United States for activities related to its former rubber chemicals and NBR businesses. The DOJ closed its investigation into potential antitrust violations involving EPDM in July 2006.

The CCB has also undertaken criminal investigations of potential violations of Canadian competition laws involving Bayer's former rubber chemicals, EPDM and NBR lines of business. Bayer AG is in the process of negotiating settlement agreements with the CCB that would resolve all charges in Canada related to allegations that its former rubber chemicals and NBR business units engaged in anti-competitive activities between 1995 and 2001 and between May and December 2002, respectively. The CCB closed its investigation into potential antitrust violations involving EPDM in August 2006.

The DOJ and the CCB have also launched criminal investigations of possible anti-competitive behavior involving a further product attributable to the former rubber-related lines of business. The DOJ and the CCB have granted conditional amnesty from the imposition of criminal liability in connection with these investigations. Conditional amnesty requires continued cooperation.

The EC has been conducting investigations of and initiated respective proceedings regarding potential violations of European competition laws involving Bayer's former rubber chemicals, EPDM and NBR lines of business. In December 2005, the EC imposed on Bayer AG, and in March 2006 Bayer AG paid, a fine of €58.5 in concluding the rubber chemicals proceeding. The EC investigation into potential antitrust violations involving NBR remains ongoing. The EC closed its investigation into potential competition law violations involving EPDM in July 2006. Bayer AG is cooperating with the EC and the antitrust authorities of certain member states of the EU with respect to their investigations of possible anti-competitive behavior involving several additional products attributable to Bayer AG's former rubber-related lines of business. The EC and certain member state authorities have granted conditional amnesty from the imposition of fines in connection with the investigations involving these additional products. Conditional amnesty requires continued cooperation. In November 2006, the EC closed the proceeding related to Butadiene Rubber and Emulsion-Styrene-Butadiene Rubber by imposing fines against several companies and granting full amnesty to Bayer AG. Bayer AG was not required to pay a fine in connection with this proceeding.

Civil litigation. Bayer AG and certain of its subsidiaries, including the Company, have been named, among others, as defendants in multiple putative class action lawsuits in various state courts in the United States and as defendants in lawsuits including multiple putative class actions pending before various federal courts in the United States. The actions involve rubber chemicals, EPDM, NBR and polychloroprene rubber ("CR"). In the state court actions, the plaintiffs have

alleged violations based on the defendants' purported participation in a conspiracy to fix prices and seek damages as indirect purchasers of the allegedly affected products. In the federal court actions, the plaintiffs have alleged the defendants' participation in a conspiracy to fix the prices and/or to allocate markets and customers for the sale of the allegedly affected products and seek damages as direct purchasers of those products. Agreements or agreements in principle have been reached to settle the majority of these court actions. The federal rubber chemicals, EPDM, NBR and CR settlements, and a number of the state rubber chemicals, EPDM, NBR and CR settlements, have received final court approval. Other settlement agreements must still be finalized, and then are subject to court approval. The foregoing settlements do not resolve all of the pending civil litigation with respect to the aforementioned products, nor do they preclude the bringing of additional claims.

In addition, Bayer AG and certain of its subsidiaries, including the Company, recently have been named, but not served, in a complaint filed in the Northern District of California and the Western District of Pennsylvania on behalf of putative classes of direct purchasers of Butadiene Rubber and Styrene-Butadiene Rubber alleging a conspiracy to fix prices. Civil litigation in Europe is likely.

Bayer AG and certain of its subsidiaries, including the Company, also have been named, among others, as defendants in multiple putative class action lawsuits in three Canadian provinces. The actions involve rubber chemicals, EPDM, NBR and CR. In the Canadian actions, the plaintiffs have alleged violations based on the defendants' alleged participation in a conspiracy to fix prices, and the Canadian plaintiffs seek damages as direct and indirect purchasers of the allegedly affected products. These proceedings are at various stages, and no class action has been certified.

Proceedings involving polyester polyols, urethanes and urethane chemicals
Government investigation. The Company was the subject of a criminal antitrust investigation by the DOJ involving allegations that it had engaged in anti-competitive activities from February 1998 through December 2002 with respect to adipic-based polyester polyols. Under the terms of a September 2004 settlement agreement with the DOJ, the Company pleaded guilty and paid a fine of $33. The agreement resolves all criminal charges against the Company in the United States for activities related to its adipic-based polyester polyols business. The CCB in Canada is conducting a similar investigation. Bayer AG is in the process of negotiating a settlement agreement with the CCB that would resolve all charges in Canada related to allegations that its adipic-based polyester polyols business unit engaged in anti-competitive activities from February 1998 through December 2002.

Civil litigation. Bayer AG and certain of its subsidiaries, including the Company, have been named, among others, as defendants in multiple putative class action lawsuits in various state courts in the United States and as defendants in multiple putative class action lawsuits which have been consolidated in federal district court in Kansas, involving allegations of price fixing with respect to polyester polyols and/or urethanes and urethane chemicals. Plaintiffs in the federal court actions seek damages on behalf of direct purchasers of polyester polyols and related polyurethane systems, while plaintiffs in the state court actions seek damages on behalf of indirect purchasers of products that contain urethanes and urethane chemicals. These cases are at various preliminary stages. Bayer AG and the Company have received final court approval of their agreement to settle all of the federal direct purchaser class action cases relating to polyester polyols (and related systems). The foregoing settlement does not resolve all the pending civil litigation with respect to

the aforementioned products, nor does it preclude the bringing of additional claims.

Bayer AG and certain of its subsidiaries, including the Company, also have been named, among others, as defendants in putative class action lawsuits involving polyester polyols in two Canadian courts, involving allegations of a price fixing conspiracy. The Canadian plaintiffs seek damages on behalf of a class of direct and indirect purchasers of the allegedly affected products. These cases are at various preliminary stages and no class action has been certified.

Proceedings involving polyether polyols and other precursors for urethane end-use products
Government investigation. On February 16, 2006, the Company was served with a subpoena by the DOJ seeking information relating to the manufacture and sale of methylene diphenyl diisocyanate ("MDI"), toluene diisocyanate ("TDI") and polyether polyols and related systems. The Company is cooperating with the DOJ in connection with the subpoena.

Civil litigation. Bayer AG and certain of its subsidiaries, including the Company, also have been named, among others, as defendants in multiple putative class action lawsuits which have been consolidated in federal district court in Kansas, involving allegations of price fixing of, inter alia, polyether polyols and certain other precursors for urethane end-use products. Bayer AG and the Company have received final court approval of their agreement to settle all of the federal direct purchaser class action cases relating to polyether polyols, MDI and TDI (and related systems). Approximately 25% of the direct purchaser plaintiffs opted out of the class settlement and reserved thereby the right to independently bring an individual action in their own name to recover damages they allegedly suffered. To date no such actions have been brought.

Bayer AG and certain of its subsidiaries, including the Company, also have been named, among others, as a defendant in two putative class action lawsuits pending in Quebec and Ontario, respectively, involving allegations of price fixing of, inter alia, polyether polyols and certain other precursors for urethane end-use products. These matters are at an early stage, and no class has been certified.

Impact of rubber-related and urethane-related antitrust proceedings on the Company
Provisions in the amount of $18 were established as of December 31, 2005, in respect of the previously described civil proceedings. This provision was paid in 2006.

These provisions taken may not be sufficient to cover the ultimate outcome of the above-described matters. The amount of provisions established for civil claims was based on the expected payments under the settlement agreements or agreements in principle described above.

In 2006 and 2005, the Company did not record any charge with respect to the agreement in principle to settle the class action civil litigation associated with polyether polyols, MDI and TDI, and their related systems. It is the present intention of Bayer AG, as between Bayer AG and the Company, to assume the financial responsibility for payment of this settlement.

In the case of settlements in civil matters which have been asserted as class actions, members of the putative classes have the right to "opt out" of the class, meaning that they elect not to participate in the settlement. Plaintiffs that opt out are not bound by the terms of the settlement and have the right to independently bring individual actions in their own names to recover damages they allegedly

(dollars in millions)

suffered.

The Company has and will continue to pursue settlements that in its view are warranted, including with plaintiffs that elect or have elected to opt out of the class action proceedings. In cases where settlement is not achievable, the Company will continue to defend itself vigorously.

The financial risk associated with the rubber-related and urethane-related antitrust proceedings described above beyond the amounts already paid and the financial provisions already established is currently not quantifiable due to the considerable uncertainty associated with these proceedings. Consequently, no provisions other than those described above have been established. The Company expects that, in the course of the regulatory proceedings and civil damages suits, additional charges, which are currently not quantifiable, will become necessary.

Additionally, Bayer AG and its former affiliate Lanxess AG entered into a master agreement, dated September 22, 2004, pursuant to which the parties, among other things, apportion between them liability for certain of the antitrust proceedings described above.

Proceedings involving Ciprofloxacin
In January 1997, Bayer AG and the Company settled a patent infringement suit brought in the United States against Barr Laboratories, Inc. This suit had arisen when Barr filed an Abbreviated New Drug Application ("ANDA") (IV) seeking regulatory approval of a generic form of Bayer AG's ciprofloxacin anti-infective product, which is sold in the United States under the trademark *Cipro*®. Shortly after settling this suit, Bayer AG applied to the U.S. Patent and Trademark Office for re-examination of its patent. The Patent and Trademark Office reissued the patent in February 1999. In addition, Bayer AG's *Cipro*® patent was the subject of additional patent invalidity challenges litigated in the U.S. federal district courts and in each instance, the validity of Bayer AG's patent was upheld. The patent expired in December 2003.

Since July 2000, the Company has been named as one of several defendants in 39 putative class action lawsuits, one individual lawsuit and one consumer protection group lawsuit (which has since been dismissed) filed in a number of state and federal courts in the United States. The plaintiffs in these suits allege that they are direct or indirect purchasers of *Cipro*® who were damaged because settlement of the Barr ANDA (IV) litigation prevented generic manufacturers from selling a generic version of *Cipro*®. The plaintiffs allege that the settlement violated various federal antitrust and state business, antitrust, unfair trade practices, and consumer protection statutes, and seek treble damages and injunctive relief. The Barr settlement is also the subject of an antitrust investigation by the U.S. Federal Trade Commission and a number of state attorneys general.

All the actions pending in federal court were consolidated in federal district court in New York in a multidistrict litigation ("MDL") proceeding. In May 2004, the Company moved for summary judgment on all of plaintiffs' antitrust claims in the consolidated cases brought by direct purchaser and indirect purchaser plaintiffs pending in that court, including certain plaintiffs' claims related to the Company's actions during the prosecution of the *Cipro*® patent in the U.S. Patent and Trademark Office and its enforcement against third party infringers. The Company also moved to dismiss those plaintiffs' patent-related claims on grounds that these claims do not state a claim for relief under the antitrust laws. The direct purchaser plaintiffs filed a cross-motion seeking summary judgment on certain liability issues. In March 2005, the court entered summary judgment in favor

(dollars in millions)

of the Company and dismissed all of plaintiffs' claims in the MDL proceeding. Plaintiffs appealed this ruling, and a decision by the U.S. Court of Appeal for the Second Circuit is pending.

The remaining lawsuits consist of a class action lawsuit brought on behalf of indirect purchasers in California state court, as well as putative class action lawsuits in Florida, New York, Kansas, Tennessee and Wisconsin. The New York and Wisconsin cases were dismissed by the trial courts and plaintiffs appealed the dismissals. On December 13, 2005, the New York intermediate appellate court affirmed dismissal of the New York class action suit. On January 19, 2006, plaintiffs moved for leave to appeal that decision to the New York Court of Appeals. On May 9, 2006, the Wisconsin Court of Appeals reinstated the Wisconsin case. On June 8, 2006, the Company petitioned the Wisconsin Supreme Court for review of the Court of Appeals' decision. The Supreme Court's decision is pending. The California and Kansas cases have been stayed. The Company filed an answer in the Florida state court action, and there has been no subsequent activity in that case. A motion to dismiss is pending in the Tennessee state court proceeding.

These cases may involve joint and several liability among the defendants, in the aggregate allege substantial unquantified damages and also seek treble and punitive damages and penalties. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability. However, the Company believes that it have meritorious defenses to the above-described proceedings and intends to continue to defend itself vigorously. The Company will regularly consider the need to establish provisions as the proceedings continue.

Proceedings involving Premise®
The Company is named as a defendant in a putative nationwide class action pending in federal court in North Carolina. Plaintiffs allege that the Company conspired with intermediaries to fix the price at which those intermediaries resold the Bayer product Premise® to pest control operators. In November 2006, plaintiffs voluntarily withdrew their further claim that the Company conspired with BASF Corporation to utilize an agency system for distributing *Premise®* (and BASF's termiticide) in violation of the Sherman Act.

Plaintiffs assert that they are entitled to recover on behalf of the proposed class a total amount in excess of $200 (subject to trebling and the addition of plaintiffs' attorneys' fees, under the antitrust laws). The Company believes that it has meritorious defenses in the proceedings involving *Premise®* and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Average wholesale price manipulation proceedings

Sixty-two pending lawsuits allege that a number of pharmaceutical companies, including the Company, manipulated the average wholesale price ("AWP") and/or Medicaid best price of their products resulting in overcharges to Medicare beneficiaries, Medicaid recipients, state governmental health programs, private health plans and privately insured patients. These suits generally seek damages, treble damages, disgorgement of profits, restitution and attorney's fees. Some of these purported class actions allege injury to patients or payors. However, no class has yet been certified against the Company. In addition, suits have been filed by the attorneys general of eight states as well as the City of New York and numerous New York counties. These suits generally seek to recover for excess costs incurred by the governmental entities and their

(dollars in millions)

constituents as a result of the alleged overcharges. Discovery is proceeding.

The claims of five states have been dismissed, in whole or in part, based on the Company's settlement of earlier AWP litigation. The Company believes that it has meritorious defenses in the remaining actions and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability. The Company will regularly consider the need to establish provisions as the proceedings continue.

Patent validity challenges and infringement proceedings

Proceedings involving Moxifloxacin
In February 2004, Bayer AG and the Company received a notice letter pursuant to the Hatch-Waxman Act from the generic manufacturers Dr. Reddy's Laboratories, Ltd. and Dr. Reddy's Laboratories, Inc. stating that they had filed an ANDA with the U.S. FDA seeking regulatory marketing approval for allegedly bioequivalent versions of *Avelox*®, Bayer's respiratory tract anti-infective, prior to the expiration of one or more patents covering *Avelox*® and/or its use. Dr. Reddy's sought the approval for its generic product prior to the expiration of three Bayer AG patents protecting the active ingredient of *Avelox*®, moxifloxacin, which expire on December 8, 2011, March 4, 2014, and December 5, 2016, respectively. Bayer AG filed a patent infringement suit against Dr. Reddy's Laboratories, Ltd. and Dr. Reddy's Laboratories Inc. in the United States District Court for the District of Delaware alleging infringement of the first two U.S. patents listed above. Dr. Reddy's alleged that the patents are invalid, not infringed and unenforceable.

A trial was held in August 2006. Dr. Reddy's has stipulated that its proposed generic product would infringe certain of the patent claims in each of the patents which Bayer AG is asserting in this case. A decision is pending. If the court rules that the patents are invalid or unenforceable, the FDA may grant approval immediately. If, on the other hand, the court rules that the patents are not invalid or unenforceable, and the ruling takes place before the FDA 30-month stay expires, the FDA may not grant final approval until the original patents have expired. The court has extended the expiration of the 30-month stay until October 21, 2007. Bayer AG and the Company believe that they have meritorious claims and defenses in this action and intend to defend the patents vigorously.

Bayer AG and the Company received separate notice letters from two other generic manufacturers, each stating that it had filed an ANDA seeking regulatory marketing approval for a generic version of *Avelox*®. Each sought approval of its generic product to be effective after the first two Bayer AG patents listed above had expired but prior to the expiration of the third patent listed above. No actions have been filed against either manufacturer.

On February 24, 2006, Bayer AG and the Company received a notice letter pursuant to the Hatch-Waxman Act from generic manufacturer Teva Pharmaceuticals USA, Inc., stating that it had filed an ANDA with the FDA seeking regulatory marketing approval for allegedly bioequivalent versions of *Vigamox*®, an ophthalmic preparation of Bayer's anti-infective compound moxifloxacin sold by Alcon Laboratories Inc. under license from Bayer AG, prior to the expiration of one or more patents covering moxifloxacin, and/or its use. The relevant Bayer AG patents expire on December 8, 2011 and March 4, 2014. On April 5, 2006, Bayer HealthCare AG, Alcon, Inc. and

(dollars in millions)

Alcon Manufacturing, Ltd. filed a patent infringement suit against Teva in the U.S. District Court for the District of Delaware. Teva has answered alleging invalidity and non-infringement. A trial date has been set for February 28, 2008. The two Bayer AG patents are the same as those involved in the suit against Dr. Reddy's Laboratories, Ltd. and Dr. Reddy's Laboratories, Inc. above. Bayer AG and the Company believe they have meritorious claims and defenses in this action and intend to defend the patents vigorously.

Proceedings involving Kogenate
As previously reported, since 2003 the Company had been party to several lawsuits involving two affiliates of Aventis, A. Nattermann & Cie GmbH and Aventis Behring LLC. The suits related to certain Aventis patents which the Company allegedly uses or infringes in its manufacture and distribution of a recombinant factor VIII product sold by the Company as *Kogenate*® and a related agreement whereby the Company supplies the finished recombinant factor VIII product to Aventis. In February 2007, the parties settled both disputes in full. In connection with this settlement, the Company extended the term of its supply agreement with Aventis through 2017, and the Company was granted a license to intellectual property related to formulations of recombinant Factor VIII.

Proceeding involving blood glucose monitors
In August 2005, Abbott commenced a lawsuit in a federal district court in California against the Company and Roche Diagnostics alleging infringement of two of Abbott's U.S. patents relating to blood glucose monitoring devices. The Company product originally accused of infringing the Abbott patents is the *Ascensia*® *Contour*® system, which is supplied to the Company by Matsushita. Matsushita is contractually obligated to indemnify the Company against the potential liability with respect to this claim, as well as defense costs, and management expects the Company to be reimbursed by Matsushita for a substantial portion of all such costs and liability, if any. Abbott subsequently added claims of infringement of one of the Abbott patents against the Company's DEX and Autodisc system. The cost of the defense and liability, if any, will be borne by the Company, without indemnification by Matsushita, as these products were designed and manufactured by the Company. The Company believes that it has meritorious defenses against these claims and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with this proceeding, it is currently not possible to estimate potential liability.

Versant® Diagnostic Assays related actions
In two separate lawsuits, filed in federal court in 2004 and 2005, respectively, Gen-Probe Inc. alleged that the Company, through the marketing and sale of certain *Versant*® assays for the detection of hepatitis C and HIV-related viruses, willfully infringed certain patents owned by Gen-Probe. Gen-Probe sought recovery of an unspecified amount in damages, which could have been subject to enhancement to up to three times the amount of any actual damages found or assessed, as well as injunctive relief. In June 2006, the Company and Gen-Probe resolved their patent litigation, with the Company obligated to pay up to $31.7, $5.0 of which was paid upon signing of the definitive settlement agreement, $10.3 of which was paid in January 2007 and the balance of which may come due in 2008 as royalties for future use of the patented technologies. The Company sold the products utilizing the patented technologies to Siemens Medical Solutions Diagnostics as part of the Company's divestiture of its Diagnostics division. The Company remains liable for the 2008 royalty payment should Siemens continue on or after January 1, 2008 to make, import or sell these products. In conjunction with the patent settlement, Gen-Probe and the

(dollars in millions)

Company also resolved their separate arbitration relating to their collaboration for viral products. Neither party will be required to make payment to the other as a result of this separate resolution.

Securities litigation

Bayer AG and the Company, along with two of their current or former officers, have been named as defendants in a class action lawsuit pending in the U.S. District Court for the Southern District of New York. The lawsuit alleges violations of the U.S. securities laws and asserts that the defendants made false and misleading statements and omissions with respect to the commercial prospects, safety and efficacy of Bayer's cerivastatin anticholesterol products and with respect to the extent of the potential product liability exposure following Bayer's voluntary decision to cease marketing and to withdraw these products in August 2001. Plaintiffs sought unspecified damages on behalf of a class of all persons who purchased Bayer AG stock (including Bayer AG American Depository Receipts) between August 4, 2000 and February 21, 2003 at allegedly inflated prices. On September 14, 2005, the court dismissed with prejudice the claims of non-U.S. purchasers of Bayer AG stock on non-U.S. exchanges. On February 24, 2006, the court certified a class of all persons who during the period from August 4, 2000 through and including February 21, 2003 either (a) purchased Bayer AG shares on the U.S. over the counter market or purchased ADRs on the New York Stock Exchange, regardless of the purchaser's country of residence at the time of the purchase; or (b) purchased Bayer AG shares or ADRs on any other stock exchange, and the purchaser was a resident or citizen of the United States at the time of purchase. Bayer AG and the Company believe that they have meritorious defenses in this action and intend to continue to defend themselves vigorously. Due to the considerable uncertainty associated with this proceeding, it is currently not possible to estimate potential liability.

Asbestos litigation

The Company is a defendant in asbestos cases which allege that the Company, along with other premises defendants, employed contractors at industrial sites where they were exposed to asbestos and were injured. Plaintiffs contend that the Company failed to warn or protect them from the known hazards of asbestos during the 1960s, 1970s and 1980s. The majority of cases are pending in West Virginia and Texas.

A subsidiary of the Company also is the legal successor to entities that sold asbestos-containing products from the 1940s until 1976 and is named as a defendant in asbestos-related litigation. The Company is and has been fully indemnified for its costs with respect to this litigation by Union Carbide. Union Carbide continues to accept the Company's tender of these cases, and it defends and settles them in the Company's name, in its own name and in the name of the several predecessor companies to the Company.

The Company believes that it has meritorious defenses in these actions and intends to continue to defend itself vigorously. Without acknowledging any liability, the Company has settled a number of these cases in the past. The Company may, on a case-by-case basis, settle additional cases for reasonable amounts when, in the Company's judgment, settlement is economically feasible given the risks and costs inherent in the litigation. The Company has made what it believes to be appropriate provisions in light of its experience in handling these cases.

(dollars in millions)

Other commercial proceedings

Lyondell Arbitration
An arbitration panel in May 2006 issued a final award in favor of Lyondell Chemical Co. in respect of a dispute with the Company over interpretation of their joint venture agreements for the manufacture of propylene oxide. The Company is seeking to vacate the final award in federal court, while Lyondell is seeking to confirm the award as well as obtain pre-award interest. The Company has established appropriate provisions in this regard. Additionally, the Company will regularly review the need to establish provisions consistent with the arbitration ruling and continuing business operations. In addition to seeking to vacate the final award, in January 2007, the Company filed suit against Lyondell in the Delaware State Court of Chancery, seeking equitable reformation of one of the license agreements relating to the joint venture and restitution of certain monies paid or, as a result of the final award, allegedly owing by the Company to Lyondell under that license agreement.

The Company separately has notified Lyondell of its claim in connection with Lyondell's failure to compensate the Company for taking approximately 351 million pounds of propylene oxide from the Company's share of capacity under the joint venture. This dispute is proceeding to binding arbitration.

Proceedings involving genetically modified rice
Since August 2006, the Company is party to multiple lawsuits, including putative class actions, filed in U.S. federal and state courts by rice farmers and resellers. Plaintiffs allege that they have suffered economic losses after traces of the genetically modified rice event LLRICE601 were identified in samples of conventional long-grain rice grown in the United States. This is alleged to have led to various commercial damages, including a decline in the commodity price for long-grain rice, costs associated with restrictions on imports and exports, and costs to secure alternative supplies. In December 2006, the Judicial Panel on Multidistrict Litigation entered an order establishing a single pretrial proceeding in the U.S. District Court for the Eastern District of Missouri for all federal cases involving LLRICE601.

After development, LLRICE601 had been further tested in cooperation with third parties, including a breeding institute in the United States. However, it was never selected for commercialization. The U.S. Department of Agriculture and the U.S. Food and Drug Administration have stated that LLRICE601 does not pose a health risk and is safe for use in food and feed and for the environment. In November 2006, the USDA advised that it had deregulated LLRICE601. The USDA is conducting an investigation in an effort to determine how LLRICE601 became present in commercial rice grown in the United States.

The Company believes it has meritorious defenses and intends to continue to defend itself vigorously. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Overtime wage claims
During the past year, the Company, as well as other major employers within the pharmaceuticals industry, has been named in lawsuits alleging that pharmaceutical sales representatives were improperly classified as exempt employees under state and federal wage and hour laws and,

therefore, were improperly denied overtime pay and other benefits such as meal and rest periods. Two putative class and collective actions were filed against the Company and its subsidiary, Bayer Pharmaceuticals Corporation, in federal district courts in California, and those actions have been consolidated in one proceeding in the United States District Court for the Central District of California. The complaints seek back overtime pay and statutory damages, penalties, interest, and attorneys' fees, and some claims purport to have been filed on behalf of a nationwide class of sales representatives. The proceeding is at a preliminary stage. The Company believes it has meritorious defenses and intends to vigorously defend this action. Due to the considerable uncertainty associated with these proceedings, it is currently not possible to estimate potential liability.

Baytown incident
In September 2006, over pressurization of a vessel which serves as a component of a manufacturing unit within the Company's Baytown, Texas facility resulted in physical damage and actual or alleged injuries to persons working at the facility. Twenty-two individuals were taken to area hospitals for examination or treatment and were released. Complaints since have been filed in state court in Chambers County, Texas on behalf of approximately fifty persons who claim they were injured or affected as a result of the incident. This matter is in its early stages. The Company believes that it has meritorious defenses in this matter and intends to defend itself vigorously. Due to the considerable uncertainly associated with this matter it is currently not possible to estimate potential liability.

22. Subsequent Events

In January 2007, Bayer AG sold its subsidiary H. C. Starck GmbH. As part of this transaction, the Company agreed to assume certain pension and other post-employment benefit obligations from the U.S. subsidiary of H. C. Starck GmbH. As a result, the Company recorded a net asset of $5, which was treated as a capital contribution.

In February 2007, a third paper reporting on a series of observational studies was published in the medical literature concerning *Trasylol*® (aprotinin), a product for use during open-heart surgery. Taken together, these three studies propose a possible correlation between the administration of aprotinin and increased risk of adverse cardiovascular, cerebrovascular or renal events and increased long-term mortality. Preliminary results of a separate observational study performed for Bayer supports the hypothesis that there is a higher risk of death and acute renal failure in aprotinin recipients. Management continues to work closely with the FDA to resolve the questions that have arisen regarding these studies and the product's safety and efficacy. These discussions follow a September 2006 Advisory Committee meeting held by the Cardiovascular and Renal Drugs Division of the FDA. Results of the review and analysis of data, changes in product labeling to reflect the new safety information, or negative publicity associated with the studies or the regulatory review process has led to and could continue to lead to a reduction in the volume of *Trasylol*® sales and to liability claims asserted against the Company.

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Report of Independent Auditors

To the Management of
Bayer Corporation

We have performed the procedures included in the Nuclear Regulatory Commission (NRC) financial assurance regulations, 10 CFR Part 30 Appendix A (b), which were agreed to by the management of Bayer Corporation (the "Company"), solely to assist the specified parties in evaluating the Company's compliance with the financial test option as of December 31, 2006, included in the applicable accompanying letter dated April 9, 2007 from Mr. Willy Scherf, Chief Financial Officer of the Company. Management is responsible for the Company's compliance with those requirements. This agreed-upon procedures engagement was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures consisted of the following related to the data contained in Attachment IV, Alternative II in the letter from the Chief Financial Officer of the Company dated April 9, 2007

1. Item 5, Tangible net worth. We subtracted the dollar amount of total liabilities of the Company (obtained from the audited financial statements of the Company) and the intangible assets (obtained from the Company's underlying accounting records) from the dollar amount of total assets (obtained from the audited financial statements of the Company.) We compared the calculated tangible net worth with the Company's response to Item 5. No exceptions were noted.

2. Item 9, Are at least 90 percent of assets located in the U.S? We determined the appropriateness of the Company's response by calculating the percentage of assets located in the U.S., based upon the Company's total U.S. assets (as obtained from the Company's underlying accounting records) and the Company's total consolidated assets (obtained from the audited financial statements of the Company.) We compared

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our calculated percentage with the Company's response to Item 9. No exceptions were noted.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of management of the Company and the Nuclear Regulatory Commission (NRC), and is not intended to be and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP

April 9, 2007