EATON CORP
Form 10-K
February 28, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the year ended December 31, 2006

Commission file number 1-1396

EATON CORPORATION
(Exact name of registrant as specified in its charter)

Ohio	34-0196300
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)

Eaton Center Cleveland, Ohio	44114-2584
(Address of principal executive offices)	(Zip code)

(216) 523-5000
(Registrant's telephone number, including area code)

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

Title of each class	Name of each exchange on which registered
Common Share ($.50 par value)	The New York Stock Exchange The Chicago Stock Exchange

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes X

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. No X

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months and (2) has been subject to such filing requirements for the past ninety days. Yes X

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (Check one): Large accelerated filer X

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). No X

The aggregate market value of Common Stock held by non-affiliates of the registrant as of June 30, 2006 was $11.3 billion.

As of January 31, 2007, there were 146.2 million Common Shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the 2007 annual shareholders meeting are incorporated by reference into Part III.

PART I

ITEM 1. BUSINESS

Eaton Corporation (Eaton or Company) is a diversified industrial manufacturer having 2006 sales of $12.4 billion. Eaton was incorporated in Ohio in 1916, as a successor to a New Jersey company incorporated in 1911. The Company is a global leader in the design, manufacture, marketing and servicing of electrical systems and components for power quality, distribution and control; fluid power systems and services for industrial, mobile and aircraft equipment; intelligent truck drivetrain systems for safety and fuel economy; and automotive engine air management systems, powertrain solutions and specialty controls for performance, fuel economy and safety. Headquartered in Cleveland, Ohio, Eaton had 60,000 employees at year-end 2006 and sells products in more than 125 countries. More information regarding the Company is available at http://www.eaton.com.

Eaton electronically files or furnishes reports pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (Exchange Act) to the United States Securities and Exchange Commission (SEC), including annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, as well as any amendments to those reports. As soon as reasonably practicable, these reports are available free of charge through the Company's Internet web site at http://www.eaton.com. These filings are also accessible on the SEC's Internet web site at http://www.sec.gov.

RECENT DEVELOPMENTS

In light of its strong results for 2006 and future prospects, on January 22, 2007, Eaton announced that it was taking the following actions:

- Increasing the quarterly dividend on its Common Shares by 10%, from $.39 per share to $.43 per share, effective for the February 2007 dividend

- Making a voluntary contribution of $150 million to its qualified pension plan in the United States

- Authorizing a new 10 million Common Share repurchase program, replacing the 1.3 million shares remaining from the 10 million share repurchase program authorized in April of 2005.

In 2006, Eaton acquired certain businesses in separate transactions for a combined net cash purchase price of $256 million. The Statements of Consolidated Income include the results of these businesses from the effective dates of acquisition. A summary of these transactions for 2006 follows (millions of dollars):

Acquired business	Date of acquisition	Business segment
Schreder-Hazemeyer Eaton acquired the remaining 50% ownership of the Belgium manufacturer of low and medium voltage electrical distribution switchgear	December 1, 2006	Electrical
Diesel fuel processing technology & associated assets of Catalytica Energy Systems Inc. A U.S. developer of emission control solutions for Trucks	October 26, 2006	Truck
Senyuan International Holdings Limited A China-based manufacturer of vacuum circuit breakers and other electrical switchgear components	September 14, 2006	Electrical
Ronningen-Petter business unit of Dover Resources, Inc. A U.S.-based manufacturer of industrial fine filters and components	September 5, 2006	Fluid Power
Synflex business unit of Saint-Gobain Performance Plastics Corp. A U.S.-based manufacturer of thermoplastic hose and tubing	March 31, 2006	Fluid Power
Marina Power & Lighting A U.S. manufacturer of marine duty electrical distribution products	March 24, 2006	Electrical

On December 28, 2006, Eaton announced it had reached an agreement to purchase AT Holdings Corporation, the parent of Argo-Tech Corporation, for $695 million. This transaction is expected to close in the first quarter of 2007. Argo-Tech's U.S.-based aerospace business, which had sales for the fiscal year ended October 28, 2006 of $206 million, is a leader in high performance aerospace engine fuel pumps and systems, airframe fuel pumps and systems, and ground fueling systems for commercial and military aerospace markets. This business will be integrated into the Fluid Power segment.

On January 5, 2007, the Company announced it had reached an agreement to purchase the Power Protection Business of Power Products Ltd., a Czech distributor and service provider of Powerware and other uninterruptible power systems, for $2 million. The transaction closed in February 2007. This business, which had 2006 sales of $3 million, will be integrated into the Electrical segment.

BUSINESS SEGMENT INFORMATION

Information by business segment and geographic region regarding principal products, principal markets, methods of distribution, net sales, operating profit and assets is presented in "Business Segment & Geographic Region Information" on pages 47 through 51 of this report. Additional information regarding Eaton's segments and business is presented below.

ELECTRICAL

Seasonal Fluctuations - Sales of this segment are historically lower in the first quarter, and higher in the third and fourth quarters of a year.

Competition - Principal methods of competition in this segment are performance of products and systems, technology, customer service and support, and price. Eaton has a strong competitive position in relation to the many competitors in this segment and, with respect to many products, is considered among the market leaders.

FLUID POWER

Seasonal Fluctuations - Sales of this segment are not affected by seasonal fluctuations.

Competition - Principal methods of competition in this segment are product performance, geographic coverage, service, and price. Eaton has a strong competitive position in relation to the many competitors in this segment and, with respect to many products, is considered among the market leaders.

TRUCK

Seasonal Fluctuations - Sales of this segment are not affected by seasonal fluctuations.

Significant Customers - Approximately 78% of this segment's sales in 2006 were made to five large manufacturers of heavy-, medium-, and light-duty trucks and off-highway vehicles.

Competition - Principal methods of competition in this segment are product performance, service, and price. Eaton has a strong competitive position in relation to the many competitors in this segment and, with respect to many products, is considered among the market leaders.

AUTOMOTIVE

Seasonal Fluctuations - Sales of this segment historically are lower in the third quarter than in other quarters during the year, as a result of the normal seasonal pattern of automotive industry production.

Significant Customers - Approximately 56% of this segment's sales in 2006 were made to six large manufacturers of vehicles and components.

Competition - Principal methods of competition in this segment are product performance, service, and price. Eaton has a strong competitive position in relation to the many competitors in this segment and, with respect to many products, is considered among the market leaders.

INFORMATION CONCERNING EATON'S BUSINESS IN GENERAL

RAW MATERIALS - Eaton's major requirements for raw materials include iron, steel, copper, nickel, aluminum, brass, silver, molybdenum, titanium, vanadium, rubber, plastic and insulating materials. Materials are purchased in various forms, such as extrusions, castings, powder metal, metal sheets and strips, forging billets, bar stock and plastic pellets. Raw materials, as well as parts and other

components, are purchased from many suppliers and, under normal circumstances, the Company has no difficulty obtaining them. In 2006, prices increased for some basic metals purchased by Eaton, and in some cases dramatically, due to raw materials supply shortages resulting from higher global demand. The Company maintained appropriate levels of inventory to guard against basic metals shortages, and did not experience the general availability constraints experienced in 2005.

PATENTS AND TRADEMARKS - Eaton views its name and mark as significant to its business as a whole. Eaton's products are marketed with a portfolio of patents, trademarks, licenses or other forms of intellectual property that expire at various dates in the future. Eaton develops and acquires new intellectual property on an ongoing basis and considers all of its intellectual property to be valuable. Based on the broad scope of Eaton's product lines, management believes that the loss or expiration of any single intellectual property right would not have a material effect on the results of operations or financial position of Eaton or its business segments. Eaton's policy is to file applications and obtain patents for its new products including product modifications and improvements.

ORDER BACKLOG - Since a significant portion of open orders placed with Eaton by original equipment manufacturers of trucks, off-highway vehicles and passenger cars are historically subject to month-to-month releases by customers during each model year, these orders are not considered firm. In measuring backlog of orders, the Company includes only the amount of these orders released by customers as of the dates listed. Using this criterion, total backlog at December 31, 2006 and 2005 was approximately $2.2 billion and $2.0 billion, respectively. Backlog should not be relied upon as being indicative of results of operations for future periods.

RESEARCH AND DEVELOPMENT - Research and development expenses for new products and improvement of existing products in 2006, 2005 and 2004 (in millions) were $321, $285 and $259, respectively. Over the past five years, the Company has invested approximately $1.3 billion in research and development.

PROTECTION OF THE ENVIRONMENT - Operations of the Company involve the use and disposal of certain substances regulated under environmental protection laws. Eaton continues to modify certain processes on an ongoing, regular basis in order to reduce the impact on the environment, including the reduction or elimination of certain chemicals used in, and wastes generated from, operations. Compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, are not expected to have a material adverse effect upon earnings or the competitive position of the Company. Eaton's estimated capital expenditures for environmental control facilities are not expected to be material for 2007 and 2008. Information regarding the Company's liabilities related to environmental matters is presented in "Protection of the Environment" on page 41 of this report.

FOREIGN OPERATIONS - Financial information related to Eaton's foreign operations is presented in "Business Segment & Geographic Information" on page 49 of this report. Information regarding risks that may affect Eaton's foreign operations is presented in Item 1A of this Form 10-K.

ITEM 1A. RISK FACTORS

Among the risks that could materially adversely affect Eaton's businesses, financial condition or results of operations are the following:

DOWNTURNS IN THE END MARKETS THAT EATON SERVES MAY NEGATIVELY IMPACT EATON'S SEGMENT REVENUES AND PROFITABILITY.

Eaton's segment revenues, operating results and profitability have varied in the past and may vary from quarter to quarter in the future. Profitability can be negatively impacted by volatility in the end markets that Eaton serves, although the Company has undertaken measures to reduce the impact of this volatility through diversification of markets it serves and expansion of geographic regions in which it operates. Future downturns in any of the markets that Eaton serves could adversely affect the Company's revenues, operating results, and profitability.

EATON'S OPERATING RESULTS DEPEND IN PART ON CONTINUED SUCCESSFUL RESEARCH, DEVELOPMENT AND MARKETING OF NEW AND/OR IMPROVED PRODUCTS AND SERVICES, AND THERE CAN BE NO ASSURANCE THAT EATON WILL CONTINUE TO SUCCESSFULLY INTRODUCE NEW PRODUCTS AND SERVICES.

The success of new and improved products and services depends on their initial and continued acceptance by Eaton's customers. The Company's businesses are affected, by varying degrees, by technological change and corresponding shifts in customer demand, which could result in unpredictable product transitions or shortened life cycles. Eaton may experience difficulties or delays in the research, development, production and/or marketing of new products and services which may prevent Eaton from recouping or realizing a return on the investments required to bring new products and services to market. The end result could be a negative impact on the Company's operating results.

EATON'S OPERATIONS DEPEND ON PRODUCTION FACILITIES THROUGHOUT THE WORLD, MANY OF WHICH ARE LOCATED OUTSIDE THE UNITED STATES AND ARE SUBJECT TO GREATER RISKS OF DISRUPTED PRODUCTION.

Eaton manages businesses with manufacturing facilities worldwide. The Company's manufacturing facilities and operations could be disrupted by a natural disaster, labor strike, war, political unrest, terrorist activity or public health concerns. Eaton's non-United States manufacturing facilities also may be more susceptible to economic and political upheaval than Eaton's United States facilities. Any such disruption could cause delays in shipments of products and the loss of sales and customers, and insurance proceeds may not adequately compensate the Company.

EATON'S SUBSTANTIAL FOREIGN SALES SUBJECT IT TO ECONOMIC RISK AS EATON'S RESULTS OF OPERATIONS MAY BE ADVERSELY AFFECTED BY CHANGES IN LOCAL GOVERNMENT REGULATIONS AND POLICIES AND FOREIGN CURRENCY FLUCTUATIONS.

As noted above in Item 1 "Foreign Operations", a significant portion of Eaton's sales are outside the United States, and the Company expects sales in foreign markets to continue to represent a significant portion of its total sales. Foreign sales and operations are subject to changes in local government regulations and policies, including those related to tariffs and trade barriers, investments, property ownership rights, taxation, exchange controls, and repatriation of earnings. Changes in the relative values of currencies occur from time to time and could affect Eaton's operating results. While the Company monitors exchange rate exposures and attempts to reduce these exposures through hedging activities, these risks could adversely affect the Company's operating results.

EATON USES A VARIETY OF RAW MATERIALS AND COMPONENTS IN ITS BUSINESSES, AND SIGNIFICANT SHORTAGES OR PRICE INCREASES COULD INCREASE OPERATING COSTS AND ADVERSELY IMPACT THE COMPETITIVE POSITIONS OF EATON'S PRODUCTS.

Eaton's major requirements for raw materials are described above in Item 1 "Raw Materials". In 2006, prices increased for some basic metals purchased by Eaton, and in some cases dramatically, due to raw materials supply shortages resulting from higher global demand. The Company maintained appropriate levels of inventory to guard against basic metals shortages, and did not experience the general availability constraints experienced in 2005. Significant shortages in excess of those experienced in 2005 and 2006 could affect the prices Eaton's affected businesses are charged and the competitive position of their products and services, all of which could adversely affect Eaton's results of operations.

EATON ENGAGES IN ACQUISITIONS AND JOINT VENTURES, AND MAY ENCOUNTER UNEXPECTED DIFFICULTIES IDENTIFYING, PRICING OR INTEGRATING THOSE BUSINESSES.

Eaton seeks to grow, in part, through strategic acquisitions and joint ventures intended to complement or expand the Company's businesses, and will continue to do so in the future. The success of this strategy will depend on Eaton's ability to identify, price and complete these transactions or arrangements. Success will also depend on the Company's ability to integrate the businesses acquired in these transactions and to develop satisfactory working arrangements with the Company's strategic partners in the joint ventures. Eaton may encounter unexpected difficulties in completing and integrating acquisitions with Eaton's existing operations, and in managing strategic investments. Furthermore, the Company may not realize the degree, or timing, of benefits Eaton anticipated when it first entered into a transaction. Any of the foregoing could adversely affect the Company's business and results of operations.

EATON MAY BE UNABLE TO ADEQUATELY PROTECT ITS INTELLECTUAL PROPERTY RIGHTS, WHICH COULD AFFECT THE COMPANY'S ABILITY TO COMPETE.

Protecting Eaton's intellectual property rights is critical to its ability to compete and succeed as a company. The Company owns a large number of United States and foreign patents and patent applications, as well as trademark and copyright registrations that are necessary, and contribute significantly, to the preservation of Eaton's competitive position in the market. Although management believes that the loss or expiration of any single intellectual property right would not have a material effect on the results of operations or financial position of Eaton or its business segments, there can be no assurance that any one, or more, of these patents and other intellectual property will not be challenged, invalidated or circumvented by third parties. Eaton enters into confidentiality and invention assignment agreements with the Company's employees, and into non-disclosure agreements with Eaton's suppliers and appropriate customers so as to limit access to and disclosure of the Company's proprietary information. These measures may not suffice to deter misappropriation or independent third party development of similar technologies. Moreover, the protection provided to Eaton's intellectual property by the laws and courts of foreign nations may not be as advantageous to Eaton as the remedies available under United States law.

EATON IS SUBJECT TO LITIGATION AND ENVIRONMENTAL REGULATIONS THAT COULD ADVERSELY IMPACT EATON'S BUSINESSES.

At any given time, Eaton may be subject to litigation, the disposition of which may have a material adverse effect on the Company's businesses, financial condition or results of operations. Information regarding the Company's current legal proceedings is presented in "Protection of the Environment" and "Contingencies" on page 41 of this report.

EATON PARTICIPATES IN MARKETS THAT ARE COMPETITIVE AND EATON'S RESULTS COULD BE ADVERSELY IMPACTED BY COMPETITORS' ACTIONS.

Eaton's businesses operate in competitive markets. The Company competes against other global manufacturers on the basis of product performance, quality and price, in addition to other factors. While Eaton's product development and quality initiatives have been competitive strengths in the past, actions by Eaton's competitors could lead to downward pressure on prices and/or a decline in the Company's market share, either of which could adversely affect Eaton's results.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Eaton's world headquarters is located in Cleveland, Ohio. The Company maintains manufacturing facilities at 202 locations in 32 countries. The Company is a lessee under a number of operating leases for certain real properties and equipment, none of which is material to its operations. Management believes that the existing manufacturing facilities are adequate for operations, and these facilities are maintained in good condition.

ITEM 3. LEGAL PROCEEDINGS

Information regarding the Company's current legal proceedings is presented in "Protection of the Environment" and "Contingencies" on page 41 of this report.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

EXECUTIVE OFFICERS OF THE REGISTRANT

Information regarding executive officers of the Company is presented in Item 10 of this Form 10-K.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's Common Shares are listed for trading on the New York and Chicago stock exchanges. Information regarding cash dividends paid and the high and low market price per Common Share for each quarter in 2006 and 2005 is presented in "Quarterly Data" on page 73 of this report. At December 31, 2006, there were 8,868 holders of record of the Company's Common Shares. Additionally, 20,356 current and former employees were shareholders through participation in the Eaton Savings Plan (ESP) and Eaton Personal Investment Plan (EPIP).

Information regarding equity compensation plans required by Regulation S-K Item 201(d) is provided in Item 12 of this Form 10-K.

ISSUER'S PURCHASES OF EQUITY SECURITIES

In fourth quarter 2006, Eaton repurchased 3.341 million Common Shares in the open market at a total cost of $255 million. These shares were repurchased under the plan announced on April 18, 2005, when Eaton's Board of Directors authorized the Company to repurchase up to 10 million of its Common Shares.

Month	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs
November 2006	2,966,877	$75.49	2,966,877	1,708,019
December 2006	373,800	77.00	373,800	1,334,219
Total	3,340,677	75.65	3,340,677	

On January 22, 2007, Eaton announced that it had authorized a new 10 million Common Share repurchase program, replacing the 1.334 million shares remaining from the 10 million share repurchase program authorized in April of 2005, described in the table above. These shares will be repurchased over time, depending on market conditions, share price, capital levels and other considerations.

ITEM 6. SELECTED FINANCIAL DATA

Information regarding selected financial data is presented in the "Ten-Year Consolidated Financial Summary" on page 72 of this report.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS

OF OPERATIONS

"Management's Discussion & Analysis of Financial Condition & Results of Operations" is presented on pages 52 through 71 of this report.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information regarding market risk is presented in "Market Risk Disclosure & Contractual Obligations" on page 65 of this report.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The report of the independent registered public accounting firm, consolidated financial statements, and notes to consolidated financial statements are presented on pages 18 through 51 of this report.

Information regarding selected quarterly financial information for the last two years is presented in "Quarterly Data" on page 73 of this report.

ITEM 9. CHANGE IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures - Pursuant to SEC Rule 13a-15, an evaluation was performed, under the supervision and with the participation of Eaton's management, including Alexander M. Cutler - Chairman and Chief Executive Officer; President and Richard H. Fearon - Executive Vice President - Chief Financial and Planning Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, Eaton's management concluded that the Company's disclosure controls and procedures were effective as of December 31, 2006.

Disclosure controls and procedures are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information

required to be disclosed in Company reports filed under the Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

"Management's Report on Internal Control Over Financial Reporting" is presented on page 21 of this report.

"Report of Independent Registered Public Accounting Firm" relating to "Management's Report on Internal Control Over Financial Reporting" is presented on page 20 of this report.

Changes in Internal Control Over Financial Reporting - During fourth quarter 2006, there was no change in Eaton's internal control over financial reporting that materially affected, or is reasonably likely to materially affect, the

Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information required with respect to the directors of the Company is set forth under the caption "Election of Directors" in the Company's definitive Proxy Statement to be filed on or about March 16, 2007, and is incorporated by reference.

A listing of Eaton's elected executive officers, their ages, positions and offices held over the past five years, as of January 31, 2007, follows:

Name	Age	Position (Date elected to position)
Alexander M. Cutler	55	Chairman and Chief Executive Officer; President (August 1, 2000 - present) Director (September 22, 1993 - present)
Richard H. Fearon	50	Executive Vice President - Chief Financial and Planning Officer (April 24, 2002 - present) Partner, Willow Place Partners LLC (2001-2002)
Craig Arnold	46	Senior Vice President and President - Fluid Power Group (October 25, 2000 - present)
Stephen M. Buente	56	Senior Vice President and President - Automotive Group (August 21, 2000 - present)
Randy W. Carson	56	Senior Vice President and President - Electrical Group (January 1, 2000 - present)
James E. Sweetnam	54	Senior Vice President and President - Truck Group (July 1, 2001 - present)
William W. Blausey, Jr.	42	Vice President - Chief Information Officer (January 25, 2006 - present) Vice President - Information Technology, Fluid Power (January 1, 2005 - January 24, 2006) Group Director - IT (August 16, 2001 - December 31, 2004)
Susan J. Cook	59	Vice President - Human Resources (January 16, 1995 - present)

Name	Age	Position (Date elected to position)
Earl R. Franklin	63	Vice President and Secretary

		(April 24, 2002 - present) Secretary and Associate General Counsel (September 1, 1991 - April 23, 2002)
Richard D. Holder	43	Vice President - Eaton Business System (May 1, 2006 - present) Vice President and General Manager, Power Distribution and Assemblies Division, Electrical Group (August 1, 2004 - April 30, 2006) Vice President, Supply Chain and Operational Excellance, Electrical Group (July 16, 2001 - July 31, 2004)
Donald J. McGrath, Jr.	54	Vice President - Communications (January 25, 2006 - present) Vice President, Corporate Communications, BASF Corporation (2002 -2005)
Mark M. McGuire	49	Vice President and General Counsel (December 1, 2005 - present) Vice President and Deputy General Counsel, International Paper Company (2003 - 2005) Associate General Counsel, International Paper Company (March 2001 - 2003)
John S. Mitchell	50	Vice President - Taxes (November 22, 1999 - present)
Billie K. Rawot	55	Vice President and Controller (March 1, 1991 - present)
Ken D. Semelsberger	45	Vice President - Corporate Development and Treasury (February 22, 2006 - present) Vice President - Strategic Planning (April 28, 1999 - February 21, 2006)
Yannis P. Tsavalas	51	Vice President and Chief Technology Officer (February 14, 2005 - present) General Manager, Global Lighting Technology, General Electric Company (2004 - 2005) Global Technology Leader, GE Lighting, General Electric Company (2003-2004) Global Product Line Manager, GE Lighting, General Electric Company (August 2000 - 2003)

There are no family relationships among the officers listed, and there are no arrangements or understandings pursuant to which any of them were elected as officers. All officers hold office for one year and until their successors are elected and qualified, unless otherwise specified by the Board of Directors; provided, however, that any officer is subject to removal with or without cause, at any time, by a vote of a majority of the Board of Directors.

Information required with respect to compliance with Section 16(a) of the Exchange Act is set forth under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's definitive Proxy Statement to be filed on or about March 16, 2007, and is incorporated by reference.

The Company has adopted a Code of Ethics, which applies to the Directors, officers (including its Chairman and Chief Executive Officer; President, Executive Vice President--Chief Financial and Planning Officer, and Vice

President and Controller) and employees worldwide. This document is available on the Company's website at http://www.eaton.com.

There were no changes during fourth quarter 2006 to the procedures by which security holders may recommend nominees to the Company's Board of Directors.

Information related to the Company's Audit Committee, and members of the Committee that are financial experts, is set forth under the caption "Board Committees - Audit Committee" in the Company's definitive Proxy Statement to be filed on or about March 16, 2007, and is incorporated by reference.

ITEM 11. EXECUTIVE COMPENSATION

Information required with respect to executive compensation is set forth under the caption "Executive Compensation" in the Company's definitive Proxy Statement to be filed on or about March 16, 2007, and is incorporated by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information required with respect to security ownership of certain beneficial owners is set forth under the caption "Share Ownership Tables" in the Company's definitive Proxy Statement to be filed on or about March 16, 2007, and is incorporated by reference.

EQUITY COMPENSATION PLANS

The following table summarizes information, as of December 31, 2006, relating to equity compensation plans of the Company pursuant to which grants of options, restricted stock, deferred compensation units or other rights to acquire Company Common Shares may be granted from time to time.

Plan category	(A) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(B) Weighted-average exercise price of outstanding options, warrants and rights	(C) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (A))
Equity compensation plans approved by security holders (1)	13,647,357(3)	$48.01(5)	5,184,978
Equity compensation plans not approved by security holders (2)	1,749,829(4)	N/A	N/A
Total	15,397,186	$48.01(5)	5,184,978

(1) These plans are the Company's 2004 Stock Plan, 2002 Stock Plan, 1998 Stock Plan, 1995 Stock Plan, and the Incentive Compensation Deferral Plan (the

"IC Deferral Plan").

(2) The 2005 Non-Employee Director Fee Deferral Plan (the "2005 Plan"), the 1996 Non-Employee Director Fee Deferral Plan (the "1996 Plan"), the Deferred Incentive Compensation Plan (the "DIC Plan"), the Deferral Incentive Compensation Plan II (the "DIC Plan II") and the Incentive Compensation Deferral Plan II (the "IC Deferral Plan II") are not considered "equity compensation plans" requiring shareholder approval under the rules of the New York Stock Exchange. Under the 2005 Plan, all non-employee directors are entitled to defer payment of their fees and allocate the deferred amounts between short-term deferred fees and retirement deferred fees, which differ in terms of earnings and method and timing of distribution. Short-term deferred fees are credited with interest based on the quarterly average yield of the 13-week U.S. Treasury bill and are distributable in cash. As specified by the director, between 50% and 100% of deferred amounts allocated to retirement deferred fees are converted into Company share units that earn Company Common Share price appreciation plus dividend equivalents, and are distributable in Company Common Shares. The portion of a Director's retirement deferred fees that are not converted to Company share units earn 10-year U.S. Treasury note returns plus 300 basis points and are distributable in cash. Under the 2005 Plan, plan participants must elect the method and timing of payment with respect to the fees that are to be deferred. For short-term deferred fees, participants may elect to receive distributions in a lump sum or in equal annual installments over a period not to exceed five years commencing in the year selected by the plan

participant, which cannot be earlier than the second year following the calendar year in which fees are deferred. For retirement deferred fees, plan participants may elect to receive distributions in a lump sum or in equal annual installments over a period not to exceed 15 years following retirement. Director fees earned subsequent to December 31, 2004 are not eligible for deferral under the 1996 Plan. Instead, the 2005 Plan is available for the deferral of these fees. Under the 1996 Plan, the Governance Committee determines, upon the participant's retirement or other termination of services as a director, whether fees deferred are distributable in a lump sum or in equal annual installments and whether the amounts converted to Company share units are distributable in cash or Company Common Shares. Both the 2005 Plan and the 1996 Plan provide for accelerated payout upon the occurrence of certain events, including those involving a change in control of the Company. Under the DIC Plan, participants, including officers and other eligible executives, were able to defer receipt of their annual incentive compensation award as either short-term deferrals (to be paid out in five years or less) or retirement compensation. Amounts deferred as retirement compensation earn the greater of Company share price appreciation plus dividend equivalents or 13-week U.S. Treasury bill returns until paid. This determination is made at the time of each payment, whether made in a lump sum or installments. Short-term deferrals earn 13-week U.S. Treasury bill returns. Amounts deferred as retirement compensation which are converted to Company share units are payable in Company Common Shares, either in a lump sum or periodic installments, as determined by the Company's Corporate Compensation Committee which is comprised of Company officers. Annual incentive compensation earned subsequent to December 31, 2004 is not eligible for deferral under the DIC Plan. Instead, the DIC Plan II is available for the deferral of this compensation. Compensation deferred under the DIC Plan II is credited with earnings in the same manner as the

DIC Plan, as described above. However, participants under the DIC Plan II, prior to the beginning of each calendar year, must elect the method and timing of payment with respect to the compensation to be earned in that year that is subject to the deferral election. Similarly, long-term incentive compensation earned subsequent to December 31, 2004 is not eligible for deferral under the IC Deferral Plan. Instead, the IC Deferral Plan II is available for the deferral of this compensation. Under the IC Deferral Plan II, participants, including officers and other eligible executives, may defer the receipt of awards received under long-term incentive compensation plans as either short-term deferrals (to be paid out in five years or less) or retirement compensation. As selected by the participant, between 50% and 100% of awards deferred as Retirement Compensation are credited as Company share units that earn Company Common Share price appreciation plus dividend equivalents and that are distributed in the form of Company Common Shares. The portion of a participant's Retirement Compensation that is not converted to Company share units earns interest at a rate equal to the average yield on 10-year U.S. Government Treasury Notes plus 300 basis points. Amounts deferred as short-term deferrals earn interest at a rate equal to the quarterly average yield of 13-week U.S. Government Treasury Bills. Under the IC Deferral Plan II, prior to the beginning of any award period for which an award may be earned, participants must elect the method and timing of payment with respect to compensation to be earned during that award period and that is subject to the deferral election. Participants were able to defer the full amount of eligible cash compensation under the 2005 Plan, the 1996 Plan and the EIC Plan. To the extent cash compensation is deferred pursuant to any of the Plans described herein, the Company may be able to preserve the deductibility of the compensation under Section 162(m) of the Internal Revenue Code that otherwise may be unavailable.

(3) Includes an aggregate of 228,965 restricted shares, 1,988,714 performance-vested stock options and 441,897 shares underlying stock units, payable on a one-for-one basis, credited to accounts as of December 31, 2006 under the Incentive Compensation Deferral Plan.

(4) Represents shares underlying stock units, payable on a one-for-one basis, credited to accounts as of December 31, 2006 under the 2005 Plan, the 1996 Plan, the DIC Plan, the DIC Plan II and the IC Deferral Plan II.

(5) Weighted average exercise price of outstanding stock options; excludes restricted stock and deferred compensation share units.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

None required to be reported.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information required with respect to principal accountant fees and services is set forth under the caption "Audit Committee Report" in the Company's definitive Proxy Statement to be filed on or about March 16, 2007, and is incorporated by reference.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1) The report of the independent registered public accounting firm, consolidated financial statements and notes to consolidated financial statements, included in this report are included in Item 8 above:

Report of Independent Registered Public Accounting Firm - Page 18

Statements of Consolidated Income - Years ended December 31, 2006, 2005 and 2004 - Page 22

Consolidated Balance Sheets - December 31, 2006 and 2005 - Page 23

Statements of Consolidated Cash Flows - Years ended December 31, 2006, 2005 and 2004 - Page 24

Statements of Consolidated Shareholders' Equity - Years ended December 31, 2006, 2005 and 2004 - Pages 25 and 26

Notes to Consolidated Financial Statements - Pages 27 through 51

(2) All schedules for which provision is made in Regulation S-X of the SEC are not required under the related instructions or are inapplicable and, therefore, have been omitted.

(3) Exhibits

3(i) Amended Articles of Incorporation (amended and restated April 27, 1994) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002

3(ii) Amended Regulations (amended and restated April 26, 2000) - Incorporated by reference to the Form 10-Q Report for the six months ended June 30, 2000

4(a) Instruments defining rights of security holders, including indentures (Pursuant to Regulation S-K Item 601(b)(4), the Company agrees to furnish to the Commission, upon request, a copy of the instruments defining the rights of holders of long-term debt)

10 Material contracts

(a) Master Purchase and Sale Agreement by and between PerkinElmer, Inc. and Eaton Corporation dated October 6, 2005 - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2005

(b) Purchase Agreement between V.G.A.T. Investors, LLC and Eaton Corporation dated as of December 24, 2006 - Filed in conjunction with this Form 10-K Report

(c) Executive Incentive Compensation Plan (effective January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2005

(d) 2005 Non-Employee Director Fee Deferral Plan (effective January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2004

(e) Deferred Incentive Compensation Plan II (effective January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2004

(f) Excess Benefits Plan II (effective January 1, 2005) -

Incorporated by reference to the Form 10-K Report for the year ended December 31, 2004

(g) Incentive Compensation Deferral Plan II (effective January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2004

(h) Limited Eaton Service Supplemental Retirement Income Plan II (effective January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2004

(i) Supplemental Benefits Plan II (effective January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2004

(j) Form of Restricted Share Award Agreement - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2004

(k) Form of Stock Option Agreement for Executives - Filed in conjunction with this Form 10-K Report

(l) Form of Stock Option Agreement for Non-Employee Directors - Incorporated by reference to the Form 8-K Report filed January 26, 2007

(m) 2004 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 19, 2004

(n) Amendment to the Plan (originally adopted in 1985) for the Deferred Payment of Directors' Fees (effective January 1, 2005) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2004

(o) Plan for the Deferred Payment of Directors' Fees (originally adopted in 1985 and amended effective September 24, 1996, January 28, 1998, January 23, 2002, and February 24, 2004) - Incorporated by reference to the Form 10-Q Report for the three months ended March 31, 2004

(p) Limited Eaton Service Supplemental Retirement Income Plan (amended and restated January 1, 2003) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002

(q) Vehicle Allowance Program (effective January 1, 2003) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2003

(r) 2002 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 15, 2002

(s) 1996 Non-Employee Director Fee Deferral Plan (amended and restated effective January 1, 2005) - Filed in conjunction with this Form 10-K Report

(t) Form of Change of Control Agreement entered into with officers of

Eaton Corporation - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002

(u) Form of Indemnification Agreement entered into with officers of Eaton Corporation - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002

(v) Form of Indemnification Agreement entered into with directors of Eaton Corporation - Incorporated by reference to the Form 8-K Report filed January 26, 2007

(w) Executive Strategic Incentive Plan I (amended and restated January 1, 2007) - Filed in conjunction with this Form 10-K Report

(x) Executive Strategic Incentive Plan II (effective January 1, 2001) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002

(y) Deferred Incentive Compensation Plan (amended and restated March 31, 2000) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2000

(z) 1998 Stock Plan - Incorporated by reference to the definitive Proxy Statement dated March 13, 1998

(aa) Incentive Compensation Deferral Plan (amended and restated October 1, 1997) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2000

(bb) Trust Agreement - Officers and Employees (dated December 6, 1996) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002

(cc) Trust Agreement - Outside Directors (dated December 6, 1996) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002

(dd) 1995 Stock Plan - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002

(ee) Group Replacement Insurance Plan (GRIP) (effective June 1, 1992) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 1992

(ff) 1991 Stock Option Plan - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002

(gg) Excess Benefits Plan (amended and restated effective January 1, 1989) (with respect to Section 415 limitations of the Internal Revenue Code) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002

(hh) Supplemental Benefits Plan (amended and restated January 1, 1989) (which provides supplemental retirement benefits) - Incorporated by reference to the Form 10-K Report for the year ended December 31, 2002

12 Ratio of Earnings to Fixed Charges - Filed in conjunction with this Form 10-K Report

14 Code of Ethics - Incorporated by reference to the definitive Proxy Statement to be filed on or about March 16, 2007

21 Subsidiaries of Eaton Corporation - Filed in conjunction with this Form 10-K Report

23 Consent of Independent Registered Public Accounting Firm - Filed in conjunction with this Form 10-K Report

24 Power of Attorney - Filed in conjunction with this Form 10-K Report

31.1 Certification of Form 10-K (Pursuant to the Sarbanes-Oxley Act of 2002, Section 302) - Filed in conjunction with this Form 10-K Report

31.2 Certification of Form 10-K (Pursuant to the Sarbanes-Oxley Act of 2002, Section 302) - Filed in conjunction with this Form 10-K Report

32.1 Certification of Form 10-K (Pursuant to the Sarbanes-Oxley Act of 2002, Section 906) - Filed in conjunction with this Form 10-K Report

32.2 Certification of Form 10-K (Pursuant to the Sarbanes-Oxley Act of 2002, Section 906) - Filed in conjunction with this Form 10-K Report

(b) Exhibits

Certain exhibits required by this portion of Item 15 are filed as a separate section of this Form 10-K.

(c) Financial Statement Schedules

None required to be filed.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Eaton Corporation
Registrant

Date: February 28, 2007

/s/ Richard H. Fearon

Richard H. Fearon
Executive Vice President -
Chief Financial and Planning Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Date: February 28, 2007

Signature	Title
* Alexander M. Cutler	Chairman and Chief Executive Officer; President; Director
* Billie K. Rawot	Vice President and Controller; Principal Accounting Officer
* Christopher M. Connor	Director
* Michael J. Critelli	Director
* Charles E. Golden	Director
* Ernie Green	Director
* Ned C. Lautenbach	Director
* Deborah L. McCoy	Director
* John R. Miller	Director
* Gregory R. Page	Director
*	Director

Victor A. Pelson

*   Director

Gary L. Tooker

* By /s/ Richard H. Fearon

     Richard H. Fearon, Attorney-in-Fact
     for the officers and directors
     signing in the capacities indicated

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors & Shareholders
Eaton Corporation

We have audited the accompanying consolidated balance sheets of Eaton Corporation as of December 31, 2006 and 2005, and the related statements of consolidated income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006. 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 in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Eaton Corporation at December 31, 2006 and 2005, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with United States generally accepted accounting principles.

As discussed in "Retirement Benefit Plans" in the Notes to the Consolidated Financial Statements, effective December 31, 2006, the Company adopted Statement of Financial Accounting Standards (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)".

As discussed in "Stock Options" in the Notes to the Consolidated Financial Statements, effective January 1, 2006, Eaton adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), "Share-Based Payment".

We also have audited in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Eaton Corporation's internal control over financial reporting as of December 31, 2006, based on criteria established in INTERNAL CONTROL - INTEGRATED FRAMEWORK issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 23, 2007 expressed an unqualified opinion thereon.

Ernst & Young LLP

Cleveland, Ohio
February 23, 2007

MANAGEMENT'S REPORT ON FINANCIAL STATEMENTS

We have prepared the accompanying consolidated financial statements and related information of Eaton Corporation included herein for the three years ended December 31, 2006. The primary responsibility for the integrity of the financial information included in this annual report rests with management. The financial information included in this annual report has been prepared in accordance with accounting principles generally accepted in the United States based on our best estimates and judgments and giving due consideration to materiality. The opinion of Ernst & Young LLP, Eaton's independent registered public accounting firm, on those financial statements is included herein.

Eaton has high standards of ethical business practices supported by the Eaton Code of Ethics and corporate policies. Careful attention is given to selecting, training and developing personnel, to ensure that management's objectives of establishing and maintaining adequate internal controls and unbiased, uniform reporting standards are attained. Our policies and procedures provide reasonable assurance that operations are conducted in conformity with law and with the Company's commitment to a high standard of business conduct.

The Board of Directors pursues its responsibility for the quality of Eaton's financial reporting primarily through its Audit Committee, which is composed of five independent directors. The Audit Committee meets regularly with management, the internal auditors and the independent registered public accounting firm to ensure that they are meeting their responsibilities and to discuss matters concerning accounting, control, audits and financial reporting. The internal auditors and independent registered public accounting firm have full and free access to senior management and the Audit Committee.

Alexander M. Cutler	Richard H. Fearon	Billie K. Rawot
Chairman and Chief Executive Officer; President	Executive Vice President - Chief Financial and Planning Officer	Vice President and Controller

February 23, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors & Shareholders
Eaton Corporation

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Eaton Corporation maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in INTERNAL CONTROL -

INTEGRATED FRAMEWORK issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Eaton Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Eaton Corporation maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also in our opinion, Eaton Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Eaton Corporation as of December 31, 2006 and 2005, and the related statements of consolidated income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006 and our report dated February 23, 2007 expressed an unqualified opinion thereon.

Ernst & Young LLP

Cleveland, Ohio
February 23, 2007

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Eaton Corporation is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act rules 13a-15(f)).

Under the supervision and with the participation of Eaton's management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. In conducting this evaluation, we used the framework set forth by the Committee of Sponsoring Organizations of the Treadway Commission in INTERNAL CONTROL - INTEGRATED FRAMEWORK. Based on this evaluation under the framework referred to above, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2006.

The independent registered public accounting firm Ernst & Young LLP has issued an audit report on management's assessment of the effectiveness of the Company's internal control over financial reporting as of December 31, 2006. This report is included herein.

Alexander M. Cutler	Richard H. Fearon	Billie K. Rawot
Chairman and Chief Executive Officer; President	Executive Vice President - Chief Financial and Planning Officer	Vice President and Controller

February 23, 2007

EATON CORPORATION
STATEMENTS OF CONSOLIDATED INCOME

	Year ended December 31		
(Millions except for per share data)	2006	2005	2004
NET SALES	$12,370	$11,019	$9,712
Cost of products sold	9,050	7,936	7,002
Selling & administrative expense	1,946	1,753	1,583
Research & development expense	321	285	259
Interest expense-net	104	90	79
Other (income) expense-net	(40)	(33)	21
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	989	988	768
Income taxes	77	189	128
INCOME FROM CONTINUING OPERATIONS	912	799	640
Income from discontinued operations, net of income taxes	38	6	8
NET INCOME	$ 950	$ 805	$ 648

NET INCOME PER COMMON SHARE ASSUMING DILUTION			
Continuing operations	$ 5.97	$ 5.19	$ 4.07
Discontinued operations	.25	.04	.06
	$ 6.22	$ 5.23	$ 4.13
Average number of Common Shares outstanding assuming dilution	152.9	154.0	157.1
NET INCOME PER COMMON SHARE BASIC			
Continuing operations	$ 6.07	$ 5.32	$ 4.18
Discontinued operations	.25	.04	.06
	$ 6.32	$ 5.36	$ 4.24
Average number of Common Shares outstanding basic	150.2	150.2	153.1
CASH DIVIDENDS PAID PER COMMON SHARE	$ 1.48	$ 1.24	$ 1.08

The notes on pages 27 to 51 are an integral part of the consolidated financial statements.

EATON CORPORATION
CONSOLIDATED BALANCE SHEETS

	December 31	
(Millions of dollars)	2006	2005
ASSETS		
Current assets		
Cash	$ 114	$ 110
Short-term investments	671	226
Accounts receivable	1,928	1,785
Inventories	1,293	1,099
Deferred income taxes	267	243
Other current assets	135	115
	4,408	3,578
Property, plant & equipment		
Land & buildings	1,083	1,003
Machinery & equipment	3,863	3,652
	4,946	4,655
Accumulated depreciation	(2,675)	(2,480)
	2,271	2,175
Goodwill	3,034	3,139
Other intangible assets	969	626
Deferred income taxes & other assets	735	700
	$11,417	$10,218

LIABILITIES & SHAREHOLDERS' EQUITY		
Current liabilities		
Short-term debt	$ 490	$ 394
Current portion of long-term debt	322	240
Accounts payable	1,050	810
Accrued compensation	305	277
Accrued income & other taxes	149	305
Other current liabilities	1,091	942
	3,407	2,968
Long-term debt	1,774	1,830
Pension liabilities	942	632
Other postretirement liabilities	766	537
Other long-term liabilities	422	473
Shareholders' equity		
Common Shares (146.3 million outstanding in 2006 and 148.5 million in 2005)	73	74
Capital in excess of par value	2,114	2,013
Retained earnings	2,796	2,376
Accumulated other comprehensive loss	(849)	(649)
Deferred compensation plans	(28)	(36)
	4,106	3,778
	$11,417	$10,218

The notes on pages 27 to 51 are an integral part of the consolidated financial statements.

EATON CORPORATION
STATEMENTS OF CONSOLIDATED CASH FLOWS

	Year ended December 31		
(Millions)	2006	2005	2004
NET CASH PROVIDED BY OPERATING ACTIVITIES			
Net income	$ 950	$ 805	$ 648
Adjustments to reconcile to net cash provided by operating activities			
Depreciation & amortization	434	409	400
Deferred income taxes	37	(20)	(133)
Pension liabilities	198	145	86
Gain on sales of businesses	(56)		
Other long-term liabilities	(45)	4	55
Other non-cash items in income	33	(1)	(1)
Changes in working capital, excluding acquisitions & sales of businesses			
Accounts receivable	(40)	(104)	(218)

Inventories	(129)	(28)	(102)
Accounts payable	185	25	143
Accrued income & other taxes	(149)	27	46
Other current liabilities	72	(29)	(122)
Other working capital accounts	77	(37)	76
Voluntary contributions to United States & United Kingdom qualified pension plans	(119)	(64)	(93)
Other-net	(17)	3	53
	1,431	1,135	838
NET CASH (USED IN) INVESTING ACTIVITIES			
Expenditures for property, plant & equipment	(360)	(363)	(330)
Cash paid for acquisitions of businesses	(256)	(911)	(627)
Proceeds from sales of businesses	65		
(Purchases) sales of short-term investments-net	(418)	(4)	606
Other-net	(42)	10	18
	(1,011)	(1,268)	(333)
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES			
Borrowings with original maturities of more than three months			
Proceeds	706	393	75
Payments	(617)	(63)	(248)
Borrowings with original maturities of less than three months-net, primarily commercial paper	(35)	392	(33)
Cash dividends paid	(220)	(184)	(163)
Proceeds from exercise of employee stock options	108	68	138
Income tax benefit from exercise of employee stock options	28		
Purchase of Common Shares	(386)	(450)	(250)
Other		2	
	(416)	158	(481)
Total increase in cash	4	25	24
Cash at beginning of year	110	85	61
Cash at end of year	$ 114	$ 110	$ 85

The notes on pages 27 to 51 are an integral part of the consolidated financial statements.

EATON CORPORATION
STATEMENTS OF CONSOLIDATED SHAREHOLDERS' EQUITY

(Millions)	Common Shares		Capital in excess of par value	Retained earnings	la c s
	Shares	Dollars			
BALANCE AT JANUARY 1, 2004	153.0	$76	$1,856	$1,816	

Net income				648
Foreign currency translation and related hedging instruments (including income tax benefits of $5)				
Unrealized loss on available for sale investments (net of income tax benefits of $1)				
Deferred loss on cash flow hedges (net of income tax benefits of $1)				
Minimum pension liability (net of income tax benefits of $25)				
Other comprehensive income				
Total comprehensive income				
Cash dividends paid				(163)
Issuance of shares under employee benefit plans, including tax benefit	4.5	3	188	(2)
Issuance of shares to trust			2	
Purchase of shares	(4.2)	(2)	(53)	(195)
Other-net				8
	-----	---	------	------
BALANCE AT DECEMBER 31, 2004	153.3	77	1,993	2,112
Net income				805
Foreign currency translation and related hedging instruments (including income taxes of $33)				
Deferred gain on cash flow hedges (net of income taxes of $2)				
Minimum pension liability (net of income tax benefits of $36)				
Other comprehensive loss				
Total comprehensive income				
Cash dividends paid				(184)
Issuance of shares under employee benefit plans, including tax benefit	2.1	1	104	(2)
Issuance of shares to trust	.1		8	
Purchase of shares	(7.0)	(4)	(92)	(354)
Other-net				(1)
	-----	---	------	------

BALANCE AT DECEMBER 31, 2005	148.5	74	2,013	2,376
Net income				950
Foreign currency translation and related hedging instruments (including income tax benefits of $16)				
Deferred gain on cash flow hedges (net of income tax benefits of $3)				
Minimum pension liability (net of income tax benefits of $1)				
Other comprehensive income				
Total comprehensive income				
Adjustment to initially apply SFAS No. 158				

Pensions (net of income tax benefits of $85)				
Other postretirement benefits (net of income tax benefits of $119)				
Cash dividends paid				(220)
Issuance of shares under employee benefit plans, including tax benefit	3.1	2	176	(2)
Purchase of shares by trust				
Purchase of shares	(5.3)	(3)	(75)	(308)
BALANCE AT DECEMBER 31, 2006	146.3	$73	$2,114	$2,796

The notes on pages 27 to 51 are an integral part of the consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Dollars in millions, except per share data (per share data assume dilution)

ACCOUNTING POLICIES

CONSOLIDATION & BASIS OF PRESENTATION

The consolidated financial statements include accounts of Eaton and all subsidiaries and other controlled entities. The equity method of accounting is used for investments in associate companies where the Company has a 20% to 50% ownership interest. These associate companies are not material either individually, or in the aggregate, to Eaton's financial position, results of operations or cash flows.

Eaton does not have off-balance sheet arrangements or financings with unconsolidated entities or other persons. In the ordinary course of business, the Company leases certain real properties and equipment, as described in "Lease Commitments" in the Notes below. Transactions with related parties are in the ordinary course of business, are conducted on an arm's-length basis, and are not material to Eaton's financial position, results of operations or cash flows.

FOREIGN CURRENCY TRANSLATION

The functional currency for substantially all subsidiaries outside the United States is the local currency. Financial statements for these subsidiaries are translated into United States dollars at year-end exchange rates as to assets and liabilities and weighted-average exchange rates as to revenues and expenses. The resulting translation adjustments are recorded in Accumulated other comprehensive income (loss) in Shareholders' equity.

INVENTORIES

Inventories are carried at lower of cost or market. Inventories in the United States are generally accounted for using the last-in, first-out (LIFO) method. Remaining United States and all other inventories are accounted for using the first-in, first-out (FIFO) method. Cost components include raw materials, purchased components, direct labor, indirect labor, utilities, depreciation, inbound freight charges, purchasing and receiving costs, inspection costs, warehousing costs, internal transfer costs, and costs of the distribution network.

In first quarter 2006, Eaton adopted Statement of Financial Accounting Standards (SFAS) No. 151, "Inventory Costs". SFAS No. 151 amends the guidance in Accounting Research Bulletin No. 43, Chapter 4, "Inventory Pricing", to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). The effect of the adoption of SFAS No. 151 was not material to the Company's financial position, results of operations, or cash flows.

DEPRECIATION & AMORTIZATION

Depreciation and amortization are computed by the straight-line method for financial statement purposes. Cost of buildings is depreciated over 40 years and machinery and equipment over principally 3 to 10 years. At December 31, 2006, the weighted-average amortization periods for intangible assets subject to amortization were 14 years for patents, 18 years for tradenames, 28 years for distributor channels and 18 years for manufacturing technology and customer relationships. Software is amortized over a range of 3 to 5 years.

Long-lived assets, except goodwill and indefinite life intangible assets as described in the Notes below, are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount may not be recoverable. Events or circumstances that would result in an impairment review primarily include operations reporting losses, a significant change in the use of an asset, or the planned disposal or sale of the asset. The asset would be considered impaired when the future net undiscounted cash flows generated by the asset are less than its carrying value. An impairment loss would be recognized based on the amount by which the carrying value of the asset exceeds its fair value.

GOODWILL & INDEFINITE LIFE INTANGIBLE ASSETS

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets", Eaton does not amortize goodwill and indefinite life intangible assets recorded in connection with business acquisitions. Indefinite life intangible assets primarily consist of trademarks. The Company completed the annual impairment tests for goodwill and indefinite life intangible assets required by SFAS No. 142. These tests confirmed that the fair value of the Company's reporting units and indefinite life intangible assets exceed their respective carrying values and that no impairment loss was required to be recognized.

FINANCIAL INSTRUMENTS

In the normal course of business, Eaton is exposed to fluctuations in interest rates, foreign currency exchange rates, and commodity prices. The Company uses various financial instruments, primarily foreign currency forward exchange contracts, foreign currency swaps, interest rate swaps and, to a minor extent, commodity futures contracts, to manage exposure to price fluctuations.

Financial instruments used by Eaton are straightforward, non-leveraged instruments for which quoted market prices are readily available from a number of independent sources. The risk of credit loss is deemed to be remote, because the counterparties to these instruments are major international financial institutions with strong credit ratings and because of the Company's control over the size of positions entered into with any one counterparty. Such financial instruments are not bought and sold solely for trading purposes, except for nominal amounts authorized under limited, controlled circumstances.

No such financial instruments were purchased or sold for trading purposes in 2006, 2005 and 2004.

All derivative financial instruments are recognized as either assets or liabilities on the balance sheet and are measured at fair value. Accounting for the gain or loss resulting from the change in the financial instrument's fair value depends on whether it has been designated, and is effective, as a hedge and, if so, on the nature of the hedging activity. Financial instruments can be designated as hedges of changes in the fair value of a recognized fixed-rate asset or liability, or the firm commitment to acquire such an asset or liability; as hedges of variable cash flows of a recognized variable-rate asset or liability, or the forecasted acquisition of such an asset or liability; or as hedges of foreign currency exposure from a net investment in one of the Company's foreign operations. Gains and losses related to a hedge are either recognized in income immediately to offset the gain or loss on the hedged item or are deferred and reported as a component of Accumulated other comprehensive income (loss) in Shareholders' equity and subsequently recognized in net income when the hedged item affects net income. The ineffective portion of the change in fair value of a financial instrument is recognized in income immediately. The gain or loss related to financial instruments that are not designated as hedges are recognized immediately in net income.

WARRANTY EXPENSES

Estimated product warranty expenses are accrued in Cost of products sold at the time the related sale is recognized. Estimates of warranty expenses are based primarily on historical warranty claim experience and specific customer contracts. Warranty expenses include accruals for basic warranties for products sold, as well as accruals for product recalls and other related events when they are known and estimable.

ASSET RETIREMENT OBLIGATIONS

In 2005, the FASB issued Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" (FIN 47), to clarify the term "conditional asset retirement" as used in SFAS No. 143, "Accounting for Asset Retirement Obligations". FIN 47 requires that a liability be recognized for the fair value of a conditional asset retirement obligation when incurred, if the fair value of the liability can be reasonably estimated. Uncertainty about the timing or method of settlement of a conditional asset retirement obligation would be factored into the measurement of the liability when sufficient information exists. Eaton believes that for substantially all of its asset retirement obligations, there is an indeterminate settlement date because the range of time over which the Company may settle the obligation is unknown or cannot be estimated. A liability for these obligations will be recorded in the period when sufficient information regarding timing and method of settlement becomes available to make a reasonable estimate of the liability's fair value.

STOCK OPTIONS GRANTED TO EMPLOYEES & DIRECTORS

As described in "Stock Options" in the Notes below, effective January 1, 2006, in accordance with SFAS No. 123(R), "Share-Based Payment", Eaton has recorded compensation expense under the "fair-value-based" method of accounting for stock options granted to employees and directors. The Company adopted SFAS No. 123(R) using the "modified prospective application" method and, consequently, financial results for periods prior to 2006 were not restated for this accounting change. Under the modified prospective method, compensation expense for stock options includes expense for all options granted prior to, but not yet vested as of the end of 2005, and expense for options granted beginning in 2006, based on the grant date fair value of the options. Expense is recognized on a straight-line basis over the period the employee or director is required to provide service in exchange for the award. Prior to 2006, as allowed by SFAS No. 123, "Accounting for Stock-Based Compensation", stock options were accounted for using the intrinsic-value-based method in Accounting Principles Board (APB) Opinion No.

25. Under that method, no compensation expense was recognized on the grant date, since on that date the option exercise price equaled the market price of the underlying Common Shares.

REVENUE RECOGNITION

Sales are recognized when products are shipped to unaffiliated customers, all significant risks of ownership have been transferred to the customer, title has transferred in accordance with shipping terms (FOB shipping point or FOB destination), the selling price is fixed and determinable, all significant related acts of performance have been completed, and no other significant uncertainties exist. Shipping and handling costs billed to customers are included in Net sales and the related costs in Cost of products sold. Other revenues for service contracts are recognized as the services are provided.

ESTIMATES

Preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying consolidated financial statements and notes. Actual results could differ from these estimates.

FINANCIAL PRESENTATION CHANGES

Certain amounts for prior years have been reclassified to conform to the current year presentation.

ACQUISITIONS OF BUSINESSES

In 2006, 2005, and 2004, Eaton acquired certain businesses and formed joint ventures in separate transactions for a combined net cash purchase price of $256 in 2006, $911 in 2005 and $627 in 2004. The Statements of Consolidated Income include the results of these businesses from the effective dates of acquisition or formation. A summary of these transactions for 2006 and 2005, and larger transactions in 2004, follows:

Acquired business	Date of acquisition	Busine segmen
Schreder-Hazemeyer Eaton acquired the remaining 50% ownership of the Belgium manufacturer of low and medium voltage electrical distribution switchgear	December 1, 2006	Electri
Diesel fuel processing technology & associated assets of Catalytica Energy Systems Inc. A U.S. developer of emission control solutions for Trucks	October 26, 2006	Truck
Senyuan International Holdings Limited A China-based manufacturer of vacuum circuit breakers and	September 14, 2006	Electri

other electrical switchgear components		
Ronningen-Petter business unit of Dover Resources, Inc. A U.S.-based manufacturer of industrial fine filters and components	September 5, 2006	Fluid Po
Synflex business unit of Saint-Gobain Performance Plastics Corp. A U.S.-based manufacturer of thermoplastic hose and tubing	March 31, 2006	Fluid Po
Marina Power & Lighting A U.S. manufacturer of marine duty electrical distribution products	March 24, 2006	Electri
Aerospace division of PerkinElmer, Inc. A U.S.-based provider of sealing and pneumatic systems for large commercial aircraft and regional jets	December 6, 2005	Fluid Po

Aerospace fluid and air division of Cobham plc A U.K.-based company that provides low-pressure airframe fuel systems, electro-mechanical actuation, air ducting, hydraulic and power generation, and fluid distribution systems for fuel, hydraulics and air	November 1, 2005	Fluid Po
Assets of Pringle Electrical Manufacturing Company A U.S. manufacturer of bolted contact switches and other specialty switches	October 11, 2005	Electri
Industrial filtration business of Hayward Industries, Inc. A U.S.-based producer of filtration systems for industrial and commercial customers	September 6, 2005	Fluid Po
Tractech Holdings, Inc. A U.S.-based manufacturer of specialized differentials and clutch components for the commercial and specialty vehicle markets	August 17, 2005	Automot
Morestana S.A. de C.V. A Mexican producer of hydraulic lifters for automotive engine manufacturers and the automotive aftermarket	June 30, 2005	Automot
Eaton Electrical (Zhongshan) Co., Ltd. (a 51%-owned joint venture) A China-based manufacturer of medium-voltage switchgear components, including circuit breakers, meters and relays	June 17, 2005	Electri
Winner Group Holdings Ltd. A China-based producer of hydraulic hose fittings and adapters	March 31, 2005	Fluid Po

Pigozzi S.A. Engrenagens e Transmissoes A Brazilian agricultural powertrain business that produces transmissions, rotors and other drivetrain components	March 1, 2005	Truck
Walterscheid Rohrverbindungstechnik GmbH A German manufacturer of hydraulic tube connectors and fittings primarily for the European market	September 1, 2004	Fluid Po
Powerware Corporation A U.S.-based supplier of Uninterruptible Power Systems (UPS), DC Power products and power quality services for computer manufacturers, industrial companies, governments, telecommunications firms, medical institutions, data centers and other businesses	June 9, 2004	Electri
FAW Eaton Transmission Co., Ltd. (a 50%-owned joint venture) Manufacturer of medium-duty transmissions for the China market	March 31, 2004	Truck

The allocations of the purchase prices for acquisitions in 2006 are preliminary and will be finalized in 2007.

On December 28, 2006, Eaton announced it had reached an agreement to purchase AT Holdings Corporation, the parent of Argo-Tech Corporation, for $695. This transaction is expected to close in the first quarter of 2007. Argo-Tech's U.S.-based aerospace business, which had sales for the fiscal year ended October 28, 2006 of $206, is a leader in high performance aerospace engine fuel pumps and systems, airframe fuel pumps and systems, and ground fueling systems for commercial and military aerospace markets. This business will be integrated into the Fluid Power segment.

On January 5, 2007, the Company announced it had reached an agreement to purchase the Power Protection Business of Power Products Ltd., a Czech distributor and service provider of Powerware and other uninterruptible power systems, for $2. The transaction closed in February 2007. This business, which had 2006 sales of $3, will be integrated into the Electrical segment.

As described above, on June 9, 2004, Eaton acquired Powerware Corporation, the electrical power systems business of Invensys plc, for a final cash purchase price of $573, less cash acquired of $27. Powerware's assets and liabilities were recorded at estimated fair values as determined by Eaton's management. The allocation of the purchase price for this acquisition is summarized below:

Current assets	$302
Property, plant & equipment	35
Goodwill	397
Other intangible assets	96
Other assets	53
Total assets acquired	883
Total liabilities assumed	337
Net assets acquired	$546

Other intangible assets of $96 included $24 related to trademarks that are not subject to amortization. The remaining $72 was assigned to patents and other intangible assets that have a weighted-average useful life of 8 years. Goodwill of $397 relates to the Electrical segment, substantially all of which is non-deductible for income tax purposes.

Eaton has undertaken restructuring activities at acquired businesses, including workforce reductions, plant consolidations and facility closures. In accordance with EITF Issue No. 95-3, "Recognition of Liabilities in Connection with a Purchase Business Combination," liabilities for these restructuring activities were recorded in the allocation of the purchase price related to the acquired business. A summary of these liabilities, and utilization of the various components, follows:

	Workforce Reductions		Plant closing & other	Total
	Employees	Dollars		
Balance at January 1, 2004	763	$ 22	$ 63	$ 85
Liabilities recorded in 2004	175	9	35	44
Utilized in 2004	(555)	(18)	(48)	(66)
Balance at December 31, 2004	383	13	50	63
Liabilities recorded in 2005	789	25	27	52
Utilized in 2005	(228)	(14)	(40)	(54)
Balance at December 31, 2005	944	24	37	61
Liabilities recorded in 2006	417	17	28	45
Utilized in 2006	(285)	(8)	(43)	(51)
Balance at December 31, 2006	1,076	$ 33	$ 22	$ 55

In accordance with EITF Issue No. 95-3, the Company finalizes its restructuring plans no later than one year from the date of the acquisition.

ACQUISITION INTEGRATION & EXCEL 07 PLANT CLOSING CHARGES

ACQUISITION INTEGRATION CHARGES

In 2006, 2005 and 2004, Eaton incurred charges related to the integration of acquired businesses. These charges were recorded as expense as incurred. A summary of these charges follows:

	2006	2005	2004
Electrical	$ 7	$ 21	$ 33
Fluid Power	23	7	8

Truck	5	4	
Automotive	5	4	
Pretax charges	$ 40	$ 36	$ 41
After-tax charges	$ 27	$ 24	$ 27
Per Common Share	$.17	$.15	$.17

2006 CHARGES

Charges in 2006 related to the integration of primarily the following acquisitions: Powerware, the electrical power systems business acquired in 2004 and the Pringle electrical switch business; several acquisitions in Fluid Power including the acquired operations of Synflex, PerkinElmer, Cobham, Hayward, Winner, and Walterscheid; and the Pigozzi, Tractech, and Morestana businesses.

Charges in the Electrical segment consisted of $7 for plant consolidations, integration and other expenses.

Charges in the Fluid Power segment consisted of $20 for plant consolidations, integration and other expenses, and $3 for workforce reductions.

Charges in the Truck segment consisted of $5 for plant consolidations, integration and other expenses.

Charges in the Automotive segment consisted of $5 for plant consolidations, integration and other expenses.

2005 CHARGES

Charges in 2005 related to the integration of primarily the following acquisitions: Powerware and the electrical division of Delta plc; several acquisitions in Fluid Power, including Winner, Walterscheid and Boston Weatherhead; and the Pigozzi and Morestana businesses.

Charges in the Electrical segment consisted of $20 for plant consolidations, integration and other expenses, and $1 for workforce reductions.

Charges in the Fluid Power segment consisted of $7 for plant consolidations, integration and other expenses.

2004 CHARGES

Charges in 2004 related to the integration of primarily the following acquisitions: Powerware; the electrical division of Delta plc; and Boston Weatherhead.

Charges in the Electrical segment consisted of $32 for plant consolidations, integration and other expenses, and $1 of workforce reductions.

Charges in the Fluid Power segment consisted of $8 for plant consolidations, integration and other expenses.

EXCEL 07 PLANT CLOSING CHARGES

In first quarter 2006, Eaton announced, and began to implement, its Excel 07 program. This program was a series of actions concluded in 2006 intended to address resource levels and operating performance in businesses that underperformed in 2005, and businesses that were expected to weaken during second half 2006 and in 2007. As part of the Excel 07 program, charges were incurred related to plant closings in all four business segments, including three significant plant closings announced in third quarter 2006 for the heavy-duty truck transmission manufacturing plant in Manchester, United Kingdom; the engine valve actuation manufacturing plant in Saginaw, Michigan; and the engine valve manufacturing plant in Montornes del Valles, Spain. A summary of charges incurred by each segment in

2006 related to Excel 07 plant closings, including workforce reductions, plant integration and other charges follow:

Electrical	$ 12
Fluid Power	15
Truck	29
Automotive	50
Pretax charges	$106

SUMMARY OF ACQUISITION INTEGRATION AND EXCEL 07 PLANT CLOSING CHARGES

A summary of acquisition integration and Excel 07 plant closing charges, and utilization of the various components follows:

	Workforce reductions		Plant closing	
	Employees	Dollars	& other	Total
Balance at January 1, 2004	21	$ 2	$ 8	$ 10
Charges in 2004	10	1	40	41
Utilized in 2004	(31)	(3)	(45)	(48)
Balance at December 31, 2004	0	0	3	3
Charges in 2005	173	4	32	36
Utilized in 2005	(7)	(1)	(34)	(35)
Balance at December 31, 2005	166	3	1	4
Charges in 2006	2,339	85	61	146
Utilized in 2006	(902)	(39)	(56)	(95)
Balance at December 31, 2006	1,603	$ 49	$ 6	$ 55

The acquisition integration and Excel 07 plant closing charges were included in the Statements of Consolidated Income in Cost of products sold or Selling & administrative expense, as appropriate. In Business Segment Information, the charges reduced Operating profit of the related business segment.

DISCONTINUED OPERATIONS

As part of the Excel 07 program, in third quarter 2006, certain businesses of the Automotive segment were sold, resulting in a $35 after-tax gain, or $.23 per Common Share. The gain on sale of these businesses, and other operating results of these businesses, were reported as Discontinued operations in the Statement of Consolidated Income.

SHORT-TERM INVESTMENTS

Eaton invests excess cash generated from operations in short-term marketable investments and classifies these investments as "available-for-sale" under Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities". In accordance with SFAS No. 115, available-for-sale investments are recorded at fair market prices, with the unrealized gain or loss recorded in Accumulated other comprehensive income (loss) in Shareholders' equity. A summary of the carrying value of short-term investments at December 31, 2006 follows:

Time deposits & certificate of deposits with banks	$323
Bonds issued by foreign governments	149
Money market investments	138
Corporate & agency bonds	60
Other	1
	$671

The fair market value of short-term investments approximates the cost of these investments.

GOODWILL & OTHER INTANGIBLE ASSETS

A summary of goodwill follows:

	2006	2005
Electrical	$1,039	$1,016
Fluid Power	1,689	1,811
Truck	144	145
Automotive	162	167
	$3,034	$3,139

The net decrease in goodwill in 2006 was due to the final allocation of purchase price to acquisitions of businesses completed prior to 2006, partially offset by increases in goodwill for businesses acquired during 2006. These transactions are described in the "Acquisitions of Businesses" Note above.

A summary of other intangible assets follows:

	2006	2005

	Historical cost	Accumulated amortization	Historical cost	Accumulated amortization
Intangible assets not subject to amortization (primarily trademarks)	$430		$381	
Intangible assets subject to amortization				
Patents	$208	$107	$191	$ 90
Technology and customer relationships	337	57	101	26
Other	204	46	108	39
	$749	$210	$400	$155

Expense related to intangible assets subject to amortization for 2006 was $51. Estimated annual pretax expense for intangible assets subject to amortization for each of the next five years is $50 in 2007, $49 in 2008, $47 in 2009, $44 in 2010 and $40 in 2011.

DEBT & OTHER FINANCIAL INSTRUMENTS

Short-term debt of $490 at December 31, 2006 included $472 of short-term commercial paper for operations in the United States and $18 for operations outside the United States. Borrowings for operations in the United States included 200 million of Euro denominated commercial paper. The foreign exchange translation gain or loss related to the Euro denominated commercial paper is recorded in Accumulated other comprehensive income (loss) in Shareholders' equity since these borrowings serve as a hedge of the Company's net assets of operations in Europe. Borrowings for operations outside the United States were largely denominated in local currencies. The weighted-average interest rate on the $472 of short-term commercial paper was 4.4% at December 31, 2006. The weighted-average interest rate on short-term debt for operations outside the United States was 2.7% at December 31, 2006. Operations outside the United States have available short-term lines of credit aggregating $399 from various banks worldwide.

A summary of long-term debt, including the current portion, follows:

	2006	2005
1.62% Yen notes due 2006		$ 43
8% debentures due 2006		86
8.90% debentures due 2006		100
6% Euro 200 million notes due 2007 (100 million converted to floating rate by interest rate swap)	$ 263	236
7.37% notes due 2007 (converted to floating rate by interest rate swap)	20	20
7.14% notes due 2007	3	3
6.75% notes due 2007 (converted to floating rate by interest rate swap)	25	25

Euro 100 million floating rate notes due 2008		
(3.991% at December 31, 2006 - EURIBOR+.375%)	132	118
7.40% notes due 2009		
(converted to floating rate by interest rate swap)	15	15
Floating rate senior notes due 2009		
(5.53% at December 31, 2006 - LIBOR +.08%)	250	
5.75% notes due 2012		
($225 converted to floating rate by interest rate swap)	300	300
7.58% notes due 2012		
(converted to floating rate by interest rate swap)	12	12
5.80% notes due 2013	7	7
12.5% British Pound debentures due 2014	11	10
4.65% notes due 2015		
(converted to floating rate by interest rate swap)	100	100
7.09% notes due 2018		
(converted to floating rate by interest rate swap)	25	25
6.89% notes due 2018	6	6
7.07% notes due 2018	2	2
6.875% notes due 2018	3	3
8-7/8% debentures due 2019		
($25 converted to floating rate by interest rate swap)	38	38
8.10% debentures due 2022	100	100
7.625% debentures due 2024		
($25 converted to floating rate by interest rate swap)	66	66
6-1/2% debentures due 2025	145	145
7.875% debentures due 2026	72	72
7.65% debentures due 2029		
($75 converted to floating rate by interest rate swap)	200	200
5.45% debentures due 2034		
($100 converted to floating rate by interest rate swap)	150	150
5.25% notes due 2035		
($50 converted to floating rate by interest rate swap)	90	100
Other	61	88
Total long-term debt	2,096	2,070
Less current portion of long-term debt	(322)	(240)
Long-term debt less current portion	$1,774	$1,830

Eaton's United States operations have long-term revolving credit facilities of $1.5 billion, of which $300 will expire in May 2008, $700 in March 2010 and the remaining $500 in August 2011. One of the Company's international subsidiaries has a long-term line of credit of Euro 100 million. The Euro 100 million floating rate notes due 2008, which have a U.S. dollar equivalent of $132 at December 31, 2006, were borrowed under this line of credit.

Aggregate mandatory annual maturities of long-term debt for each of the next five years are $322 in 2007, $133 in 2008, $268 in 2009, $1 in 2010 and $6 in 2011. Interest paid was $151 in 2006, $113 in 2005 and $96 in 2004.

Eaton has entered into fixed-to-floating interest rate swaps to manage interest rate risk. These interest rate swaps are accounted for as fair value hedges of certain of the Company's long-term debt. The

maturity of the swap corresponds with the maturity of the debt instrument as noted in the table of long-term debt above. A summary of interest rate swaps outstanding at December 31, 2006, follows (currency in millions):

	Interest rates at December 31, 2006		
Notional amount	Fixed interest rate received	Floating interest rate paid	Basis for contracted floating interest rate paid
E 100	6.00%	4.10%	6 month EURIBOR+0.54%
$ 20	7.37%	9.85%	6 month LIBOR+4.47%
$ 25	6.75%	6.89%	6 month LIBOR+1.50%
$ 15	7.40%	7.34%	6 month LIBOR+1.95%
$225	5.75%	6.39%	6 month LIBOR+0.78%
$ 12	7.58%	7.15%	6 month LIBOR+1.76%
$100	4.65%	5.47%	6 month LIBOR+0.12%
$ 25	7.09%	7.79%	6 month LIBOR+2.40%
$ 25	8.88%	9.20%	6 month LIBOR+3.84%
$ 25	7.63%	7.85%	6 month LIBOR+2.48%
$ 75	7.65%	7.98%	6 month LIBOR+2.58%
$100	5.45%	5.83%	6 month LIBOR+0.43%
$ 50	5.25%	5.52%	6 month LIBOR+0.17%

The carrying values of cash, short-term investments and short-term debt in the balance sheet approximate their estimated fair values. The estimated fair values of other financial instruments outstanding follow:

	2006			2005		
	Notional amount	Carrying value	Fair value	Notional amount	Carrying value	Fair value
Long-term debt & current portion of long-term debt (a)		$(2,096)	$(2,213)		$(2,070)	$(2,221
Foreign currency principal swaps	$192	(5)	(5)	$ 83	(2)	(2
Foreign currency forward exchange contracts	(23)	(6)	(7)	12	5	5
Fixed to floating interest rate swaps	829	(15)	(14)	1,080	12	12

(a) Includes foreign currency denominated debt.

The estimated fair values of financial instruments were principally based on quoted market prices where such prices were available and, where unavailable, fair values were estimated based on comparable contracts, utilizing information obtained from established, independent providers. The fair value of foreign currency principal swaps, which related to the Euro and Pound Sterling, and foreign currency forward exchange con