

# RETE ELETTRICA NAZIONALE





## Highlights



### MBI

Terna has switched from predictive to "on-condition" maintenance and this has been possible due to, among other things, the use of a specialized IT system named MBI (Monitor Business Intelligence). This system processes all the information required to draw up diagnostics, which is automatically received from the remote control system and from the on-line sensors installed on components. Upon completion of the checks performed by technical staff, in accordance with the specific engineering models implemented, the system provides precise recommendations as to the most appropriate interventions to perform also indicating their priority, based on assessment of the technical-economic risk involved.





### Life Work

Terna continues to develop techniques that allow intervention to be carried out without disconnection of voltage supply. This means that maintenance can be performed while the plant is still in operation, thanks to the use of special equipment and strict operating procedures, which allow specialized workers to intervene on lines that are still transmitting electricity, while fully guaranteeing their safety. Terna is currently the only Company in Italy authorized to perform HV and VHV power line maintenance in this way.



## Quality Keys

The main quality indicators of the electricity supply service once again confirm that Terna has provided excellent service levels over the year 2004.

**ASA** (Average System Availability)

**Result: 99.15%**

Average real availability of all the NTN network elements in the year.

**AIT** (Average Interruption Time)

**Result: 1.389 min/year**

Average time of electricity system supply interruption in the year.

**SAIFI** (System Average Interruption Frequency Index)

**Result: 0.22**

Average number of supply interruptions per consumer directly connected to the NTN in the year.

The organization, procedures and work methods used, combined with the technological and process innovations introduced during the year, have enabled the Company to achieve these results while implementing continual reduction of operating costs.





### High-voltage power substations

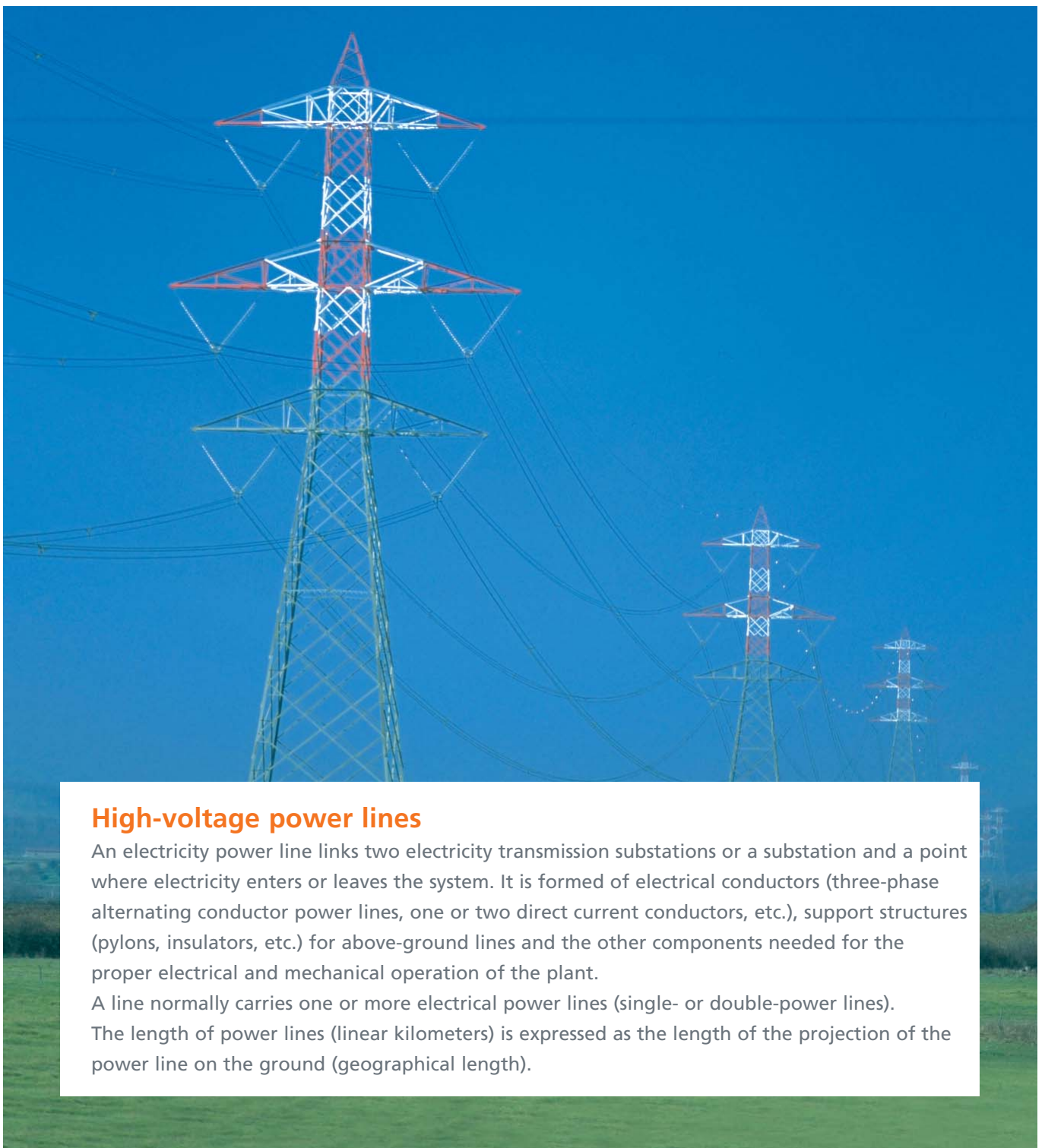
An electricity transmission and switching substation is part of an electricity network. Located in a specific part of the network, it serves to dispatch electricity among the various power lines in the network and to transfer electricity between different voltage networks.



300 high- and  
very high-voltage

transmission substations across the country.





### High-voltage power lines

An electricity power line links two electricity transmission substations or a substation and a point where electricity enters or leaves the system. It is formed of electrical conductors (three-phase alternating conductor power lines, one or two direct current conductors, etc.), support structures (pylons, insulators, etc.) for above-ground lines and the other components needed for the proper electrical and mechanical operation of the plant.

A line normally carries one or more electrical power lines (single- or double-power lines). The length of power lines (linear kilometers) is expressed as the length of the projection of the power line on the ground (geographical length).





38,696 km

of high- and very high-voltage power lines.

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## Board of Directors, Board of Statutory Auditors and Independent Auditors

### Board of Directors

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*Chairman*

Fulvio Conti

*Chief Executive Officer*

Sergio Mobili

*Directors*

Luca Arnaboldi

Paolo Cantarella

Davide Croff

Claudio Machetti

Salvatore Machì

Massimo Romano

Paolo Ruzzini

Salvatore Sardo

*Secretary to the Board*

Filomena Passeggio

### Board of Statutory Auditors

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*Chairman*

Giovanni Ferreri

*Acting Auditors*

Bruno Franceschetti

Giancarlo Russo Corvace

*Alternate Auditors*

Daniela Gallucci

Fabrizio Orazi

### Independent Auditors

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KPMG SpA



## Structure of powers

### *Board of Directors*

The Board of Directors is vested by the By-laws with the widest powers for the ordinary and extraordinary business of the Company and, specifically, it has the authority to carry out all the acts which it deems expedient for the fulfilment and achievement of the corporate purpose, excluding only those acts which the law and the By-laws reserve for the shareholders in general meeting.

### *Chairman of the Board of Directors*

Pursuant to the By-laws, the Chairman is empowered to legally represent the Company and sign on its behalf, chair the general meetings, call and chair the Board of Directors and verify the implementation of the resolutions adopted by said Board. On the basis of the Board resolution dated March 3, 2004, the Chairman is also acknowledged certain powers of a non-operational nature, such as the function of overseeing the Company's management policies and the handling of the managerial staff, as well as overseeing the auditing activities.

### *Chief Executive Officer*

The Chief Executive Officer is also empowered to legally represent the Company and sign on its behalf as a result of the By-laws, and is also vested, on the basis of the Board resolution dated March 3, 2004, with all the powers for the administration of the Company, with the exception of those otherwise assigned by the law, by the By-laws or reserved for the Board of Directors in accordance with the same resolution.

## Letter to stakeholders



Dear Terna Stakeholder,

The year 2004 has been for your Company not only one of challenge with respect to the stock exchange listing, but also one of important changes to the framework of applicable regulations and rules. In addition, there has been an expansion to the scope of consolidation and optimization of the Company's equity structure. In this year, Terna has shown that it knows how to achieve significant results, developing a strategy directed at operational excellence through increased efficiency, optimization of investments and quality of service. These operational leverages will provide a strong contribution to the Group's value growth in the next few years.

During the month of June, the Terna listing process has concluded: 50% of the share capital was placed on the market by way of an IPO directed to the general Italian public and at the same time a private placement directed at Italian and foreign institutional investors. From 23 June, the Terna shares were listed on the electronic equity market organized and run by Borsa Italia (the "MTA"). Terna has been included in the MIB30, S&P/MIB market indexes and in the European Dow Jones STOXX 600 and MSCI indexes.

The Terna listing process has involved significant organizational and managerial changes directed at ensuring the autonomous management of the Company. Further, once listed, Terna adopted a Corporate Governance system in line with the recommendations contained in the Self-disciplinary Code provided by Borsa Italiana. Specifically, in order to guarantee minority shareholder representation, the number of Board of Directors members has been changed from seven to ten, including three independent Directors. In addition, the internal audit and remuneration committees have been set up.

With resolution no. 5 dated 30 January 2004, the Electricity and Gas Authority ("AEEG") approved the tariff regulations related to the regulatory period 2004-2007. The tariffs have been set with reference to the acknowledged cost components, the regulatory value of fixed assets associated with the grid infrastructures (Regulatory Asset Base – RAB) and their remuneration (6.7%). The AEEG, in order to ensure the conditions associated with the National Transmission Network (NTN) development requirements, has further envisaged a remuneration rate increased by 2% compared to the RAB remuneration rate for development operations.

The new tariff regulation has contributed to stabilizing the value of our activities and has provided the basis for solid future growth.

During the last year, even the regulatory framework outlined by Law no. 290 of October 27, 2003, has made important changes necessary. On May 11, 2004, a Decree of the Prime Minister was issued providing the criteria, terms and conditions of the property merger and management of the electricity transmission grid. Last January 31, in observance of the provisions of the above-mentioned Decree, our Company's Extraordinary Shareholders' Meeting approved the required amendments to the By-laws and on February 28, a contract was signed for the transfer to Terna of



the Independent System Operator (ISO) business segment. However, the contract's effectiveness has not yet been determined.

In 2004, net growth was registered compared to 2003 and quality of service and grid reliability targets were surpassed. It was the first financial year in which the shareholdings in the Brazilian company Transmissora Sudeste Nordeste SA (100%) and Novatrans Energia SA (100%) had been consolidated. The companies are owners of two VHV transmission lines in Brazil. One of these lines was completed during 2004.

Revenues reached euro 1.023 million, with a growth of 11% over the 2003 *pro forma* statements; the gross operating margin amounted to euro 683 million, with 9.6% growth. Operating income reached euro 512 million, registering an increase of 17.4%. Net income reached euro 236 million with 37% growth. These results, achieved also thanks to a favorable regulatory context and the important contribution of the Brazilian companies, enable us to offer a dividend distribution in line with the highest levels in the industry.

Maintenance of high returns by way of a suitable dividend policy, supported by significant and stable cash flow generation, represents the most important of the undertakings assumed toward the market at the time of listing. Again for 2005, operating results forecasted will enable us to maintain an attractive dividend policy, which was made even more interesting by the Company's undertaking to distribute dividends twice a year.

The solid equity base and limited level of risk that characterize the Group have received confirmation in the excellent evaluations expressed by the Standard & Poor's and Moody's rating agencies (AA-/A1 + Aa3/P1) and by the successful fixed-rate euro bond issue for an overall amount of 1.4 billion in the month of October.

Today, the Terna Group faces a future full of increasingly difficult challenges. In the next few months, the merger of the NTN property and management will be completed and the announced reduction to the Enel SpA shareholding in the resulting merged entity will be accomplished. This will involve an increase in activities that Terna has carried out up to now, acquisition of new capabilities in terms of grid and energy flow management and complete autonomy with respect to Enel Group.

In 2005, management will continue its focus on efficiency and quality of service. We constantly measure ourselves against costs and the quality offered by the leading operators on the world energy market. We have set ambitious operating, financial and strategic objectives for each of the next few years with the goal of maintaining a high level of profitability that will ensure continued growth to the Group's value.

The Chief Executive Officer

Sergio Mobili  


## Notice to the Shareholders' Meeting

The Shareholders' Meeting is called in ordinary and extraordinary session at the Enel Congress Center in Viale Regina Margherita 125, Rome, on April 1, 2005 at 11.00 a.m. in first calling and, if necessary, on April 2, 2005, at the same time and place, in second calling, in order to discuss and vote on the following

### AGENDA

#### Ordinary business:

1. Financial Statements as of December 31, 2004. Reports of the Board of Directors, the Board of Statutory Auditors and the Independent Auditors. Related resolutions. Presentation of the Consolidated Financial Statements as of December 31, 2004.
2. Allocation of the net income for the year.
3. Appointment of the Board of Statutory Auditors.
4. Establishment of the remuneration of the effective members of the Board of Statutory Auditors.

#### Extraordinary business:

1. Authorization of the Board of Directors to increase the share capital up to a maximum extent of Euro 2,200,000, by means of the issue of ordinary shares reserved for the executives of Terna SpA and/or of companies controlled by the latter, to be allocated by means of offer under subscription against payment and with the exclusion of the purchase option pursuant to the combined provisions of Article 2441, last section of the Italian Civil Code and Article 134.2 of Italian Legislative Decree no. 58 dated February 24, 1998. Related and consequent resolutions. Amendments of Article 5 of the By-laws.

The Chairman of the Board of Directors  
*Fulvio Conti*

The notice of convocation of the ordinary and extraordinary shareholders' meeting is published in the Official Gazette of the Italian Republic, Part II, no. 48 dated February 28, 2005.

## Summary of the Resolutions of the Ordinary and Extraordinary Shareholders' Meeting

The ordinary part of the Shareholders' Meeting of Terna SpA, held in first call on April 1, 2005 in Rome, at the Enel Congress Center in Viale Regina Margherita, 125:

- > approved the Financial Statements of Terna SpA at December 31, 2004;
  - > acknowledged the figures of the Consolidated Financial Statements of the Terna Group, likewise relating to December 31, 2004, which closed with net earnings of euro 236,000,000;
  - > passed a resolution to appropriate Terna SpA's net earnings for 2004, equal to euro 674,263,934.91 in the following manner:
    - a) to the extent of euro 3,508,779.75 to meet legal reserve requirements;
    - b) to the extent of euro 90,000,000 to cover the *interim* dividend for the year 2004 – equal to euro 0.045 for each of the 2,000,000,000 ordinary shares – available for payment as from October 21, 2004, subject to prior detachment of coupon no. 1 on October 18, 2004;
    - c) to the extent of euro 140,000,000 as payment of the dividend for the year 2004, to be distributed in the amount of euro 0.070 for each of the 2,000,000,000 ordinary shares and to be available for payment – gross of any withholdings required by law – as from May 26, 2005, with “detachment date” of coupon no. 2 set for May 23, 2005;
    - d) to the extent of euro 440,755,155.16 as “retained earnings”;
  - > renewed the Board of Statutory Auditors, which shall remain in office until approval of the 2007 Financial Statements, appointing the following gentlemen:
    - Giovanni Ferreri, Chairman;
    - Giancarlo Russo Corvace, Acting Auditor;
    - Roberto Tasca, Acting Auditor;
    - Bruno Franceschetti, Alternate Auditor;
    - Vito Di Battista, Alternate Auditor;
- establishing the relative remuneration as euro 55,000 *p.a.* for the Chairman and as euro 45,000 *p.a.* for the other Acting Auditors, as well as specific reimbursement costs.

In the extraordinary part of the same Shareholders' Meeting a resolution was also passed to entrust the Board of Directors, for a five year period, with the authority to increase, in one or more instances, the share capital for a maximum amount of euro 2,200,000, by way of issue of a maximum of 10,000,000 ordinary shares with par value of euro 0.22 each, *cum coupon*, to be offered for subscription against payment to senior management of the Terna Group.



## Terna and the financial markets

Stockmarket and share highlights	2004
Unit Dividend (euro) <sup>(1)</sup>	0.115
Maximum IPO price	2.14
Minimum IPO price	1.70
Average price for December	2.05
Stockmarket capitalization <sup>(2)</sup> (millions of euro)	4,108
No. of shares (in millions)	2,000

<sup>(1)</sup> Of which, 0.045 euro distributed as an advance payment and 0.7 euro to be distributed during 2005.

<sup>(2)</sup> Calculated on the average price for December.

Other financial ratios	Current <sup>(3)</sup>	2004
Terna share weight		
> on the MIB30 index (%)	0.93%	0.98%
> on the S&P/MIB index (%)	0.75%	0.77%
<b>Rating</b>		
Standard & Poor's	Outlook M/L term Short term	stable AA- A1+
Moody's	Outlook M/L term Short term	stable Aa3 Prime1

<sup>(3)</sup> As of March 7, 2005.

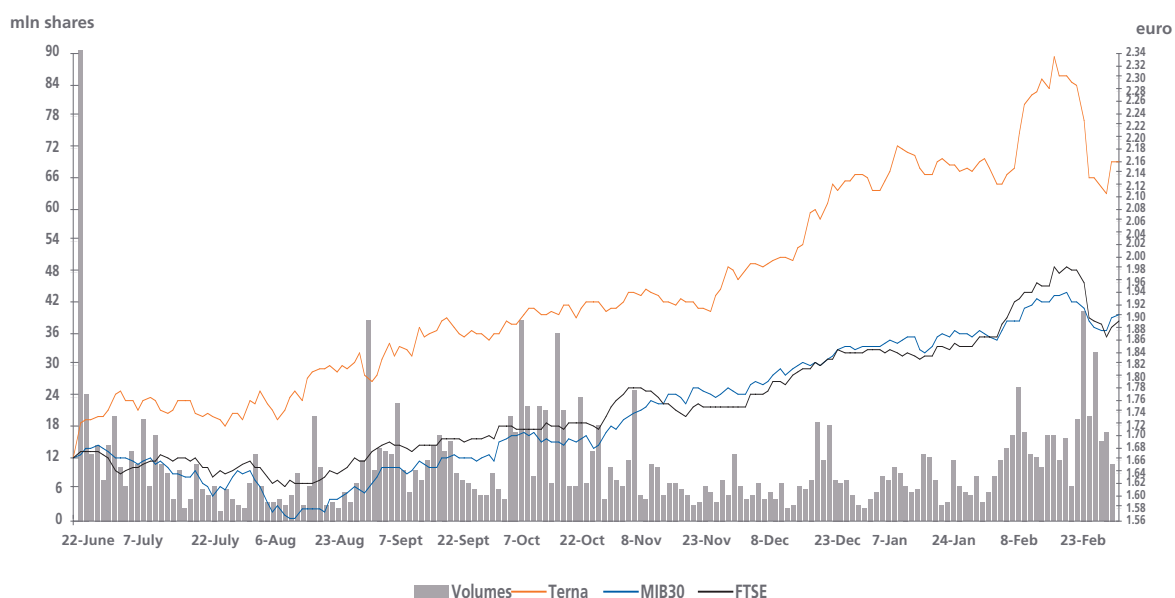
Ordinary Terna SpA stock has been listed since June 23, 2004 on the Electronic equity market organized and run by Borsa Italiana (the "MTA"). As from September 20, 2004 the stock was included on the MIB30 and S&P/MIB stockmarket indexes with quotas of 0.98% and 0.77% respectively. Terna is also present on the European Dow Jones STOXX 600 and MSCI stockmarket indexes.

During 2004, Terna stock registered a substantial appreciation of its share price, rising from euro 1.761 per share on the first day of listing to a value of euro 2.11 as of December 30, thus disclosing a positive variation of around 19.8%. During the same period, the Italian MIB30 index and the average of the other listed European electricity companies, represented by the FT-SE E300 Electricity index, both disclosed a positive change of around 11 percentage points.

The average daily volumes traded during the year came to around 9.5 million shares or 0.5% of the share capital. For further information, please visit the area relating to Investor Relations on the website (<http://www.enel.it/it/terna/>, sezione investor relations) where the following are available: economic-financial figures, presentations, updates in real time on the share performance, information concerning the composition of the Directors and Officers and the general Shareholders' Meeting regulations, as well as periodic updates concerning corporate governance developments.

Steps have also been taken to set up links specifically dedicated to non-institutional investors (telephone numbers: 06/8305 8376 and 06/8305 9206; e-mail address: [azionisti.retail@terna.it](mailto:azionisti.retail@terna.it)) and to institutional investors (telephone number: 06/8305 7145; e-mail address: [investor.relations@terna.it](mailto:investor.relations@terna.it)).

### Terna stock and MIB30 e FT-SE Electricity Index Performance



Source: Bloomberg





## **Statutory Financial Statements of Terna SpA**



## **Report on operations of Terna SpA**



## Introduction

The present report on operations, drawn up to accompany the Financial Statements for the year as at 31 December 2004, provide the information required under Article 2428 of the Italian Civil Code as well as the information considered necessary for completeness and to supply an adequate explanatory note on the Company.

Pursuant to Article 82 of the CONSOB Resolution no. 11971/1999, the Company availed of the exemption from publishing the quarterly report as of December 31, 2004.

### Significant events in 2004

> The Shareholders' Meeting, held on January 28, 2004, resolved to reduce Terna SpA's share capital, in accordance with Article 2445 of the Italian Civil Code, from euro 2,036,050,000.00 to euro 440,000,000.00 by means of the reimbursement of the capital for euro 1,200,000,000.00 as well as by means of setting aside euro 396,050,000.00 to reserves subject to the cancellation and consequent reduction of the number of ordinary shares making up the share capital from 2,036,050,000 to 2,000,000,000 and the simultaneous reduction of the par value of said shares from euro 1.00 (one point nought) to euro 0.22 (nought point twenty-two) each. This resolution was recorded in the Companies' Register on January 29, 2004 and therefore became fully effective as from April 29, 2004, since there were no objections raised by the creditors.

> During June, the process for Terna's listing was concluded. A total of 870 million shares were placed on the market, equating to 43.5% of the Company's share capital, which are joined by a further 130 million shares offered under option to the global co-ordinators (so-called greenshoe, exercised on June 29) for a total of one billion shares, corresponding to 50% of Terna's share capital. The placement of the Terna shares occurred by means of public offer (IPO) targeted at the Italian general public and by means of a simultaneous private placement addressing institutional investors in Italy and abroad.

The final offer price was set at euro 1.7 per share corresponding to an equity value of euro 3.4 billion. As from June 23, Terna shares were listed on the Electronic equity market organized and run by Borsa Italiana ("MTA").

Terna has sustained some of the placement costs at the same time benefiting from said costs, specifically the costs for the institutional communications campaign prior to the subscription phase, incurring during the year charges of around euro 10 million recorded in the Income Statement for the period.

> Immediately after the close of the Offer, the Company adopted a system of Corporate Governance in line with the recommendations contained in the Code of Self-governance drawn up by Borsa Italiana SpA, for the purposes of facilitating the integration within the Board of Directors of members who can be classified as independents as well as for the formation of the Committees for Remuneration and for Internal Auditing, bodies anticipated and recommended by said Code.

> On September 2, 2004 Terna obtained the following assessments from the rating agencies Standard & Poor's and Moody's, both of whom indicated a stable outlook:

- Standard & Poor's :	AA-	long-term rating
	A1+	short-term rating
- Moody's:	Aa3	long-term rating
	Prime 1	short-term rating

These excellent assessments which confirm the equity soundness and the limited level of risk which characterize the Group, place Terna at the top among the companies in the sector at European level, and among the best ever in Italy.

> During the third quarter of 2004, the Company decided to allocate an advance payment on the 2004 dividend, a decision made on the basis of the results indicated in the half-year report approved by the Board of Directors' meeting held on September 6, 2004.

Therefore, in compliance with the provision of Article 2433 of the Italian Civil Code and Article 26.3 of the By-laws, the Board resolved to make the advance payment to the shareholders to the extent of euro 0.045 per share, involving a total outlay of euro 90 million.

The payment, gross of any legal withholdings, took place on October 21, 2004, with a detachment date for coupon no. 1 as of October 18, 2004.

> On October 12, 2004 Terna launched a fixed-rate Euro bond issue on the market for a sum total of euro 1.4 billion, in accordance with the matters resolved by the Board of Directors during the meeting held on September 6, 2004.

The operation is organized in two tranches amounting to euro 600 and euro 800 million, respectively with maturity dates of 10 and 20 years.

The ten-year bond, issued at 99.968, offers an annual dividend coupon of 4.25%, corresponding to a spread of 22 basis points on the swap rate of 10 years.

The twenty-year bond, 99.624, offers an annual dividend coupon of 4.90%, corresponding to a spread of 38 basis points on the swap rate of 20 years.

The placement, targeted at institutional investors and organized and supervised by Credit Suisse First Boston, JP Morgan and UBS, involved demand of more than 2 and a half times the offer, and participation by foreign investors of approximately 2/3rds.

Shareholders are reminded that the legislative framework relating to the transmission sector was amended by means of Italian Law no. 290/03 which anticipated the unification between the ownership and management of the National Transmission Network ("NTN") delegating the criteria, methods and conditions for the unification, the management, including therein the regulation of the voting rights, of the body emerging from the unification and its subsequent privatization, to a subsequent Decree of the Prime Minister ("DPCM").

It also laid down that as from July 1, 2007 no company operating in the sector involved in the production, importing, distribution and sale of electricity and natural gas, whether via subsidiary or parent companies or companies controlled by the same parent company, and in any event no

publicly controlled companies, may hold, directly or indirectly, shareholding of more than 20% of the capital of the companies who are owners of or manage national networks for the transportation of electricity and natural gas.

> By way of fulfilment of the matters established principally by the aforementioned Law no. 290 dated October 27, 2003 on the structure of the electricity transmission sector in Italy, the Prime Minister's Decree dated May 11, 2004 anticipated, amongst other aspects, the criteria, methods and conditions for the unification of the ownership and management of the NTN. More specifically, the following is anticipated:

- by October 31, 2005 all the activities, functions, assets and legal relationships, both active and passive, belonging to the ISO will be transferred to Terna, with a few exceptions;
- the aforementioned transfer will take place against payment. For this purpose, the ISO and Terna will agree upon the extent of the assets and legal relationships, the staff units to be transferred as well as the related value. Should an agreement fail to be reached by April 30, and if the transfer takes place by means of a purchase/sale contract, the determination of the price will be appraised by independent experts;
- as of the date of efficacy of this transfer, Terna will undertake the legal ownership and functions of the ISO, while the ISO and Terna will take steps to change their respective corporate names;
- the body deriving from the unification will have to carry out its management activities in accordance with the principles of neutrality and impartiality, without discrimination with regards to users or categories of users;
- by December 31, 2004 the ISO will draw up an integrated document, entitled "The Network transmission, dispatch, development and safety Code", containing the technical regulations for accessing and using the NTN.

In relation to the above, on the basis of the directives issued by the Electricity and Gas Authority under resolution no. 250/2004 relating to the adoption by the ISO of the Network Code pursuant to the aforementioned Prime Minister's Decree and on the basis of the observations made by the various operators regarding a first draft drawn up by the ISO and published for consultation purposes on its website on November 16, 2004, the ISO has forwarded the final version of this document to the Electricity and Gas Authority and the Ministry of Production Activities (MAP) for subsequent approval.

As far as the Company's management activities during 2004 were concerned, the following aspects are illustrated:

- Regulated Activities;
- Activities in non-regulated spheres;
- Vietti Reform;
- Subsidiary companies.



## Regulated Activities

### New Regulatory Period 2004-2007

By means of resolution no. 5 dated January 30, 2004 the Electricity and Gas Authority approved the tariff regulations relating to the second period of regulation 2004–2007. This resolution updates the tariff parameters established by the Electricity and Gas Authority resolution no. 228/2001 for the year 2004 (as from February), acknowledging the norms introduced by Italian Law no. 290/03 which established that the Electricity and Gas Authority – when defining the tariffs for the remuneration of the transport and distribution networks for the second period of regulation partly for the purposes of guaranteeing the growth requirements of the electricity service – must adopt criteria which includes the revaluation of the infrastructures, a risk-free rate of return which is at least in line with that of long-term Government securities, as well as a symmetric distribution between users and operators of the improved efficiencies achieved with respect to the objectives set using the price cap mechanism, applied to the tariff components intended to cover the operating costs and depreciation.

The fee for the transmission service is established by the Electricity and Gas Authority on the basis of the “recognized sector costs”, obtained from the average costs of the transmission companies. These costs represent the tariff calculation basis for the first year of each regulation period. The tariff thus calculated is then revised annually by the Electricity and Gas Authority on the basis of regulatory mechanisms differentiated on the components of the recognized cost which remunerate:

- > the operating costs and the amortization/depreciation, subject to the revision as a result of the change in the consumer price index for families of blue- and white-collar workers referring to the previous twelve months, and the annual rate of reduction (productivity recovery factor) fixed by the Electricity and Gas Authority equating to 2.5%; this cost item may also vary as a result of the assimilation in the mechanism of costs deriving from unforeseeable and exceptional events, from changes in the legislative framework and from the variation of the obligations relating to the general service, or from costs relating to measures controlling demand by means of the efficient use of the resources;
- > the remuneration of the capital recognized for regulatory purposes (the so-called RAB – Regulatory Asset Base), which is updated as from the second year of the present regulatory period on the basis of the following elements: the average annual rate of change of the deflatory factor for fixed gross investments reported by ISTAT (Central Statistics Institute); the expected rate of change of the electricity demand volumes in Italy; the rate of change associated with the net investments made by June 30 of the previous year; the rate of change associated with the additional remuneration acknowledged the growth initiatives realized.

The tariffs which remunerate the entire transmission sector (ISO plus all the network owners) are collected according to the following mechanism:

- > the producers pay the ISO an amount for each kWh introduced onto the network, while for the energy withdrawn from the network the distributing companies pay the ISO a special tariff component (CTR), transferred by the distributing companies to the end customers, differentiated by daily time bands (F1, F2, F3, F4);
- > the ISO deducts a portion from the total amount of the aforementioned payments to cover its running costs, recognized by means of a special tariff component subject to annual review;
- > the remaining amount is paid by the ISO to the owners of the various portions of the NTN, in proportion to the NTN ownership percentages and according to the matters anticipated by the operating agreements stipulated by the aforementioned owners with the ISO itself.

#### Year 2004

The individual amounts of the tariff components paid by the distributors and by the producers and of the tariff component covering the ISO's costs fixed by the AAEG (Resolution no. 05/2004) for 2004 (February-December), first year of the second period of regulation, are illustrated below on a comparative basis with the same figures for 2003, the last year of the 1<sup>st</sup> regulatory period:

	2004	2003
Fee due by the producers	€cent/kWh 0.0253	€cent/kWh 0.0253
Fee due by the distributors for time band F1	€cent/kWh 0.76	€cent/kWh 0.74
Fee due by the distributors for time band F2	€cent/kWh 0.49	€cent/kWh 0.48
Fee due by the distributors for time band F3	€cent/kWh 0.32	€cent/kWh 0.33
Fee due by the distributors for time band F4	€cent/kWh 0.14	€cent/kWh 0.16
Tariff component covering the costs of the ISO	€cent/kWh 0.0336	€cent/kWh 0.0407

With reference to the fees due from the distributors, it should also be mentioned that, by means of the same resolution no. 05/2004, the Electricity and Gas Authority also took steps to amend the definition of the F1, F2, F3 and F4 time bands for the second regulation period, albeit as from April 2004, concentrating the withdrawals remunerated by means of the most onerous tariff components in the Summer months.

Following the Electricity and Gas Authority resolution, the network usage fee relating to the first quarter of 2004 was calculated with the utilization of the time bands in force during 2003 and with the individual tariffs equating to the 2003 ones for January and the 2004 ones for February and March, while the remaining part of the year, in other words from April onwards, was calculated by applying both the new tariffs and the new time bands.

During 2004, the ISO took steps to determine the annual portion of the tariff revenues, pertaining to each individual Owner for the various years making up the first regulatory period 2000-2003, on the basis of the remuneration mechanism established by the Standard Agreement regulating the

dealings between the NTN Owners and the ISO. The average percentage of the revenues due to Terna for the aforementioned period came to around 93.5% against a provisional percentage of 94.1%, set by the Electricity and Gas Authority via letter dated January 2001, by means of which the ISO had taken steps to determine the portion of tariff revenues due to Terna. This led to the request by the ISO of a negative adjustment for the period 2002-2003 amounting to around euro 15.1 million.

As far as 2004 is concerned, the ISO has made it known that its provisional estimate of the NTN ownership percentage belonging to Terna has decreased further; the revenues from network usage fees for 2004 have therefore been adjusted to this new provisional percentage by means of the issue by Terna of a credit note in December.

#### Tariff review and amendments to the time bands for 2005

During July 2004, the Electricity and Gas Authority, in compliance with the tariff review criteria contained in Resolution no. 05/2004 and the related Technical Report, by means of Resolution no. 135/04 took steps to review the fee for the 2005 transmission service.

This tariff review was carried out by the Electricity and Gas Authority by applying the revision method illustrated in the report, specifically taking into account:

- > the rate of change in consumer prices for families of blue- and white-collar workers by ISTAT (Central Statistics Institute) in the previous twelve months equating to 2.2% for the tariff portion intended to cover the operating costs and amortization/depreciation;
- > the average annual rate of change of the deflatory factor for fixed gross investments reported by ISTAT (Central Statistics Institute) equating to 1.8%, the expected rate of increase in the electricity demand volumes in Italy equating to 1,5%, as well as the data transmitted by the individual owners relating to the growth investments implemented before June 30, 2004 for the tariff portion intended to remunerate the RAB.

On the basis of the matters illustrated above, the tariff components paid by the distributors and by the producers for the remuneration of the transmission service have thus been updated with respect those for 2004:

	2005	2004
Fee due by the producers	€cent/kWh 0.0254	€cent/kWh 0.0253
Fee due by the distributors for time band F1	€cent/kWh 0.77	€cent/kWh 0.76
Fee due by the distributors for time band F2	€cent/kWh 0.49	€cent/kWh 0.49
Fee due by the distributors for time band F3	€cent/kWh 0.32	€cent/kWh 0.32
Fee due by the distributors for time band F4	€cent/kWh 0.14	€cent/kWh 0.14
Tariff component covering the costs of the ISO	€cent/kWh 0.0336	€cent/kWh 0.0336

Lastly, shareholders are informed that by means of Resolution no. 235/04, the Electricity and Gas Authority took steps to review the distribution of the time bands for 2005. This review was carried out in order to take into account the calendar differences existing between 2004 and 2005, with particular reference to the differing arrangement of the midweek holidays.

#### Lombardy TAR ruling and consequent appeal before the Council of State

Resolution no. 05/2004 amended the system of the tariff bands, as from April 2004, moving the periods of greater remuneration from the Winter to the Summer period. As of July 27, 2004 the Lombardy TAR (Regional Administrative Court) upheld the appeal presented by several electricity customer consortiums against Resolution no. 05/2004 (2004-2007 tariffs) with regard to the part relating to the introduction of the new consumption time bands. On August 5, by means of Provisional Decree no. 3849/2004 the Council of State suspended the Lombardy TAR ruling, upon the proposal of the Electricity and Gas Authority, and confirmed this suspension during the joint sitting on August 31, 2004, fixing the hearing for the discussion of the merit for December 21, 2004. On December 21, 2004 the sixth section of the Council of State upheld the appeal presented by the Electricity and Gas Authority declaring the inadmissibility of the first degree appeal upheld by the Lombardy TAR therefore reinstating the validity, as from April 2004, the new time bands set forth by Resolution no. 05/2004.

#### Activities in non-regulated spheres

During 2004, Terna continued with its activities relating to the diversified businesses in non-regulated spheres, in the area of the running, maintenance, engineering and realization of high voltage plants, targeted at both customers outside the Enel Group and other Group companies. These activities are proceeding according to the programs already launched in previous accounting periods.

With reference to Enel Group customers, total revenues came to euro 48 million (euro 47.5 million in 2003) and mainly referred to agreements for the running and maintenance of HV plants belonging to Enel Distribuzione and to the fiber optics maintenance, development and laying agreements of the company Enel.Net Srl.

With regard to external customers, revenues recorded in the period amounted to approximately euro 18.8 million (euro 17.6 million in 2003) including around euro 9.5 million relating to plant engineering activities and about euro 5 million relating to HV plant management. In terms of market coverage (percentage of customers on the potential market served by the Company), the Terna share came to 49.3% or 229 customer out of 464, with a loyalty retention ratio of 69.6%.

## Vietti Reform

Italian Legislative Decree no. 6 dated January 17, 2003 – company law reform – anticipates among other things the abolition of the 2<sup>nd</sup> paragraph of Article 2426 of the Italian Civil Code – accounting policies –, which originally made it possible to carry out value adjustments and provisions exclusively for tax purposes, as well as the amendment of paragraph 14 of Article 2427 of the Italian Civil Code. The consequence of these amendments is that, as from January 1, 2004, the Financial Statements must be drawn up following the statutory regulations only.

In order to fully enforce the company reform, the Tax Legislator, as part of the more extensive tax law reform, by means of Italian Legislative Decree no. 344 dated December 12, 2003, established the possibility of making the tax deduction irrespective of the booking to the Income Statement of negative items such as: the amortization and depreciation of intangible and tangible fixed assets; other value adjustments and provisions.

The new provisions also apply to amortization and depreciation, to other value adjustments and to provisions made in accounting periods prior to that when the Italian Legislative Decree dated January 17, 2003 entered into force (January 1, 2004), consequently the Financial Statements as of December 31, 2004 acknowledge the effects of the aforementioned tax adjustment, which led to the recording in the Income Statement of net extraordinary income totaling euro 421.3 million.

## Subsidiary Companies

During the year, Terna carefully defined the organizational structure tasked with activities in Brazil. This structure, functional in type, organizes the staff in five divisions common to TSN and Novatrans, and determines the responsibilities and tasks, whilst the strategy, co-ordination and control role continues to be performed by Terna's divisions.

Some general and specific highlights for 2004 relating to the two Brazilian companies Transmissora Sudeste Nordeste SA ("TSN") and Novatrans Energia SA ("Novatrans"), in which Terna holds investments, are illustrated below.

On November 10, Terna acquired all the shares in TSN belonging to Inepar Energia SA and one share of a minority shareholder, thus increasing its holding in the company to 100%. These shares were subsequently afforded as collateral in favor of the lending bank, in addition to all the ordinary and preference TSN shares, with the exception of the individual shares belonging to the members of the Board of Directors (for a total of 4 shares).

## Brazilian legislative and regulatory scenario

On March 15, 2004, Law no. 10,848 was issued, implementing the new model of the Electricity Sector, involving effects on the generation and distribution and sale activities.

The transmission area was not affected, while the special grantor power-related prerogatives of the



Ministry for Mines and Energy and the Electricity Agency ("ANEEL") and the composition of the Management Body of the National Electricity System Operator ("ONS") have been modified.

#### ANEEL resolutions and authorizations

On March 10, by means of the Authorizing Resolution no. 83 ANEEL approved addendum no. 2 to concession agreement 095/2000 with Novatrans, thus ratifying the transfer of corporate control to Terna and extending the contractual start date of the commercial operation of all the North-South II line from February 8, 2004 until April 8, 2004. The extension was requested as a result of the delays in construction caused by events outside the company's control. This addendum was signed on April 29 by Novatrans, Terna and ANEEL.

On June 30, ANEEL issued Legislative Resolution no. 70 which established the new values of the Concession Fee (RAP) in force as from July 1, 2004 until June 30, 2005.

The TSN fee was set at R\$ 224.6 million, reflecting the adjustment for inflation (IGPM rate) accumulated between June 2003 and May 2004, equating to 7.030%; likewise, the Novatrans fee was fixed at R\$ 246.9 million. In addition, Novatrans was acknowledged an additional one-off payment of R\$ 279,766.24 which reflects the IGPM accumulated on the invoicing of several project elements which was delayed because the necessary certification (*Termos de Liberação*) for the start-up of commercial operations by ONS was lacking.

The fee review did not include the rise of the fee in order to compensate the increase in the values of the PIS and COFINS rates, which for the PIS rose from 0.65% of the fee to 1.65% in January 2003 and for the COFINS from 3% of the fee to 7.6% in February 2004. Such compensation was anticipated in the concession agreement. The companies requested ANEEL that their rights to be compensated be recognized and they presented the related request to obtain a fee review.

On December 3, ANEEL acknowledged them "a definite and liquid right" to obtain compensation for the increase in the PIS/COFINS rates, which made it possible to record related revenues in the accounts of R\$ 18.5 million in 2004 (8.5 for TSN and 10 for Novatrans). ANEEL has indicated that it is currently drawing up specific regulations with regards to this matter which will be subject to public consultation (*Audiencia Pública*). It is therefore reasonable to assume that the compensation will be paid during the next fee review (July 1, 2005, in other words during the 2005/2006 cycle).

## Operating and financial review

When calculating the results for the 2004 period, in accordance with new corporate and tax law provisions in force, the elimination of tax effect was carried out (the so-called "tax clean-up"). Consequently, the net income for the period and the Shareholders' Equity as of December 31, 2004 include euro 421.3 million relating to the net effect of said interference present until December 31, 2003 (amortization/depreciation and operating grants in excess of the technical-economic rates, and the related deferred taxation).

These effects, as anticipated both by the new Financial Statements regulatory regime introduced by Legislative Decree no. 6 of January 17, 2003 and by the Italian Accounting Authority in the document "OIC 1" dated October 25, 2004, were stated among extraordinary income and expense.

The Financial Statements as of December 31, 2004 closed with net income of euro 674.3 million, after having provided depreciation on tangible fixed assets amounting to approximately euro 143.5 million, net financial expense of euro 17.2 million, net extraordinary income of euro 409.6 million and income taxes totaling euro 165.2 million. The gain for the period, not taking into account the effect of the tax clean-up, came to euro 253 million.

The value of production amounted to around euro 928.1 million, of which euro 873.6 million for sales and services mainly referable to the payment due to the company for use of the NTN. More specifically, on the basis of the calculations deriving from the application of the Electricity and Gas Authority's Resolution no. 05/04 and taking into account the matters laid down in the operating Agreement entered into with the ISO, fees for network usage have been liquidated for a total of around euro 810.8 million, up by around euro 28.5 million (+ 3.6%) when compared with the same period in 2003.

Production costs amounted to around euro 481.0 million of which euro 163.2 million relating to staff and euro 143.4 to amortization/depreciation.

Net extraordinary income totaling approximately euro 409.6 million, was essentially attributable to the tax neutralization following the assimilation of the so-called Vietti reform.

Income taxes for the period, amounting to euro 165.2 million, included euro 85.1 million for IRES (corporate income tax) and euro 19.3 million for IRAP (regional tax on productive activities); taxes paid in advance were also recorded for euro 7.5 million in addition to deferred taxes of euro 53.3 million.

The Balance Sheet discloses net tangible fixed assets amounting to euro 3,848.3 million, net capital employed of euro 3,406.2 million covered by Shareholders' Equity amounting to euro 1,838 million (54.0%, compared with 92.6% as of December 31, 2003) and by net financial debt of euro 1,568.2 million (46.0%, compared with 7.4% as of December 31, 2003).

Terna SpA's reclassified Income Statement for 2004 and 2003 is presented below.

## Income Statement

In millions of euro	2004	2003	Change	%
Revenues:				
> NTN usage fees	810.8	782.3	28.5	3.6
> Other sales and services	62.8	61.6	1.2	1.9
> Other sundry revenues and income	32.0	33.3	(1.3)	(3.9)
<b>Total revenues</b>	<b>905.6</b>	<b>877.2</b>	<b>28.4</b>	<b>3.2</b>
Operating costs:				
> Payroll and related costs	163.2	163.8	(0.6)	(0.4)
> Goods and services and use of third-party assets	115.3	105.0	10.3	9.8
> Materials	20.0	14.4	5.6	38.9
> Other costs	28.7	15.9	12.8	80.5
> Capitalized costs	(22.5)	(17.4)	(5.1)	29.3
<b>Total operating costs</b>	<b>304.7</b>	<b>281.7</b>	<b>23.0</b>	<b>8.2</b>
<b>GROSS OPERATING MARGIN</b>	<b>600.9</b>	<b>595.5</b>	<b>5.4</b>	<b>0.9</b>
Amortization, depreciation and accruals:				
> Depreciation and amortization	143.4	291.0	(147.6)	(50.7)
> Accruals and writedowns	10.4	37.0	(26.6)	(71.9)
<b>Total amortization, depreciation and accruals</b>	<b>153.8</b>	<b>328.0</b>	<b>(174.2)</b>	<b>(53.1)</b>
<b>OPERATING INCOME</b>	<b>447.1</b>	<b>267.5</b>	<b>179.6</b>	<b>67.1</b>
> Net financial income (expense)	(31.1)	(35.1)	4.0	(11.5)
> Income (expense) from equity investments	13.9	0.0	13.9	100
> Net extraordinary income (expense)	409.6	(15.0)	424.6	(2,830.7)
<b>INCOME BEFORE TAXES</b>	<b>839.5</b>	<b>217.4</b>	<b>622.1</b>	<b>286.2</b>
Income taxes for the period	165.2	93.9	71.3	75.9
<b>NET INCOME FOR THE PERIOD</b>	<b>674.3</b>	<b>123.5</b>	<b>550.8</b>	<b>446.0</b>

Revenues amounting to euro 905.6 million disclosed an increase of euro 28.4 million essentially attributable to the payment for using the NTN, the positive effect deriving from the application of the tariffs laid down by the Electricity and Gas Authority Resolution no. 05/04 with particular reference to the time band effect, and the rise in the demand for energy (euro + 49.5 million), offset by lower revenues as a result of the review of the NTN ownership percentage (euro - 21 million).

The item *other sales and services* amounts to euro 62.8 million and includes euro 46.1 million relating to services and supplies with other Enel Group companies, euro 1.4 million referring to services invoiced to the subsidiary companies and euro 15,3 million to services contracted with third party clients (euro 13.7 million in 2003); the Terna market share with reference to HV specialized engineering services rose further when compared with previous years.

The decrease in *other revenues* and income is essentially due to:

- > the more modest change in contract work in progress when compared with the previous year (euro 1.4 million);
- > the decrease in operating grants due to the elimination of tax effect (euro 5 million);
- > the increase in out-of-period income, essentially due to the release to the Income Statement of the provision for the disposal of excess plant when compared with effective utilization during the period (euro 3.7 million) and the positive adjustment concerning the NTN usage fee for 2000 paid by ISO (euro 1.2 million).

The increase of around euro 23 million in *operating costs* (euro 304.7 million) refers to:

- > higher costs for services and the use of third party assets essentially associated with the institutional communications campaign (around euro 10 million);
- > additional costs for materials, essentially deriving from greater inventory consumption (euro 5.6 million);
- > the rise in the item "Other costs", is essentially attributable to out-of-period expense for adjustments to the 2002 and 2003 NTN usage fee for euro 14.8 million, offset by lower costs for easement (euro 1.7 million) and lower liabilities for the Supplementary Welfare Fund for Enel executives (approximately euro 2 million);
- > greater capitalization for internal work amounting to around euro 5.1 million (euro +5.6 million for materials, euro - 0.5 million for personnel).

The *gross operating margin* therefore amounted to euro 600.9 million, up euro 5.4 million or 0.9%.

*Amortization and depreciation* disclosed a drop of euro 147.6 million essentially as a result of the aforementioned elimination of the tax effect which in 2003 had led to the recording of greater amortization/depreciation in the Income Statement of euro 151.4 million (Vietti reform).

The substantial decrease (euro 26.6 million) in the item *provisions and writedowns* is mainly attributable to the provisions made in 2003 in order to take account of the NTN ownership actual percentages, provisions which were no longer necessary in 2004 since the ISO had established new ownership percentage estimates for the current year.

Therefore, the *operating income* came to euro 447.1 million, up euro 179.6 million or 67.1%.

The decrease of euro 4 million in *financial expense* reflects:

- > lower interest expense charged by the parent company (euro 11.7 million) as a result of the paying off of the debt undertaken during the period the company was formed and the related derivative instruments;
- > greater interest expense (euro 7.7 million) referring in particular to the issue during October 2004 of the fixed-rate bond.

*Income from equity investments*, amounting to euro 13.9 million, is attributable to the interest on the capital resolved by the subsidiary company TSN following the application of the so-called "interest on equity" anticipated by current Brazilian legislation.

*Net extraordinary income* amounting to approximately euro 409.6 million essentially refers to the aforementioned effects of the elimination of tax effect present as of December 31, 2003 (euro 421.3 million).

The incidence of *income taxes* on *pre-tax income*, net of the effect of the elimination of tax effect, came to 39.5%.

## Balance Sheet

Terna SpA's Balance Sheet for 2004 and 2003 is summarized reclassifying the balances and separately indicating the effects of the aforementioned tax effect elimination.



In millions of euro	at Dec. 31, 2004	at Dec. 31, 2003	Change		
			Ordinary	Tax effect elimination	Total
<b>Reclassified Balance Sheet</b>					
Net fixed assets:					
> Tangible and intangible	3,848.3	3,051.4	101.3	695.6	796.9
> Long-term financial assets	308.8	168.6	140.2		140.2
<b>Total</b>	<b>4,157.1</b>	<b>3,220.0</b>	<b>241.5</b>	<b>695.6</b>	<b>937.1</b>
Net current assets:					
> Trade receivables	139.2	202.8	(63.6)		(63.6)
> Inventories	32.6	27.7	4.9		4.9
> Other assets	46.4	19.4	27.0		27.0
> Net tax assets (payables)	(3.2)	(34.5)	31.3		31.3
> Trade payables	(177.4)	(158.4)	(19.0)		(19.0)
> Other liabilities	(238.2)	(235.8)	20.5	(22.9)	(2.4)
<b>Total</b>	<b>(200.6)</b>	<b>(178.8)</b>	<b>1.1</b>	<b>(22.9)</b>	<b>(21.8)</b>
<b>Gross capital employed</b>	<b>3,956.5</b>	<b>3,041.2</b>	<b>242.6</b>	<b>672.7</b>	<b>915.3</b>
Sundry provisions	(550.3)	(305.3)	6.4	(251.4)	(245.0)
<b>Net capital employed</b>	<b>3,406.2</b>	<b>2,735.9</b>	<b>249.0</b>	<b>421.3</b>	<b>670.3</b>
Shareholders' Equity	1,838.0	2,533.9	(1,117.2)	421.3	(695.9)
Net financial debt	1,568.2	202.0	1,366.2		1,366.2
<b>TOTAL</b>	<b>3,406.2</b>	<b>2,735.9</b>	<b>249.0</b>	<b>421.3</b>	<b>670.3</b>

Net financial debt is analyzed as follows;

Net financial debt*	2004	2003	Change
Terna bonds	1,400.0	0.0	1,400.0
EIB and SAN PAOLO loans	318.2	325.0	(6.8)
Due to the parent company	0.0	456.2	(456.2)
Novatrans Shareholder Loan	(6.0)	(289.8)	283.8
Cash and on hand	(144.0)	(289.4)	145.4
<b>Total</b>	<b>1,568.2</b>	<b>202.0</b>	<b>1,366.2</b>

The increase in *tangible and intangible fixed assets* derives from the following factors: tangible fixed assets disclosed a net increase during the period of around euro 101 million mainly as a result of net investments made (euro 277.8 million in purchases – euro 23 million in operating

grants), partly offset by the depreciation provided (euro 143.5 million) and net disposals (euro 10.1 million). The increase in *long-term financial assets* (euro 140.2 million) was essentially the result of the rise in the subsidiary company Novatrans share capital (euro 141.2 million).

*Net current assets* presented a negative balance of euro 200.6 million; at the end of 2003 it presented a negative balance of euro 178.8 million. The change of euro 21.8 million derives from a decrease in net assets of euro 31.7 million attributable to:

- > a drop in trade receivables equating to euro 63.6 million nearly entirely attributable to a decrease in amounts due from the ISO as a result of the new time band breakdown as per Resolution no. 05/04 which in contrast to 2003 is more remunerative in the Summer months, as well as of the adjustments to the NTN ownership percentage;
- > a rise in inventories amounting to euro 5 million essentially as a result of inventories of contract work in progress;
- > the increase of approximately euro 27 million in other assets as a result of:
  - accrued income and prepaid expenses totaling approximately euro 17 million (of which euro 10 million in accrued income on derivative products, euro 3.2 million for issue discounts and euro 3.9 million in issue costs) deriving from the bond issue totaling euro 1,400 million;
  - amounts due from subsidiary companies for interest on capital totaling around euro 12 million.

*Net tax liabilities* fell by around euro 31.3 million mainly as a result of:

- > the increase in amounts receivable for euro 12.7 million, of which euro 7.5 million in credits for taxes paid abroad, in relation to which recovery is permitted in Italy in order to avoid double taxation taking place and euro 5.2 million for the VAT credit being the excess between the tax liability emerging at the time of settlement for December and the advance payment made;
- > the decrease in taxes payable of around euro 19 million is essentially due (as per the underlying table) to the lower advance paid over in 2003 as a result of lower taxes due for 2002 following the so-called Tremonti tax concessions.

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**In millions of euro**

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Taxation due for 2002	63.9
Taxation due for 2003	93.3
> advances calculated in the amount due for 2002	63.3
> 2003 liability	30.0
Taxation due for 2004	104.5
> advances calculated in the amount due for 2003	92.4
> 2004 liability	12.1
<b>Difference</b>	<b>17.9</b>

The increase of around euro 19 million relative to *trade payables* is due to increased activities during the last few months of the year.

The sharp increase in *sundry provisions* amounting to around euro 245 million essentially reflects:

- > the increase in the deferred taxation liabilities amounting approximately to euro 312 million, of which euro 251.4 million relating to the aforementioned effect of the Vietti reform while the difference relates to the change in the balances during the year (essentially depreciation in excess of the depreciation rates);
- > the decrease of 37.6 relating to the complete extinction of the Supplementary Welfare Reserve for Enel Executives (PIA);
- > the decrease of euro 10.3 million in the provision for employee termination indemnities as a result of the increase following the provision for the year of around euro 9 million and utilization totaling euro 19.3 million (euro 13.6 million for concessions to staff for the Terna and Enel 3 placement transactions and euro 2.1 million intended for pension funds);
- > the decrease of euro 19.1 million in other provisions for risks and charges as a result of the increases and utilizations during the period (respectively, euro 17.7 and euro 36.8 million).

## Investments in tangible fixed assets

In line with the types of activities carried out by the Company and the matters anticipated in the Operating Agreement stipulated with the ISO, capital expenditure can be divided up into four macro-categories:

- > **Development:** measures which concern the variation or the enhancement of the transport, transformation and/or interconnections capacities, which can be commissioned directly by the ISO or awarded under tender. This category also includes the acquisition of portions of the national transmission network.
- > **Upgrades:** measures for updating Terna's plants in accordance with legislative provisions or authorization requirements, with special focus on legislation regarding electromagnetic fields and the environmental impact of the structures.
- > **Renovation/Modifications:** measures which have concerned the essential modification of the technical and functional features of the plant and/or upgrading of the plant configurations, so as to significantly increase the useful life.
- > **Rationalization:** measures targeted at changing the configuration of the plants so as to improve the running efficiency.

## Investments made

<b>Investments in tangible fixed assets</b>		
In millions of euro	2004	2003
Development:	176.0	163.2
> assigned directly	145.2	120.2
> under tender	22.8	7.6
> for acquiring portions of the NTN	8.0	35.4
Changes	15.2	13.3
Rationalization	9.8	10.4
Upgrades	3.3	1.5
Renovation	65.8	49.4
Other	7.7	3.0
<b>Total</b>	<b>277.8</b>	<b>240.8</b>

The breakdown of investments by plant type in 2004 is as follows:

<b>Total investments</b>		
In millions of euro	2004	2003
Power lines	154.1	106.4
Transformer stations	110.9	127.2
Other	12.8	7.5
<b>Total</b>	<b>277.8</b>	<b>240.8</b>

The main investments made during the year were as follows:

<b>Lines</b>		
Plant	Description	Amount (in millions of euro)
S. Fiorano Robbia	Construction of 380 kV power line	52.9
Laino-Feroletto-Rizziconi	Construction of 380 kV power line	33.7
Candela-Foggia	Double circuit stretch with BN-FG	13.1
S. Giacomo-Teramo	Construction of 380 kV junctions with Montalto-Suvereto	4.2

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## Stations

Plant	Description	Amount (in millions of euro)
Altomonte	Armored 380 kV installation	8.0
Carpi	Construction of a 380/132 kV overhead delivery station	5.3
S. Damaso	High speed train line connection	3.9
Fratta	Construction and renovation of plant	3.3
Verderio	Rebuilding of plant	3.2
Feroleto	Design and construction of new 380 kV section	2.7
Sorgente	Renovation, adaptation and development	2.4
Laino	Extension of 380 kV section and installation of 1 250 MVA ATR 380/150 kV	2.3
Mantova	New 380 kV power station	2.3

### Initiatives undertaken for reducing the environmental impact

With particular emphasis on the construction of new power lines, Terna's initiatives to reduce the environmental impact involved an increased use of innovative design tools that ensure minimal impact on the landscape accompanied by ongoing research into new technological solutions. The design of all new equipment takes place exclusively using maps of the terrain obtained by means of aerial photography, which, due to the high potential of the instrument, makes it possible to assess the impact of future work on the entire area involved with great accuracy.

The same mapping system represents an important means for presenting plans for new work to the local authorities from the initial planning stage, enabling them to contribute proposals for the definition and the improvement of all the key environmental, landscape and visual impact problems involved.

With regard to electromagnetic fields, a calculation program for the mapping of the fields generated by power lines was developed in collaboration with CESI.

During 2004, Terna completed the engineering activities for the power line pylons (De Lucchi and Foster design) that won the "Supports for the Environment" competition, for which the executive project has been prepared and the first prototypes created and tested. The new pylons will be ready for the construction of the new 380 kV Tarnuzze-Casellina power line, in accordance with environmental regulations.

At the same time, the first round-section pylons for 380 kV double-circuit power lines for the Laino-Rizziconi 380 kV power line in the Pollino National Park were produced and installed.

The installation ensured compliance with Environmental Impact Assessment specifications and was agreed upon with the Park's authorities.



Three round-section pylons were utilized in the upper Val Canonica, in an area of great landscape beauty, for the construction of the new 380 kV international interconnection power line from S. Fiorano (Italy) to Robbia (Switzerland).

## Plant and equipment

The following table shows the number of the installations and the extent of the network:

	at Dec. 31, 2004		at Dec. 31, 2003	
	no.	km	no.	km
Stations	300		295	
Transformers	569		565	
Bays	3,902		3,864	
Lines		34,958		34,824
Double-circuit lines	1,931	38,696	1,906	38,577

The main changes during 2004 resulted from:

- > Terna's execution of the development activities resolved by the ISO. With regard to these activities, shareholders are informed in particular of the start-up during the year of the following plants:
  - 380 kV power lines: Altomonte-Laino (42 km), S. Giacomo-Teramo (15 km), Candela-Foggia (39 km);
  - 380 kV station in Mantua (Mantua), 380 kV station in Chivasso Termica (Turin), 380 kV station in Teramo (Teramo), 380 kV station in Altomonte (Cosenza), 220 kV station in S. Benedetto del Querceto (Bologna), 220 kV station in Busachi (Oristano), 150 kV station in Nurri (Nuoro), 132 kV station in Tassara (Brescia) and 132 kV station in Pinasca (Turin);
- > the acquisition by Terna of:
  - approximately 163 km of power lines, 1 132 kV station in Alessandria (Alessandria) and 2 overhead cable sectioning plants in Tolle Alta (Livorno) and Cala Telegrafo (Livorno) previously owned by Enel Distribuzione and included by the ISO, when drawing up the last Three-year Growth Plan subsequently approved, as part of the National Transmission Network;
  - the 150 kV Agip Gela-C.P. San Cono power line, measuring approximately 30.4 km, already forming part of the NTN but previously owned by EniPower Trasmissione;
- > the transfer to Enel Distribuzione of around 63 km of lines previously owned by Terna and sold off from the NTN upon the ISO's proposal since they were considered to be no longer directly functional for the electricity transmission service. At the time of this transfer, and following the interest shown by Enel Distribuzione, Terna also sold to the latter several network components,

constructed previously as the result of certain connection requests made by several independent producers which had never been included within the sphere of the NTN perimeter and therefore were not subject to specific remuneration by the ISO. This concerned 2 power lines (132 kV branch for the connection of the Tecnoborgo power station and 132 kV Jesi-Jesi Energia line) stretching in total approximately 5.4 km and four 150-132 kV stations at Tecnoborgo (Piacenza), Pietracatella (Campobasso), Avigliano (Potenza) and Forenza Maschito (Potenza);

- > the shutdown of the 150 kV station at S. Chiara Tirso (Oristano) and the demolition or shutdown of several stretches of 220 kV and 132 kV line for a total of approximately 100 km.

In conclusion, the program for the replacement of existing transformers with higher power versions continued during 2004, and together with the installation of new transformers took the value of the total switching capacity to 108,749 MVA as of December 31, 2004 compared with 107,485 MVA as of December 31, 2003.

## Financial flows

### Cash flow

<b>Statements of cash flows</b>			
In millions of euro	2004	2003	Change
<b>A) OPENING SHORT-TERM FINANCIAL DEBT (-) ASSETS (+)</b>	<b>289.4</b>	<b>583.6</b>	<b>-294.2</b>
Cash and Banks	0.1	0.1	0.0
Intercompany current account	289.3	583.5	-294.2
<b>B) CASH FLOW FROM OPERATIONS</b>			
Net income	674.3	123.5	550.8
Effects of tax clean-up	-421.3	0.0	-421.3
Amortization and depreciation	143.5	291.0	-147.5
Net writedowns (revaluations)	0.0	0.0	0.0
Net change in provisions	3.9	18.8	-14.9
Net change in employee termination indemnity provision	-10.3	-5.0	-5.3
Net loss (gain) on the disposal of assets	1.8	1.4	0.4
<b>Cash generated by operations</b>	<b>391.9</b>	<b>429.7</b>	<b>-37.8</b>
Change in net current assets			
> (increase) decrease in net current assets	46.6	22.9	23.7
> increase (decrease) in payables	-24	-21.3	-2.7
> changes in other Balance Sheet items	-23.6	7.8	-31.4
<b>Total B) – Cash flow from operations</b>	<b>390.9</b>	<b>439.1</b>	<b>-48.2</b>
<b>C) CASH FLOW FROM (FOR) INVESTMENT ACTIVITIES</b>			
> Investments in tangible fixed assets	-277.8	-240.8	-37.0
> Investments in intangible fixed assets	0.0	0.0	0.0
> Other changes in tangible fixed assets	31.1	19	12.1
> Other changes in long-term financial assets	3	0.9	2.1
> Changes in equity investments	-143.2	-156.2	13.0
<b>Total C)</b>	<b>-386.9</b>	<b>-377.1</b>	<b>-9.8</b>
<b>D) CASH FLOW FROM (FOR) FINANCING ACTIVITIES</b>			
> New medium- and long-term loans	3,093.6	0.0	3,093.6
> Repayment of medium- and long-term loans	-1,997.9	-22.4	-1,975.5
> Repayment of loans from subsidiary companies	125.2	-289.8	415.0
> Dividends and other capital transactions	-1,370.3	-44.0	-1,326.3
<b>Total D)</b>	<b>-149.4</b>	<b>-356.2</b>	<b>206.8</b>
<b>E) CASH FLOW GENERATED FOR THE PERIOD</b>	<b>-145.4</b>	<b>-294.2</b>	<b>592.9</b>
<b>F) CLOSING NET SHORT-TERM DEBT (-) ASSETS (+)</b>	<b>144.0</b>	<b>289.4</b>	<b>-145.4</b>
Cash and Banks	0.1	0.1	0.0
Intercompany current account	143.9	289.3	-145.4

## Net debt positions

In millions of euro	2004	2003
<b>Opening net financial debt</b>	<b>-202.0</b>	<b>-220.0</b>
<b>Liquidity generated by operations</b>	<b>390.9</b>	<b>439.1</b>
Investments in tangible and intangible assets	-277.8	-240.8
Purchases of equity investments	-143.8	-156.2
Disposals of equity investments	0.6	0.0
Other changes in fixed assets	34.1	19.9
<b>Liquidity absorbed by investment activities</b>	<b>-386.9</b>	<b>-377.1</b>
Dividends distributed	-170.2	-44.0
Increases/decreases in the share capital	-1,200.0	0.0
<b>Shareholders' Equity flows</b>	<b>-1,370.2</b>	<b>-44.0</b>
Change in financial debt	-1,366.2	18.0
<b>Closing net financial debt</b>	<b>-1,568.2</b>	<b>-202.0</b>

The *liquidity generated by operations* during the period came to approximately euro 391 million and is mainly attributable to cash generated by operations during the period (income, amortization/depreciation, provisions) as well as the increase in current assets.

*Investment activities* absorbed financial resources for around euro 387 million and concerned investments in tangible fixed assets during the period and the subscription of the share capital increase of the Brazilian subsidiary Novatrans; other increases concerned operating grants and the disposal of assets.

*Flows of Shareholders' Equity* also absorbed liquidity, for approximately euro 1,370 million, as a consequence of the reimbursement of the Parent Company's share capital and the distribution of dividends to shareholders during the period.

These flows together with those absorbed by investment activities led to a total requirement of euro 1,757.1 million covered by liquidity generated by operations for euro 390.9 million while the remaining balance of euro 1,366.2 million was covered by the change in net long-, medium- and short-term debt.

*Net financial debt* (euro 1,568.2 million) as of December 31, 2004 and the related maturities are as follows:

In millions of euro	Total	Current portion	Non-current portion
EIB loans	318.2	18.2	300.0
Bond issues	1,400.0		1,400.0
Loans to subsidiary companies	-6.0	-6.0	
Cash	-144.0	-144.0	
<b>Total</b>	<b>1,568.2</b>	<b>-131.8</b>	<b>1,700.0</b>

## Performance of the subsidiary companies

The information illustrated is presented in accordance with Italian accounting standards.

### TSN

This company operates on the basis of a thirty-year concession granted by ANEEL, expiring on December 20, 2030.

During the period under review, the Sudeste Nordeste 500 kV transmission line, with an extension of 1,062 km<sup>(1)</sup>, from Serra da Mesa (Goiás State) to Sapeaçu (Bahia State), including the intermediate sub-stations at Rio das Éguas, Bom Jesus da Lapa and Ibicoara, was fully operational.

Revenues amounted to approximately euro 61 million and entirely concerned the fee due to the company on the basis of the concession agreement with ANEEL.

Operating costs amounted to around euro 14 million, of which approximately euro 5.5 million relating to costs for services and euro 8.4 million relating to other costs including around euro 7 million attributable to local taxes and levies.

The operating income amounted to euro 41 million after having provided amortization and depreciation of euro 6.1 million.

Financial expense totaled euro 23.4 million (including euro 13.9 million relating to interest on the capital), leading to pre-tax income of euro 17.6 million. Income taxes for the period amounted to euro 5.2 million and the net income came to euro 12.4 million.

The Balance Sheet disclosed net capital employed equating to euro 197.4 million (including euro 200.3 million relating to tangible assets) euro 87.4 million of which covered by Shareholders' Equity and euro 110 million covered by net borrowing.

### Novatrans

This company operates on the basis of a thirty-year concession granted by ANEEL, expiring on December 20, 2030, for the running of the Norte-Sul II line, which was completely operational by April 2004.

Revenues amounted in total to around euro 57.9 million and were nearly all attributable to the fee due to the company on the basis of the concession agreement with ANEEL.

<sup>(1)</sup> "As Built" length of the 500 kV lines (compared with 1,050 km in the concession agreement), which join the 15 km relating to 230 kV double-circuit stretches (taking them as two individual circuits) for a total of 1,077 km.



Operating costs amounted to around euro 22.9 million, of which euro 1.8 million referring to payroll and related costs, around euro 8.3 million relating to costs for services and euro 12.8 million to other costs including approximately euro 8 million attributable to local taxes and levies.

The operating income came to euro 27.8 million after having provided amortization and depreciation of euro 7.2 million.

Financial expense totaled euro 39.1 million, involving a pre-tax loss of euro 11.2 million. Income taxes for the period amounted to euro 3 million, therefore taking the loss for the period to euro 14.2 million.

The Balance Sheet disclosed net capital employed equating to euro 270.5 million (of which euro 264.9 million relating to tangible fixed assets) euro 83.4 million of which covered by Shareholders' Equity and euro 187.1 million covered by net borrowing.

## Corporate governance

### Section I: governance structure

#### Introduction

The corporate governance system in existence within the Company, following the start of trading in Terna shares on the electronic equity market organized and run by Borsa Italiana SpA which took place on June 23, 2004, is consistent with the principles contained in the Code of Self-governance for listed companies, with the recommendations formulated by the CONSOB on the subject and, more generally, with the best practice established internationally. This corporate governance system essentially has the aim of creating value for the shareholders, in awareness of the social importance of the activities which the Group is involved in and the consequent need to adequately consider, with regards to related performance, all the interests involved.

#### Shareholding set up

The Company's share capital is entirely made up of ordinary shares, which are completely unrestricted and endowed with the right to vote both during ordinary general meetings of the shareholders and extraordinary sessions. On the basis of the results of the shareholders' register and the information available, nobody – with the exception of Enel SpA, holder of 50% of the share capital, whose management and co-ordination activities Terna is subject to – holds an interest in the share capital greater than 2%; in addition, there is no evidence of shareholders' agreements covering the Company's shares.

#### Organization of the Company

In accordance with the matters laid down by Italian legislation concerning listed companies, the organization of the Company features the presence of:

- > a Board of Directors appointed to see to the corporate management;
- > a Board of Statutory Auditors required to (i) oversee the observance of the law and the memorandum of association, as well as the observance of the correct principles of administration when performing the corporate activities and (ii) also check the adequacy of the Company's organizational structure, internal auditing system and administrative-accounting system;
- > the Shareholders' Meeting, responsible for resolving amongst other things – in ordinary and extraordinary session – with regard to (i) the appointment and removal of the members of the Board of Directors and the Board of Statutory Auditors and concerning the related remuneration and responsibilities, (ii) the approval of the Financial Statements and the allocation of the net income, (iii) the acquisition and disposal of own shares, (iv) the amendments to the By-laws, (v) the issue of convertible bonds.

The accounts auditing activities are entrusted to a specialized company, duly enrolled in the CONSOB register, specifically appointed for this purpose by the general meeting of the shareholders subject to the agreement of the Board of Statutory Auditors.

The company appointed to audit Terna's accounts performs the same role for the subsidiary companies. In accordance with the provisions of the Code of Ethics adopted by the Company, the auditing of the Company's statutory Financial Statements and the Consolidated Financial Statements is incompatible with the performance of consulting activities provided to Terna or its subsidiaries, such incompatibility extending to the entire network of the Independent Auditing Firm.

## Section II: implementation of the provisions of the Code of Self-governance for listed companies and other information

### Board of Directors

Role and functions	<p>The Company's Board of Directors covers a central role within the sphere of the corporate organization and it heads up the functions and responsibilities of the strategic and organizational policies, as well as the verification of the existence of the controls necessary for monitoring the performance of the Company and its subsidiaries.</p> <p>Within this context, and on the basis of the matters laid down by the law and that which is anticipated by its own specific resolutions, the Board of Directors:</p> <ul style="list-style-type: none"><li>&gt; grants and withdraws powers of attorney to an Executive Committee and/or to one or more Directors, establishing the content, limits and any operating formalities. The current Board structure provides for the presence of just one Chief Executive Officer. On the basis of the current powers of attorney, the Chief Executive Officer is vested with the widest powers for the management of the Company, with the exception of those otherwise assigned by the law, the By-laws or reserved for the Board of Directors on the basis of the resolutions of the latter body described hereunder;</li><li>&gt; receives, on the same basis as the Board of Statutory Auditors, on-going and comprehensive disclosure from the Chief Executive Officer regarding the activities carried out when exercising the powers of attorney, summed up on a quarterly basis in a specific report. Specifically, as far as all the transactions of greatest significance are concerned (including therein any atypical or unusual transactions or those with related parties, whose approval is not reserved for the Board of Directors), the Chief Executive Officer reports to the Board itself with regard to (i) the characteristics of said transactions, (ii) the parties involved and their possible correlation with the Company or its subsidiaries, (iii) the procedures for determining the corresponding amounts anticipated and (iv) the related economic and equity effects;</li><li>&gt; establishes, on the basis of the proposals formulated by the specific committee and having heard the opinion of the Board of Statutory Auditors, the remuneration of the Chief Executive Officer and the other Directors who cover specific offices;</li><li>&gt; defines and assesses the adequacy of the general organizational and administrative set up of the Company and its subsidiaries;</li><li>&gt; examines and approves the strategic, industrial and financial plans. From this point of view, the current structure of the powers within the Company anticipates, in particular, that the Board of Directors resolves on the approval of the annual budget and the Company's long-term plans (which in aggregate form also contain the annual budgets and the long-term plans of the subsidiary companies) drawn up by the Chief Executive Officer;</li><li>&gt; examines and approves the transactions of significant economic, equity and financial importance, especially if carried out with related parties or otherwise featuring potential conflicts of interest. More specifically, the following are dependent on the prior approval of the Board of Directors</li></ul>
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(i) the performance of investments and the stipulation of contracts of a significant size (by this we mean in general those with a value greater than euro 20 million, while this threshold is reduced to euro 2 million for infraGroup contracts), as well as (ii) the participation in bids for tenders which involve a commitment greater than euro 5 million and the (iii) undertaking and disposal of equity investments in other companies;

- > makes arrangements with regard to the exercise of the voting right to be expressed during the general meetings of the subsidiaries and other companies in which investments are held;
- > evaluates the general performance of corporate operations, with particular emphasis on situations of conflict of interest, using the information received from the Chief Executive Officer and from the Internal Auditing Committee and periodically checking the achievement of the scheduled results;
- > reports to the shareholders during general meetings.

#### Appointment, composition and duration in office

In accordance with the provisions of the Company's By-laws, the Board of Directors is made up of between seven and thirteen members, appointed for a period of no longer than three accounting periods and who can be re-appointed at the end of their mandate. It can be supplemented by a Director without the right to vote, whose possible appointment is reserved for the Italian State by virtue of the legislation on privatizations; so far, this power to appoint has not been exercised by the State. On the basis of the amendments to the By-laws requested by Prime Minister's Decree dated May 11, 2004 (containing "Criteria, methods and conditions for the unification of the ownership and the management of the National Transmission Network") and resolved by the extraordinary Shareholders' Meeting held on January 31, 2005 – amendments, what is more, destined only to have an effect as from the moment of the efficacy of the transfer to Terna of the activities of ISO SpA (the ISO), – the Company's Directors must possess the requisites of respectability and professionalism in common with those applicable to the statutory auditors of listed companies; these Article of Association amendments also require that at least a third of the Directors in office possess the independence requisites anticipated by the Code of Self-governance for listed companies. In conclusion, the requisites of independence anticipated by Article 10 of EC Directive 2003/54 are also applicable to the Directors, by virtue of the indicated amendments and taking into account the specific activities performed by the Company.

The By-laws also anticipate – by way of implementation of the matters laid down by privatization legislation and the matters required by the Prime Minister's Decree dated May 11, 2004 – that the appointment of the entire Board takes place by means of the "list voting" mechanism, aimed at guaranteeing a presence within the management body of members appointed by the minority shareholders to the extent of three tenths of the directors to be elected with rounding off, in the event of a fractional number lower than the unit, to the next unit up. This system will be applied

for the first time during the next renewal of the Board of Directors.

This elective system anticipates that the lists of the candidates may be presented by the outgoing Board of Directors or by the shareholders who, alone or together with other shareholders, represent at least 1% of the share capital. It is also anticipated that the lists be deposited at the registered offices and published in newspapers with a national coverage suitably in advance with respect to the date of the Shareholders' Meeting – the deadline anticipated is 20 days if the list is presented by the outgoing Board of Directors and 10 days if the lists are presented by the shareholders – thereby guaranteeing a transparent procedure for the appointment of the Board. In-depth disclosure with regard to the personal and professional characteristics of the candidates, accompanied by indication of the possible suitability of the same to qualify as independents, will be deposited at the registered offices at the same time as the lists, as well as immediately published on the Company's website, with a specific reference which will be included in the general meeting's notice of convocation.

Shareholders are hereby informed that, as from the moment the aforementioned amendments to the By-laws, requested by the Prime Minister's Decree dated May 11, 2004 and resolved by the extraordinary Shareholders' Meeting held on January 31, 2005, become effective, a limit equating to 5% of the share capital will become applicable to the operators in the electricity sector in relation to the right to vote when appointing the Directors.

At present, steps have not been taken to form a specific Committee, as part of the Board, for the appointment proposals since so far no problematic situations have been noted by the shareholders when drawing up adequate candidatures, which would allow a Board composition in line with the matters recommended by the Code of Self-governance for listed companies. In accordance with the matters resolved by the ordinary Shareholders' Meeting held on March 3, 2004 and by the subsequent ordinary shareholders' meetings held on May 12, 2004 (during which steps were taken to appoint Davide Croff following the resignation of a Director) and on September 16, 2004 (during which the Board of Directors was supplemented by means of the appointment of three members elected by the minority shareholders, in other words Luca Arnaboldi, Paolo Cantarella and Salvatore Machi), the Board of Directors currently in office is made up of ten members, whose mandate will expire at the time of the approval of the 2006 Financial Statements, unless the entire Board falls from office beforehand in accordance with the matters laid down by Article 3.2, letter b) of the aforementioned Prime Minister's Decree dated May 11, 2004. In relation to the appointments made during said meetings, the Board currently comprises the following members, whose brief professional resume is presented below:

**> Fulvio Conti, 57 years old, Chairman**

A Business Studies graduate. He covered important positions of responsibility within various Italian companies during the 1990s. From 1993 until 1996 he was the Finance Director for the

Montedison Group. From 1996 until 1998, he covered the role of General Manager and Administration, Finance and Control Director for Ferrovie dello Stato SpA. In 1998/1999 he covered the position of General Manager and Administration, Finance and Control Director at Telecom Italia SpA and undertook offices in numerous companies in the Telecom Italia Group. He has been with Enel since 1999 in his current position as Administration, Finance and Control Director. He acts as Director in many Enel Group companies, the most significant being Enel Produzione SpA, Enel Green Power SpA, Enel Trade SpA., Enel Distribuzione SpA, Enel Gas SpA, Enel Energia SpA, Wind Telecomunicazioni SpA, Enel Investment Holding BV, Enelpower SpA, and Enel.factor SpA

**> Sergio Mobili, 64 years old, Chief Executive Officer**

A graduate in electrotechnical engineering from the Polytechnic of Milan. He has been with Enel since 1967, and developed his managerial career in the Distribution sector both at territorial level (Director for the three Veneto regions and Lombardy) and head office. He was appointed director of the Transmission division in August 1999, and has covered the role of Chief Executive Officer of Terna since its formation.

**> Luca Arnaboldi, 43 years old, Director**

Lawyer and chartered accountant, since 2003 he has been managing partner for Italy and a member of the Global Management Committee with the law firm MCDermott, Will & Emery/Carnelutti, after having carried out between 1989 and 2003 his own professional activities within the law firm Carnelutti, until internally he took over the positions of Deputy Chairman and Managing Partner. He has covered and still covers numerous positions on the Board of Statutory Auditors of important Italian companies, including Alitalia, Blockbuster Italia, Birra Peroni Industriale. He also covers the office of Deputy Chairman of the Board of Directors of the Cecchi Gori Group FIN.MA.VI. SpA. Formerly a contract professor of business law (between 1998–1999) at the “European School of Economics” in Milan, since 2003 he has been a contract professor of industrial law at the faculty of law of Castellanza’s LIUC University as well as lecturer for the level II “Private Equity” University Masters course held by the Polytechnic of Milan.

**> Paolo Cantarella, 60 years old, Director**

A graduate in mechanical engineering from the Polytechnic of Turin, after having worked for several Turin-based companies in the component engineering sector, he started his own activities at FIAT in 1977. Chief Executive Officer of Comau (1983), a FIAT Group company operating in the manufacturing systems and equipment sector, he subsequently joined FIAT Auto first of all (1989) covering the position of head of purchasing and logistics and then becoming (in February 1990) General Manager and (in December 1990) Chief Executive Officer and head of the automobile sector of the FIAT Group. From February 1996 until June 2002, he was appointed Chief Executive

Officer of FIAT and Chairman of FIAT Auto. Awarded in 1997 the title of Knight of Industry and Chairman for 2000 and 2001 of ACEA (Associazione di costruttori europei di automobili ed autoveicoli industriali), during the period 2001-2002 he performed the functions of co-chairman of the "European Union–Russia Industrialists' round table". He currently covers the office of board director of the Polaroid Corporation.

**> Davide Croff, 57 years old, Director**

Business Studies graduate, Post Graduate Student in Economics–Pembroke College, Oxford. He covered positions of increasing responsibility within the Bank of Italy and the FIAT Group, before covering, from 1989 to 1990 the role of Deputy General Manager and until 2003 the role of Chief Executive Officer of Banca Nazionale del Lavoro SpA. Currently he is the Chairman of the "La Biennale" Foundation in Venice and "Ugo and Olga Levi" Foundation in Venice, as well as the director of various companies, the most significant being Permasteelisa SpA, Termomeccanica SpA and VeneziaFiere SpA.

**> Claudio Machetti, 46 years old, Director**

A graduate in statistical science. He started his managerial career in 1983 in the Financial Division of Banco di Roma. From 1992 until 2000 he covered various positions at Ferrovie dello Stato SpA (assistant to the Head of the Finance Division, head of the Central Financial Markets Service, manager of the Operational Finance Division) also undertaking the office in 1997 of Chief Executive Officer of Fercredit SpA–FS Group. He has been with Enel since March 2000 in his current role as Finance head of the Group; he also covers the office of director in other Enel Group, including the important position of Chief Executive Officer of Enel.factor SpA.

**> Salvatore Machì, 67 years old, Director**

Graduate in electronic engineering. Following a specialization course at the Higher Institute of Telecommunications and professional experience gained at Esso and IBM, he joined Enel in 1965. Here he worked until 1999 covering various roles, including the head of the Transmission Division, national head of Thermoelectrical Production and director of Purchasing and Contract Work. Chief Executive Officer (from July 1999 until April 2000) and, therefore, Chairman (until July 2003) of ISO SpA, also during this period he was board director of Gestore del Mercato Elettrico SpA. Since March 2003, he has chaired the Board of CESI–Centro Elettrotecnico Sperimentale Italiano SpA, where previously (from July 1999 to October 2001) he covered the role of Chief Executive Officer; he also currently covers the office of board director at Api Energia SpA.

**> Massimo Romano, 44 years old, Director**

Scientific High School diploma. From 1990 until 1994 he was head of Institutional Relations at



ILVA SpA (IRI Group). Director of External relations of the Lucchini Group from 1994 until 1997, he was employed by Enel in 1997 as director of Institutional Relations. As from 1999 he undertook responsibility for the Institutional and International Affairs Divisions which from February 2004 also integrated the activities of the Regulatory Affairs Division. Member of the management committee of the Istituto di Economia Politica dell'Energia e dell'Ambiente at the "Luigi Bocconi" University in Milan.

**> Paolo Ruzzini, 52 years old, Director**

Graduate in electronic engineering. From 1992 until 1995 he covered the position of head of Personnel and Organization within the Olivetti Group. In 1996 he undertook the office of director of the Solutions Division, first at Olivetti Sistemi e Servizi and then at Olivetti Solutions (Olsy). In 1998, when Olsy was acquired by Wang Laboratories, he became director of the "Solutions Integration Olivetti Wang Global" business line. Before joining Enel in July 2003 as director of Personnel and Organization of the Group, he was Chief Executive Officer of Getronics Italia SpA from September 1999. He currently covers the office of director within several Enel Group companies, the most significant being Enel Produzione SpA, Enel Distribuzione SpA, and Enelpower SpA.

**> Salvatore Sardo, 52 years old, Director**

Graduate in economics. From 1992 until 1997 he was head of Planning and Control at Stet SpA; following the merger of Stet with Telecom Italia in 1997 he undertook responsibility for the Administration and Control Divisions within Telecom Italia SpA. He has covered many corporate offices in the Telecom Italia Group, including that of Chairman of Seat Pagine Gialle SpA from 1998 until 2001 and, until 2003, he was director of the Property and Services sector. He joined Enel in February 2003 where he is Director of Purchasing and Services for the Enel Group.

All the Directors dedicate the time for a profitable performance of their duties, irrespective of the offices covered outside the Company, since they are fully aware of the responsibilities concerning the position covered; they are kept constantly informed by the competent corporate divisions on the main legislative and regulatory innovations concerning the Company and the exercise of their roles.

The directors perform their duties with cognition of the facts and autonomously, pursuing the objective of creating value for the shareholders.

**Board meetings and the role of the Chairman**

Since the start-up of trading of Terna shares on the electronic equity market organized and run by Borsa Italiana SpA, which took place on June 23, 2004, during the 2004 accounting period the Board of Directors held 5 meetings with an average duration of 1 and a half hours each. The

Board's activities are co-ordinated by the Chairman. The latter calls the board meetings, establishes the agenda and directs the related business, ensuring that the Directors are provided on a timely basis – with the exception of in urgent cases or in the event of necessity– with the documentation and the information necessary so that the Board may express itself consciously with regard to the business submitted for their examination. He also checks on the implementation of the Board resolutions, chairs the general meeting of the shareholders and – on a par with the Chief Executive Officer – is empowered to legally represent the Company.

The Chairman is also responsible – on the basis of the board resolution dated March 3, 2004 – for the task of supervising (i) the Company's management policies and the management of the executive staff, as well as (ii) the auditing activities.

#### **Non-executive directors**

The Board of Directors is mainly made up of non-executive members (in that they lack operating powers of attorney and/or executive roles within the corporate sphere), capable of guaranteeing, by number and authoritativeness, that their opinion may have a significant effect when board decisions are adopted. The non-executive Directors contribute their specific skills to board discussions, so as to encourage an examination of the business being debated from different points of view and a consequent undertaking of resolutions which are pondered, aware and in line with the corporate interests. With the exception of the Chief Executive Officer, the other 9 members of the Board of Directors (Fulvio Conti, Luca Arnaboldi, Paolo Cantarella, Davide Croff, Claudio Machetti, Salvatore Machì, Massimo Romano, Paolo Ruzzini, Salvatore Sardo) must consider themselves to be non-executive. In this connection, shareholders are informed that the Chairman also does not cover an executive role, in that the indicated and albeit important functions covered in the corporate sphere – associated as much with the role, acknowledged to him by means of the provisions of the By-laws, of guarantor of the application of correct corporate governance within the Board of Directors, as with the supervisory tasks assigned to him by the Board itself regarding the management policies of the Company and the management of the executive staff, as well as the auditing activities – do not take on the form of specific operational powers of attorney.

#### **Independent directors**

On the basis of the information provided by the individual parties concerned and by way of implementation of the matters recommended by the Code of Self-governance for listed companies, the Board of Directors meeting held on February 15, 2005 certified the existence of the independence requisite as belonging to the following 4 non-executive directors: Paolo Cantarella, Davide Croff, Salvatore Machì and Luca Arnaboldi.

More specifically, the following Directors are classified as independent:

- (i) those who do not have (directly, indirectly or on behalf of third parties) or have not recently had any economic dealings with the Company, with its subsidiaries, with the Executive Director or with the majority shareholder of such a significance that they might condition the autonomy of their opinion;
- (ii) those who are not holders (directly, indirectly or on behalf of third parties) of shareholdings of such an extent that they would allow said directors to exercise control or significant influence over the Company, not even via participation in shareholders' agreements;
- (iii) those who are not close family members of the Executive Director or parties who found themselves in the conditions indicated above under points (i) and (ii).

Even if the independence of opinion characterizes the activities of all the Directors, executive and non, the presence of Directors who can be classified as "independent" according to the aforementioned acceptance of the term – whose role adopts significance both within the Board of Directors and within the sphere of the Committees – is considered to represent a suitable method for ensuring an adequate reconciliation of the interests of all the members of the body of shareholders.

## Committees

### Remuneration Committee

During the meeting held on May 12, 2004 a specific Remuneration Committee was formed as part of the Board of Directors, with the task of setting forth to the Board itself proposals (i) for the remuneration of the Chief Executive Officer and the other Directors who cover specific offices, as well as (ii) for the determination of the criteria for remuneration to be allocated to the Company's top management and that of its subsidiaries, on the basis of the indications of the Chief Executive Officer. Following the integration of the Board of Directors by means of the appointment of Directors nominated by the minority shareholders, which took place during the general meeting held on September 16, 2004, steps were taken on September 29, 2004 to appoint the members of the Remuneration Committee, which currently comprises Paolo Cantarella (acting as co-ordinator), Paolo Ruzzini and Claudio Machetti, all non-executive directors, the first also being independent. During the 2004 accounting period, this Committee held 2 meetings, which involved the regular participation of the members and an average duration of one hour each.

The Remuneration Committee, within the sphere of its responsibilities, aims to perform a prominent role for the purposes of the imminent implementation within the Company of specific stock option plans for management, understood to be incentive and loyalty retention instruments oriented at attracting and motivating resources of an adequate level and experience, further developing the sense of belonging and ensuring over time constant pressure for the creation of value. In addition, as far as the remuneration of the Chief Executive Officer and the other Directors who cover specific roles is

concerned, the Committee intends to put forward specific proposals to the Board of Directors which anticipate that part of these fees are linked to the economic results achieved by the Company and to the accomplishment of specific targets.

During the meetings held in 2004, the Remuneration Committee paused to look at the definition of a performance management system within Terna, specifically launching analysis of an incentive system based on a stock option plan for the top management of the Company and its subsidiaries.

#### **Internal Auditing Committee**

Again on May 12, 2004 a specific Internal Auditing Committee was also formed as part of the Board of Directors, with advisory and proposal-related tasks and more specifically the following duties:

- > assist the Board of Directors in fixing the lines of policy for the internal auditing system and in periodically checking the adequacy and effective functioning of the latter;
- > assess the work plan drawn up by the head of internal auditing and receive the periodic reports from the same;
- > evaluate, together with the administration managers of the Company and with the Independent Auditing Firm, the adequacy of the accounting standards used and their consistency for the purposes of drawing up the Consolidated Financial Statements;
- > evaluate the proposals put forward by the independent auditors for the awarding of the appointment to audit the accounts, as well as the work plan drawn up for the auditing activities and the results illustrated in the report and the advice letter;
- > report at least every six months to the Board of Directors with regards to the activities carried out and the adequacy of the internal auditing system;
- > carry out additional tasks which may be delegated by the Board of Directors, especially as far as dealings with the independent auditors are concerned;
- > issue a prior opinion at the time of significant transactions with related parties.

Following the aforementioned integration of the Board of Directors by means of the appointment of Directors nominated by the minority shareholders, which took place during the general meeting held on September 16, 2004, steps were taken on September 29, 2004 to appoint the members of the Internal Auditing Committee, which currently comprises Davide Croff (acting as co-ordinator), Luca Arnaboldi and Salvatore Machì, all non-executive and independent directors.

During the 2004 accounting period, this Committee held 4 meetings, which involved the regular participation of the members and an average duration of one hour each, which were attended by the Auditor appointed by the Chairman of the Board of Statutory Auditors, in consideration of the specific supervisory functions over the internal auditing system delegated to said Board by current legislation concerning listed companies.

During the 2004 accounting period, the Internal Auditing Committee paused to look in particular at

the disclosure to be provided to the Board of Directors concerning the procedures for the handling of financial risks and the transactions with related parties, as well as at the adoption of the IFRS/IAS accounting standards within the corporate sphere and at the consequent adaptation of the computerized information systems. The Committee also examined the lines of policy for the internal auditing system and for the auditing activities, also meeting with the Independent Auditing Firm.

## Board of Statutory Auditors

In accordance with the provisions of the Company's By-laws, the Board of Statutory Auditors is made up of three acting Auditors and two alternate Auditors, appointed for a period of three years; they can be re-elected on expiry of their mandate. All the members of the Board of Statutory Auditors must possess the requisites of respectability and professionalism requested by special legislation concerning the auditors of companies with listed shares, being supplemented by means of specific provisions of the By-laws; furthermore, on the basis of said By-laws, they cannot cover the office of acting auditor in more than four companies which issue securities issued on organized markets. On a similar basis to the matters laid down for the Board of Directors, the By-laws anticipate that the appointment of the entire Board of Statutory Auditors should take place by means of the "list voting" mechanism, aimed at guaranteeing a presence within the supervisory body of an acting Auditor and an alternate Auditor appointed by the minority shareholders. This system will be applied for the first time during the next renewal of the Board of Statutory Auditors. This elective system anticipates that the lists of the candidates may be presented by the shareholders who, alone or together with other shareholders, represent at least 1% of the share capital. It is also anticipated that the lists be deposited at the registered offices and published in newspapers with a national coverage at least 10 days before the date of the general meeting. In order to ensure a transparent procedure for the appointment of the Board of Statutory Auditors, in-depth disclosure with regard to the personal and professional characteristics of the candidates will be deposited at the registered offices at the same time as the lists, as well as immediately published on the Company's website, with a specific reference which will be included in the general meeting's notice of convocation. The Board of Statutory Auditors in office, appointed by the ordinary shareholders' meeting held on March 12, 2002, has a mandate which will expire at the time of the approval of the 2004 Financial Statements and currently comprises the following acting members, whose brief professional resume is presented below:

### > Giovanni Ferreri, 70 years old, Chairman

Graduate in law from the "La Sapienza" University in Rome, he passed his bar exams in 1961 and since 1975 has been a member of the counsel for the defence at the Supreme Court. He is also an auditor and joint-owner with Gianfranco Graziadei of the international law firm Graziadei-Ferreri, with head offices in Rome and branches in Milan, Munich and New York. He also covers the office of Deputy Chairman of AS Roma SpA.

**> Bruno Franceschetti, 66 years old, Acting Auditor**

Business consultant and chartered accountant, he is a member of the Associazione Nazionale Tributaristi Italiani and lecturer at the Inland Revenue Police Academy in Rome, the Scuola Sottufficiali dell'Aquila and the Scuola di Polizia Tributaria. Since 1990 he has also been a lecturer at the Scuola Superiore Centrale and was, during the academic year 2004/2005, a contract professor of Business Economics at the University of Pescara. He also covers positions as consultant and expert witness for the Courts of Rome and Milan.

**> Giancarlo Russo Corvace, 52 years old, Acting Auditor**

Graduate in business studies from Rome's LUISS University, he also gained a Master in Business Administration at the Scuola di Amministrazione Aziendale at Turin University. Business consultant and chartered accountant, until 1985 he carried out his own activities at the Department of Financial Affairs of Banca Nazionale del Lavoro and until 1988 covered the offices of Chief Executive Officer with the company Ifigest Fiduciaria Sim SpA (now Banca Ifigest). Since 1989 he has been a partner of the law firm Graziadei-Ferreri at the Rome head offices. He also currently covers numerous other positions, including that of director at Aisofw@re SpA.

Since the start of trading of Terna's shares on the Electronic equity market organized and run by Borsa Italiana SpA, which took place on June 23, 2004, the Board of Statutory Auditors has held 4 meetings lasting around 1 and a half hour each on average; said meeting saw the regular participation of the acting auditors.

**Internal  
auditing system**

With regard to internal auditing, the Company is equipped with a specific system which is entrusted with the mission of (i) checking the adequacy of the various corporate processes in terms of efficacy, efficiency and economic nature, as well as (ii) guaranteeing the reliability and correctness of the accounting entries and the safeguarding of the corporate equity and (iii) ensuring the compliance of the operating fulfilments with internal and external regulations and the corporate directives and policies which aim to guarantee sound and efficient management.

The internal auditing system is divided up into two separate types of activities:

- > the "regular control", comprising all the control activities which the individual operating units or subsidiary companies carry out on their processes. These control activities are delegated under the primary responsibility of the operational management and are considered to be an integral part of each corporate process;
- > the audit, delegated to the specific corporate division of the Company and aimed essentially at identifying and containing the corporate risks of all types by means of monitoring the regular controls, both in terms of adequacy of the controls themselves and in terms of results effectively

achieved by the related application. The auditing activities in question are therefore extended to all the corporate processes of the Company and the subsidiary companies and the related managers are informed of both the indication of the corrective action deemed necessary and the performance of follow-up activities intended to check the results of the recommended action. Responsibility for the internal auditing system falls to the Board of Directors, which takes steps – with the assistance of the Internal Auditing Committee – to fix the lines of policy and to periodically check their adequacy and effective functioning, ensuring that the main corporate risks are identified and handled suitably.

The Chief Executive Officer has the task of implementing the policies put forward by the Board of Directors by means of the planning, management and monitoring of the internal auditing system, for which he appoints a head and ensures the suitability of the means available for the performance of the related activities.

The head of internal auditing (identified as the manager of the Company's auditing division) does not depend hierarchically on any operating division manager, co-ordinates the functions delegated to internal auditing within the Company and its subsidiaries and reports regularly on his activities to the Chief Executive Officer and the Chairman as well as, on a six-monthly basis (unless the circumstances require a more timely disclosure), to the Internal Auditing Committee and to the Board of Statutory Auditors.

## Transactions with related parties

Within the sphere of the Company and its subsidiaries, the conditions have been prepared for ensuring that the transactions with related parties are carried out in observance of principles of substantive and procedural correctness.

From the point of view of procedural correctness, it is anticipated that, in the presence of such transactions, the Directors who have an interest (even potential or indirect) in the transaction:

- > inform the Board of Directors on a timely basis regarding the existence of said interest, specifying the nature, the terms, the origin and the purport;
- > they remove themselves from board meetings at the time of resolution, as long as this does not prejudice the permanence of the constituent *quorum*.

Furthermore, in such cases, the board resolutions take steps to adequately justify the reasons and the expedience of the transaction. With regard to substantive correctness – in order to ensure the equity of the conditions stipulated at the time of transactions with related parties and if this should be required by the nature, by the value or by other features of the individual transaction – it is anticipated that the Board of Directors should avail itself of the assistance of independent experts for the valuation of the assets/goods forming the subject matter of the transactions concerned and for the performance of the financial, legal or technical consulting activities.



## Handling of confidential information

For the transactions of greatest significance carried out with related parties, the issue of a prior opinion by the Internal Auditing Committee is also anticipated.

During the meeting held on April 2, 2004 the Company's Board of Directors approved specific regulations for the handling and processing of confidential information, also containing the procedure for the communication outside the Company of documents and information concerning said Company and its subsidiaries, with particular reference to price sensitive information. These regulations have the purpose of maintaining the secrecy of the confidential information, at the same time ensuring that the disclosure to the market relating to the corporate information is correct, complete, adequate, timely and non-selective. The Directors and the Statutory Auditors of the Company are obliged to observe the provisions contained in these regulations and in any event to keep the documents and the information acquired during the performance of their tasks confidential. On a general basis, the regulations place the handling of the confidential information of related pertinence under the responsibility of the Chief Executive Officer of the Company and the delegated bodies of the subsidiary companies, laying down that the disclosure of the information relating to the individual subsidiaries must in any event come about by way of agreement with the Company's Chief Executive Officer.

These regulations also establish specific procedures to observe for the communication outside the Company of documents and information of a corporate nature – dwelling in particular on the disclosure of price sensitive information – and carefully discipline the formalities by means of which the corporate spokesmen enter into contact with the press and other mass media (or with financial analysts and institutional investors). During the same meeting held on April 2, 2004, the Company's Board of Directors also approved the code of conduct concerning internal dealing, in observance of the regulatory instructions dictated by Borsa Italiana SpA. These instructions oblige companies with listed shares to be transparent in their dealings with the market relating to significant transactions which cover the financial instruments of these same companies or their subsidiaries, transactions which may emerge as carried out by individuals in possession of significant decision-making powers within the corporate sphere and who have access to price sensitive information (so-called "significant individuals").

With respect to the aforementioned regulations laid down by Borsa Italiana, the code of conduct adopted by Terna features the following qualifying elements, considered suitable for adequately raising the contents from a qualitative point of view:

> application of the transparency obligations concerning internal dealing to around sixteen "significant individuals" within the sphere of the Company and its subsidiaries (in addition to Terna's Directors and the acting Statutory Auditors). In order to ensure an adequate flexibility of

- the scope of the “significant individuals”, the possibility of an extension of the aforementioned transparency obligations to other parties is also provided for, parties whose identification is submitted for the Chairman and the Chief Executive Officer of the Company separately;
- > halving of the size thresholds of the transactions to be communicated to the market on a quarterly basis (from euro 50,000 to euro 25,000) or without delay after the related performance (from euro 250,000 to euro 125,000);
  - > application of the transparency obligations also to transactions for the exercise of stock options or purchase options carried out by “significant individuals”;
  - > restriction on “significant individuals” prohibiting the performance of transactions (other than those concerning purchase options) during the 30 days which precede the approval of the draft statutory Financial Statements and the *interim* report by Terna’s Board of Directors. It is also anticipated that the Board itself may identify additional blocking periods during the year, in concurrence with specific events;
  - > setting-up of an adequate sanctioning system to the charge of the “significant individuals” who violate the provisions of the code of conduct.

### Dealings with institutional investors and the body of shareholders

Since the moment of listing of its shares on the stockmarket, the Company believes that the establishment of on-going dialogue, based on the mutual comprehension of the roles, with the body of shareholders as well as with the institutional investors, complies with one of its specific interests, as well as with a duty *vis-à-vis* the market; dialogue intended in any event to take place in observance of both the procedure for communicating documents and corporate information outside the Company and the principles contained in the “Guide for disclosure to the market”. In this connection it was ascertained, partly in consideration of the dimensions of the Company, that this dialogue could be facilitated by the creation of dedicated corporate structures. Steps were therefore taken to establish within the Company (i) an investor relations area, currently located within the “Administration, Finance and Control” division and (ii) an area tasked with conversing with the body of shareholders within the “Company Secretariat”.

Furthermore, it was thought to encourage additional dialogue with the investors by means of an adequate set up of the contents of the Company’s website ([www.terna.it](http://www.terna.it), investor relations section), on which both information of an economic-financial nature (Financial Statements, *interim* and quarterly reports, presentations to the financial community), and updated information and documents of interest for the body of shareholders (press releases, composition of the corporate bodies, By-laws and general Shareholders’ Meeting regulations, information and documents on corporate governance, Code of Ethics, the organizational and management model pursuant to Italian Legislative Decree no. 231/2001) can be found.

## General Meetings

The call contained in the Code of Self-governance to consider the general meeting as a privileged moment for establishing profitable dialogue between the shareholders and the Board of Directors (despite the presence of an ample diversification of the communication methods of the listed companies with their shareholders, the institutional investors and the market) has been carefully evaluated and fully shared by the Company, who considered it opportune – in addition to ensuring the regular participation of its Directors in the meetings' work– to adopt specific measures aimed at adequately valorizing the general meeting institution.

As a point of fact, partly on the basis of the matters hoped for by special legislation concerning listed companies, steps were taken to introduce specific provisions within the Company's By-laws, aimed at facilitating the gathering of the voting proxies from the independent shareholders of the Company and its subsidiaries, thereby encouraging the related involvement in the meetings' decision-making processes.

Furthermore, by means of the general meeting resolution dated March 3, 2004 – and, therefore, in anticipation of the listing of its shares on the stockmarket – the Company endowed itself with specific regulations aimed at guaranteeing the orderly and functional course of the general meetings by means of a detailed discipline of the various phases into which it is split up, in observance of the fundamental right of each shareholder to request clarification on the various matters being discussed, to express their opinion and to put forward proposals.

These regulations, despite not taking on the guise of provisions of the By-laws, are approved by the ordinary Shareholders' Meeting by virtue of a specific responsibility assigned to said body by the By-laws. The contents of the regulations are aligned to the most evolved standards drawn up specifically by certain trade associations (Assonime and ABI) for listed companies.

## Code of Ethics

Back in May 2002, Terna's Board of Directors voted for the adoption of the Enel Group's Code of Ethics (revised in March 2004), in awareness of the social and environmental implications which accompany the activities carried out by the Company, and in consideration of the importance covered as much by a co-operative approach with the stakeholders as by Terna's good reputation (both in internal dealings and externally).

This code expresses the commitments and the ethical responsibilities when conducting business, disciplining and adapting the corporate conduct to standards marked with maximum transparency and correctness toward all the stakeholders. In particular, the Code of Ethics is split into:

> general principles in dealings with the stakeholders, which in an abstract manner define the reference values which Terna aspires to when carrying out its activities. As part of these principles, mention is made in particular of: the honesty, impartiality, correctness in the event of potential conflicts of interest, confidentiality, valorization of the share-based investment, the value of the human resources, the transparency and completeness of the information, the quality of the services, the protection of the environment;

- > criteria concerning conduct toward each class of stakeholders, which specifically provide the guidelines and norms which Enel collaborators are obliged to follow in order to guarantee the observance of the general principles and in order to avoid the risk of non-ethical conduct;
- > implementation mechanisms, which describe the preordained system of control and ensure the observance of the Code of Ethics and its on-going improvement.

## Organizational and management model

Back in December 2002, Terna's Board of Directors voted for the adoption of the organizational and management model of the Enel Group (integrated in July 2003) complying with the requirements of Italian Legislative Decree no. 231 dated June 8, 2001, which introduced a system of administrative responsibility (but in fact criminal) within the Italian legal system to the charge of companies for certain types of offences committed by the related directors, executives or employees in the interests or to the advantage of the companies themselves.

On June 24, 2004, Terna's Board of Directors adopted an updated version of this organizational and management model which, despite faithfully following the structure of the previous model in its contents, updates and amends certain provisions in consideration of the stockmarket listing of the Company's shares which took place.

With regard to its layout, the model is split up into three parts:

- > a "general part", which contains a description, amongst other things, of the content matter of Italian Legislative Decree no. 231/2001, the objectives and the functioning of the model, the duties of the internal auditing body called to oversee the functioning and the observance of said model, the information flows, the sanctioning system;
- > a "special part A", concerning the offences committed in dealings with government agencies;
- > a "special part B" relating to corporate offences.

This model is consistent, with regard to the contents, with the matters anticipated by the guidelines drawn up on the subject by trade associations and with the best practice, and represents an additional step towards the uprightness, transparency and sense of responsibility in internal dealings and with the outside world, at the same time offering the shareholders guarantees for an efficient and correct management.

Three tables are presented below which summarize some of the most significant information contained in the second part of the document.

## Structure of the Board of Directors and of the Terna committees

Board of Directors						Internal Auditing Committee		Remuneration Committee		Possible Appointment Committee		Possible Executive Committee	
Office	Members	Executive	Non Executive	Independents	****	Number of other offices	**	***	****	***	****	***	****
Chairman	Fulvio Conti		X		100%	10							
Chief Executive Officer	Sergio Mobili	X			100%	-							
Director	Luca Arnaboldi (*)		X	X	100%	4	X	75%				Non-existent	Non-existent
Director	Paolo Cantarella (*)		X	X	100%	1			X	100%			
Director	Davide Croff		X	X	80%	3	X	100%					
Director	Claudio Machetti		X		80%	1			X	100%			
Director	Salvatore Machi (*)		X	X	100%	2	X	100%					
Director	Massimo Romano		X		100%	-							
Director	Paolo Ruzzini		X		100%	3			X	100%			
Director	Salvatore Sardo		X		20%	-							

Quorum requested for the presentation of the lists for the appointment of the Board of Directors: 1% of the share capital

Number of meetings held during 2004 (\*\*\*\*)

BoD: 5

Internal Auditing Committee: 4

Remuneration Committee: 2

Appointment Committee: N.A.

Executive Committee: N.A.

### NOTES

- \* The presence of the asterisk indicates if the Director has been appointed by the minority shareholders (you are hereby informed that so far steps have not been taken to apply the "list voting" mechanism).
- \*\* This column contains indication of the number of offices as Director or Statutory Auditor covered by the individual concerned in other companies listed on organized markets, abroad as well, in financial, banking or insurance companies or those of significant size.
- \*\*\* This column indicates by means of an "X" if any of the Directors belong to Committees.
- \*\*\*\* This column contains indication of the percentage of participation of each Director respectively in the meetings of the Board of Directors and the Committees. All cases of absence have been adequately justified.
- \*\*\*\*\* Only the meetings held as from June 23, 2004 (in other words as from the start of trading in Terna shares on the Electronic equity market organized and run by Borsa Italiana SpA) until December 31, 2004 have been taken into account.

### Terna's Board of Statutory Auditors

Office	Members	Percentage of participation at meetings of the Board of Statutory Auditors	Number of other offices**
Chairman	Giovanni Ferreri	100%	1
Acting Auditor	Bruno Franceschetti	75%	-
Acting Auditor	Giancarlo Russo Corvace	100%	1
Alternate Auditor	Daniela Gallucci	N.A.	-
Alternate Auditor	Fabrizio Orazi	N.A.	-

Number of meetings held during 2004: 4 (\*\*\*)

Quorum requested for the presentation of the lists for the appointment of the Board of Statutory Auditors: 1%

#### NOTES

- \* The presence of the asterisk indicates if the Auditor has been appointed by means of lists presented by the minority shareholders.
- \*\* This column contains indication of the number of offices as director or statutory auditor covered by the individual concerned in other companies listed on organized markets.
- \*\*\* Only the meetings held as from June 23, 2004 (in other words as from the start of trading in Terna shares on the Electronic equity market organized and run by Borsa Italiana SpA) until December 31, 2004 have been taken into account.

## Other provisions of the Code of Self-governance

	YES	NO	Summary of the reasons for any deviation from the recommendations of the Code
<b>System of the powers of attorney and transactions with related parties</b>			
Has the BoD assigned powers of attorney defining:	X		
a) limits	X		
b) operating formalities	X		
c) and frequency of the disclosure?	X		
Does the BoD propose to examine and approve the transactions with a particular economic, equity and financial significance (including transactions with related parties)?	X		
Has the BoD defined guidelines and criteria for the identification of the "significant" transactions?	X		
Are the guidelines and criteria indicated above described in the report?	X		
Has the BoD defined specific procedures for the examination and approval of the transactions with related parties?	X		
Are the procedures for the approval of the transactions with related parties described in the report?	X		
<b>Procedures for the most recent appointment of directors and statutory auditors</b>			
Did the registration of the candidatures for the office of director take place at least ten days in advance?	X		
Were the candidatures for the office of director accompanied by in-depth disclosure?	X		
Were the candidatures for the office of director accompanied by indication of the suitability of the candidates to qualify as independent?	X		
Did the registration of the candidatures for the office of auditor take place at least ten days in advance?		X	The last renewal took place before the listing of Terna shares on the stockmarket
Were the candidatures for the office of auditor accompanied by in-depth disclosure?		X	The last renewal took place before the listing of Terna shares on the stockmarket
<b>General Meetings</b>			
Has the Company approved General Meeting regulations?	X		
Are the regulations attached to the report (or has it been indicated where they can be obtained/downloaded from)?	X		
<b>Internal auditing</b>			
Has the Company appointed a head of internal auditing?	X		
Is this individual hierarchically independent from the heads of the operating areas?	X		
Organizational grade of the head of internal auditing			Head of the auditing division
<b>Investor relations</b>			
Has the Company appointed a head of investor relations?	X		
Organizational unit and references of the head of investor relations			<p><b>&gt; Relations with institutional investors:</b>  <i>Investor Relations</i> – Viale Regina Margherita no. 125  00198 Rome – tel. 06.83057145 - fax 06.83054289  e-mail: investor.relations@terna.it</p> <p><b>&gt; Relations with individual shareholders:</b>  <i>Company Secretariat</i> – Viale Regina Margherita no. 125  00198 Rome – tel. 06.83058376 – fax 06.83054618  e-mail: azionisti.retail@terna.it</p>



## Organization and Human Resources

### New organizational structure

The process for the listing of Terna stock led to the need to make organizational, operational and managerial changes aimed at ensuring the operational autonomy of the Company, despite anticipating the opportune formalities for co-ordination with the Parent Company and the definition of a reference workforce which takes account of the acquisition of services from other Enel Group companies.

On a consistent basis with this outlook, a functional type of organizational structure was planned, within which three new management divisions are anticipated:

- > Regulatory Affairs and External Relations
- > Auditing
- > Business Development.

The other four staff divisions already existing ('Personnel and Organization', 'Administration, Finance and Control', 'Purchases and Tender Contracts' and 'Legal Affairs and 'Company Secretariat') have been assigned new and additional responsibilities associated with the Company's stockmarket listing. Specifically, within the Administration, Finance and Control Division the new Finance and Investor Relations units have been set up.

The supervision of the primary activities is, what is more, ensured by two new divisional offices:

- > the "Plant Engineering and Maintenance" division, which is responsible for:
  - the "Power Plant Technologies Development" department
  - the "Plant Development" Department
  - the 8 Transmission Operating Areas
- > the "Plant Running and Monitoring" division, which is responsible for the three Running and Remote Control Centres.

The new organizational structure has been operational since February.

The following table shows a breakdown of the workforce by category.

Breakdown of the workforce	at	at	Changes
	Dec. 31, 2004	Dec. 31, 2003	
<b>Total</b>	<b>2,871</b>	<b>2,821</b>	<b>50</b>
Senior management	34	30	4
Middle management	221	204	17
Office staff	1,467	1,422	45
Workers	1,149	1,165	-16

The figures for both years are net of leavers as of December 31 (amounting to 25 as of December 31, 2004 and 227 as of December 31, 2003).

The increase in the headcount during 2004 was mainly the result of the almost complete achievement of the intake plan put together in 2003 in face of the need to handle the turnover, so as to guarantee the maintenance and development of the Company's distinctive expertise, and to permit a generation changeover partly supporting the technological evolution underway within the core processes.

The stockmarket listing of Terna also made the acquisition of professional profiles necessary for the careful supervision of new processes or part of these not present within the Company previously, indispensable, so as to guarantee the operational autonomy of the same.

The "sustainability of the performance" by means of the valorization of Human Capital, over time and within a context of change, characterized the resource development and training plan started up during 2004.

The objective of increasing the Skills Capital, facilitating a sharing of the wealth of knowledge present in-house and its constant alignment with the new technological and organizational growth requirements, guided the specialist training activities targeted at technical staff (O&M and Engineering). Alongside support training initiatives, planned on a parallel and on a consistent basis with the development of innovation projects, action was implemented targeted at transforming the specialist know-how into widespread sensitivity/knowledge.

Again with a view to encouraging to the maximum the integration and transfer of knowledge, the training of young school-leavers and university graduates employed was concentrated in particular on on-the-job training, as well as providing for traditional classroom and remote-learning activities. Furthermore, the commitment to both subjects of safety and to the on-going training of blue-collar workers was high.

Partly in light of the institutional/organizational set up changes and the phase of transition toward integration with the ISO, management and, more generally, the staff resources were subject to targeted training by means of the attendance of outside managerial and specialist courses to a greater extent than in the past.

In conclusion, two Training Campaigns were started up targeted at all the staff by means of the EDLS (Enel Distance Learning System): the first concerned the organizational and management model adopted on the basis of Italian Legislative Decree no. 231/2001; the second supported the action for revising the corporate Quality Management System.

During 2004, 2,848 employees were involved in traditional/EDLS training activities.

With the aim of acquiring a greater awareness of the Company resources and elements supporting the Policies and the Plan for the Management and Development of the resources, during 2004 two assessments campaigns were created (skills, performance, potential) which concerned all the executives and middle management. The campaigns were supported by specific training action on People Management, which benefited the heads involved in the process in their capacity as assessors.

The launch of the campaigns was preceded by a review of the Professional System directed at the model of the Skills which make up the reference base for the management and development of the resources.

Lastly, in order to rally all management together with respect to the objective of creating value for the shareholders, consequent to the recent stockmarket listing, the MBO was extended to all the middle management.

#### **Terna-ISO integration project**

Following the issue of the Prime Minister's Decree dated May 11, 2004 which provides for the management and ownership unification of the electricity transmission network, Terna launched a series of initiatives with the ISO aimed at guaranteeing, as from the first day, the fully operational nature of the body emerging from the unification.

More specifically, the following were carried out together:

- > analysis and definition of the governance mechanisms with a view to the hold of the Terna governance system, from the point of view of the integration of the ISO activities;
- > definition and reorganization of the Dispatch and Operation, network Development and Maintenance core processes with a view to the complete functioning of said processes;
- > definition of the integration logics and subsequent rationalization of the Terna/ISO systems;
- > Management Appraisal, in order to provide useful elements for the definition of the managerial set up post-integration and for the identification, also with a view to benchmarking outside, of the pool of talent for which personalized growth plans can be organized;
- > the launch, in January 2005, of a survey into the organizational culture of Terna and the ISO, targeted at all the staff, whose purpose is to seize the strong points to valorize within the integrated Company.

## Research and Development

As far as research activities which require specific professional skills were concerned, Terna avails of the collaboration of CESI SpA in which it holds a 15% equity investment.

The research project of greatest interest during 2004 concerned:

- > the implementation of an expert system supporting the power line and stations maintenance activities, entitled MBI, which besides being a technical database, supports the proposals and the handling of the maintenance operations plans;

The related costs incurred during the year amounted to approximately euro 2.2 million.

The following activities are planned for 2005:

- > the study and set up of on-line diagnostic systems for power line insulators;
- > the research and set up of innovative solutions for reducing electromagnetic fields.

## Innovation

Other activities more fully directed toward practical application for optimizing and improving the efficiency of the processes, carried out mainly by means of internal work groups, include:

- > the set up of new work methods under live conditions for power lines: replacement of protection cables, also with fibre optics, and insulator cleaning;
- > the set up of new work methods under live conditions at electricity stations;
- > the study and set up of work on power lines using helicopters;
- > the study and installation of innovative systems for the on-line detection of the temperature of conductors aimed at the best use of the same;
- > project for the installation of conductors with a greater transport capacity;
- > the search for innovative methods for underground HV cable diagnostics;
- > the set up of detection methods using helicopter-borne laser systems for monitoring power lines;
- > the search for new plant engineering solutions for the construction of electricity stations;
- > the search for and set up of HV compact equipment systems;
- > the search for and set up of intrinsically safe HV gauging equipment;
- > the set up of new criteria for the revision of the main station-based electrical equipment for improving the operating efficiency.

## New systems

During 2004, the development activities for innovative projects also realized with the collaboration of Enel.it were more or less completed.

The main systems which will become fully operative within the first few months of 2005 include:

- > GIS (geo-referencing system of the National Electricity Network integrated with the SAP system – for all the management activities – and with the database of the Ministry for the Environment for

national mapping making);

- > SDSA (advanced station design system – integrated with activities for estimating and acquiring external resources);
- > CMS (advanced system for supporting the process for the purveying of external resources integrated with SAP and with SDSA systems);
- > WI-FI Lan (extension of the corporate intranet network in wireless mode at the stations for the utilization of palmtop or laptop computers);
- > VTS (system which utilizes an advanced voice recognition platform for the handling of safety activities for work on plants – work plans and safety procedures for the movements by Terna and non-Terna staff);
- > Maintenance Budget Reporting and Analysis System (system for estimating and analysis of the final balances of the plant renovation and maintenance activities, integrated with SAP, MBI, Service Quality Observatory);
- > PLANNING (system for the handling of the corporate budget organized over all the business units on a consistent basis with the Budget Maintenance reporting and analysis system);
- > Equipment management (system for the classification of the equipment for the Operating Groups, collation of references and norms for the management, scheduling of maintenance measures (required by law, anticipated by the manufacturers, anticipated by Terna);
- > MOQ, system for supporting the internal auditing activities (scheduling, taking stock of activities, handling of non-compliances, preventive action and corrective action).

## Consolidated systems

### ISO 9001: Vision 2000 certification

Terna is ISO 9001:Vision 2000 certified; the Quality Management System adopted is based on the process-based organization of the corporate activities.

The corporate processes have been configured from a network perspective, so as to valorize the interrelationships and reduce the inefficiencies, with an integrated overview toward the management systems present in-house.

Supporting this system, the corporate intranet website permits the tracking on the network of the processes and the availability of the documents on a constantly up-dated basis.

### Integrated SAP system

All the corporate processes, both operational and management-related, are supported by a single ERP system, the SAP. The system centralizes the information input during the process activities and correlates it so as to create a complete integration between the corporate processes. The SAP modules adopted within Terna are: SAP CO (Controlling) SAP FI (Financial) SAP PM (Maintenance) SAP PS (Projects) SAP SD (Sales) SAP MM (Passive Cycle). The centralized cash management module

SAP TR TM is currently being implemented, as part of the Company's financial and management autonomy process.

#### **Balanced Scorecards and the incentive system**

Terna has adopted a Business Intelligence system to support strategic corporate decision-making. By gathering economic, technical and management information in a process-based format, it is able to record the numerical values achieved by specific gaugeable aspects of the processes in question. The Company's incentive schemes are based on this Balanced Scorecard system.

## Transactions with related parties

Related parties were identified taking as reference the provisions of the CONSOB Communication no. 2064231 dated September 30, 2002.

With regard to Terna SpA's transactions during the 2004 accounting period, they are represented by transactions with subsidiary companies and companies belonging to the Enel Group.

The transactions carried out by Terna SpA with related parties mainly concern the exchange of goods, the provision of services, the borrowing and lending of financial resources, the coverage of insurance risks and up to the moment of listing for assistance activities concerning staff organization, as well as administrative, tax, legal and corporate assistance.

All the transactions form part of the ordinary operations and are regulated on an arm's length basis, in other words at conditions which would be applied between two independent parties.

Lastly, shareholders are reminded that within the sphere of the corporate governance regulations which Terna has adopted and which are detailed in the specific section of this Report on Operations, the conditions have been anticipated for ensuring that the transactions with related parties are carried out in observance of the criteria of procedural and substantive correctness.



The transactions with related parties are indicated in the Explanatory Notes within the commentary to the individual Balance Sheet items as summarized in the table below:

Main Income Statement items	In millions of euro	Company and nature of transaction
Revenues for other sales and services	30.2	Enel Distribuzione SpA - Services for the running and maintenance of the HV lines belonging to Enel Distribuzione SpA, as well as for the sale to the same of power lines not belonging to the NTN
	11.7	Enel.Net Srl - services relating to the support of the F.O. on plants belonging to Terna as well as the running, maintenance and development of the same
	0.7	Enel SpA - IPO consultant fees
	1.1	Enel Green Power - Services relating to jobs for the construction of plants, and other sundry services
	1.6	Enel Produzione SpA - Services relating to jobs for the construction of plants, as well as sundry services and maintenance on Enel Produzione SpA plants
	1.7	Wind Telecomunicazioni SpA - Servicing for teletransmission and telephone equipment housing activities
	0.7	Novatrans Energia SA - Terna personnel services
	0.7	Transmissora Sudeste Nordeste SA - Terna personnel services
	0.5	Enelpower SpA - Sundry maintenance and services on Enelpower SpA plants
Costs for services	24.3	Wind Telecomunicazioni SpA - Telecommunications services and services for the development of special projects (SCTI)
	7.8	Enel.it Srl - Services for the realization and the maintenance of IT projects, for the operating of applications and connections to the Internet and to databases, electronic mail and the Intranet, hire and management of PCs
	5.7	Enel Facility Management SpA - services for: - catering service by means of the provision of meals in company restaurants (canteens) to Terna staff – Property service (cleaning, ordinary maintenance and operating of installations, security, etc.) in the buildings occupied by Terna staff
	4.6	Ape Srl - Services relating to: - the provision of meals replacing the canteen service (luncheon vouchers) to services for the management/administration of Terna staff
	4.2	Enel Distribuzione SpA - Reimbursement of the discounts on supplies of electricity to employees and pensioners as well as sundry services on plants
	14.5	Enel SpA - sundry services for stockmarket listing (euro 10 Mln) and Management Fees (euro 4 Mln)
Financial income and expense		
Other financial income from parent companies	4.4	Enel SpA - Interest income on Intercompany bank account
	25.2	Enel SpA - Charges relating to interest expense on medium/long-term loans and on derivative products relating to the same
Financial income and expense		
Other financial income from subsidiary companies	11.6	Novatrans Energia SA - interest income on loan
	13.9	Transmissora Sudeste Nordeste SA - Interest on equity

## Terna stock held by the Directors and Statutory Auditors

Pursuant to the matters laid down by Article 79 of CONSOB Resolution no. 11971/99, the table below presents a list of the Terna shares and the shares of its subsidiary companies held by the Directors and by the Statutory Auditors, as well as by the spouses not legally separated and by dependent children, directly or via subsidiary companies, trust companies or third parties, emerging from the shareholders' register, communications received and information acquired by said Directors and Statutory Auditors. Therefore, all the individuals who during 2004 covered the offices of Director or Statutory Auditor are included.

Name and Surname	Investee Company	Number of shares held at the end of 2003	Number of shares acquired in 2004	Number of shares sold in 2004	Number of shares held at the end of 2004	Title
Fulvio Conti	Terna SpA	n.a.	12,000	0	12,000	Owned
Sergio Mobili	Terna SpA	n.a.	0	0	0	-
	TSN - Transmissora Sudeste Nordeste SA	0	1	0	1	Owned
	Novatrans Energia SA	0	1	0	1	Owned
Claudio Machetti	Terna SpA	n.a.	12,000	0	12,000	Owned
Massimo Romano	Terna SpA	n.a.	12,000	0	12,000	Owned
Paolo Ruzzini	Terna SpA	n.a.	12,000	0	12,000	Owned
Salvatore Sardo	Terna SpA	n.a.	12,000	0	12,000	Owned
Carlo Tamburi*	Terna SpA	n.a.	6,000	0	6,000	Owned

\* In office until May 12, 2004.

## **Significant events subsequent to the end of the accounting period, outlook for 2005 and other information**

The main events following the end of the accounting period, are described as follows.

**Publication of the Electricity and Gas Authority Resolution no. 15/05 relating to the implementation of Article 1 of the Prime Minister's Decree dated May 11, 2004, in other words concerning the definition of the revenues due to the ISO business segment being transferred to Terna**

This resolution set the tariff intended to cover the costs of the part of the ISO which will not be transferred to Terna (the so-called ISO-CIP6) at 0.0095 euro cents/kWh.

In this resolution, the Electricity and Gas Authority also clarified the allocation of certain economic items present in the 2004 accounts of ISO SpA establishing in particular that, by means of separate measures, it will adopt the necessary provisions so that:

- a) the amounts set aside as of December 31, 2004 by ISO in the reserve for management margin on cross-border interconnection guarantees are destined to reduce the payments for the purveying of the resources on the market for the dispatching service;
- b) the revenue from infrazone congestion set aside by ISO as of December 31, 2004, or rather the amounts corresponding to the CCT 2004 margin, are destined to reduce the charges for the energy transmission service.

Lastly, again in the decree in question, the Authority announces that by means of a specific resolution it will adopt the provisions aimed at regulating the financial flows generated by the tariff proceeds destined to cover the costs acknowledged the two bodies emerging from the re-unification (Terna TSO and ISO-CIP6).

**Amendments to the By-laws required by the Prime Minister's Decree dated May 11, 2004, in view of the unification of the ownership and management of the NTN**

On January 31, 2005, Terna's extraordinary Shareholders' Meeting resolved, by means of the approval of the amendments proposed by the Board of Directors on December 14, 2004, the adaptation of the By-laws to the provisions of the Prime Minister's Decree dated May 11, 2004, containing "Criteria, methods and conditions for the unification of the ownership and the management of the National Transmission Network".

The most significant changes to the By-laws among those approved by the Shareholders' Meeting included:

- > the corporate name, changed to «Terna – Rete Elettrica Nazionale Società per Azioni» (in abbreviated form Terna SpA);
- > the corporate purpose, changed so as to ensure consistency also with the ownership and the operation by Terna of the functions as operator of the national electricity transmission network;
- > the fixing of a limit, equating to 5% of the share capital, to the charge of the electricity sector operators in relation to the exercise of the voting right when appointing the Directors;

> the introduction of special requirements for covering the role of Directors.

The aforementioned changes to the By-laws will become applicable only as from the date of transfer to Terna of the activities of Gestore della Rete di Trasmissione Nazionale SpA (ISO), in accordance with the matters anticipated by the aforementioned Prime Minister's Decree.

#### Terna-ISO unification

On February 28, 2005 Terna SpA and ISO SpA, in observance of the matters laid down by the Prime Minister's Decree dated May 11, 2004, signed the agreement for the transfer to Terna of the ISO business segment, comprising the activities, functions, assets and legal relationships as indicated by the same Prime Minister's Decree.

The purpose of the agreement is to integrate the ownership and management of the NTN.

The business segment being transferred includes approximately 580 resources, and includes:

- > the dispatching activities, or rather the management of the flows introduced and withdrawn from the NTN in order to balance electricity supply and demand;
- > the planning and development activities, or rather the definition of the investment programs for enhancing the NTN.

The parties have agreed a price of euro 68.3 million for the transfer of the business segment, net of approximately euro 112 million in trade payables due to Terna. The overall valorization of the business segment transferred therefore amounts to euro 180 million.

The date of efficacy of the unification between the ownership and management of the NTN is deferred until the occurrence of the following abeyance conditions:

- > the new concession by the Ministry of Production Activities for the performance of the electricity transmission and dispatching activities within the national territory belonging to Terna;
- > the approval, by the Ministry of Production Activities and the Energy Authority, of the Network Code anticipated by the Prime Minister's Decree;
- > the issue by the Antitrust Authority of a favorable opinion on the transaction.

## Outlook for operations in 2005

During the next accounting period the matters anticipated by the Prime Minister's Decree dated May 11, 2004 will be implemented, specifically in relation to the unification between the ownership and management of the national transmission network.

Consolidation will also follow of the Company's leadership within the sphere, of the development and maintenance of the NTN and, from an operational point of view, the technological innovation and the growth of the staff in terms of professionalism and consolidation of the widespread "managerial nature". Such action, which the company intends to pursue, aims to ensure and safeguard the creation of value for the shareholder.

As part of the quantitative-qualitative overseeing of the corporate professionalism and the

management of the turnover with a view to the generation changeover, the intake plan may be expanded and a voluntary early retirement plan implemented in continuity with the matters already carried out in 2003-2004. In relation to the process for integration with the ISO and the creation of a new body, the commitments will be targeted at the re-definition of policies and plans of action consistent with the changed context. Internal communication events and initiatives will be implemented during the pre and post integration phase so as to permit the maximum involvement of the staff in the process of change.

## Other information

**Adoption of the international accounting standards** European Ruling no. 1606/2002 anticipates that, as from the 2005 accounting period, all the companies listed on organized markets in the EU shall adopt the “International Financial Reporting Standard” (IFRS) accounting standards for drawing up Consolidated Financial Statements.

The Italian legislator, within the sphere of the authority granted by said Ruling, by means of the EU Law 2003 (Law no. 306 dated October 31, 2003) extended this obligation to the statutory Financial Statements of listed companies as well.

During the session held on November 26, 2004, the Cabinet approved the outline of the Legislative Decree bearing the “exercise of the options anticipated by Article 5 of the Ruling (EU) no. 1606/2002, concerning international accounting standards”. The Legislative Decree was forwarded, for the prescribed opinion, to the competent parliamentary commissions.

This Legislative Decree lays down that companies issuing financial instruments listed on organized markets, have the faculty to draw up the Statutory Financial Statements using the new regulations as early as from 2005 and on a compulsory basis as from 2006. The obligation for the preparation of the Consolidated Financial Statements however is applicable as from 2005.

To-date, the Legislative Decree is being discussed and compared with the professional categories and the associations concerned.

Coinciding with this, the IASB (International Accounting Standard Board) has planned a series of projects aimed at the implementation of the international standards assimilated by the EU, including therein the regulation of transactions currently not disciplined. Some of these projects have already been concluded while others are being defined.

During 2004, in collaboration with the Group companies which also include Terna, Enel launched a specific process for the analysis and evaluation of the main differences between the

accounting standards adopted at present and those affected by the introduction of the IFRS. The problems related to the processes and the computerized information system have also been planned and adaptation activities started which are expected to be completed within the first three months of 2005.

With respect to the accounting standards currently adopted by Terna, the greatest impacts are recognized:

- > in the provision according to which goodwill is not subject to amortization and its ability to be recovered must be verified, at least annually, for the purposes of the identification of a possible loss in value (impairment test);
- > in the utilization of actuarial techniques for the valuation of the employee termination indemnity and other staff indemnities, including benefits for electricity at reduced tariffs granted to employees and pensioners;
- > in the adoption of the fair value for the valuation of derivatives instruments.

**Code concerning the protection of personal data (Italian Legislative Decree no. 196 dated June 30, 2003)**

During 2003, Terna Spa drew up the Programmatic Security Document in accordance with Italian Presidential Decree no. 318/1999. The document will be updated in compliance with Italian Legislative Decree no. 196 dated June 30, 2003 by the legal deadline anticipated as June 30, 2005.

**Own shares**

The Company does not possess, nor has it acquired or transferred during the year, even indirectly, its own shares, or shares of subsidiary companies.

**Statutory Financial Statements  
as of December 31, 2004**



## Balance Sheet - Assets

Euro	at Dec. 31, 2004	at Dec. 31, 2003	Changes for the period
<b>A) SHARE CAPITAL NOT PAID-IN</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>B) FIXED ASSETS</b>			
<b>I. Intangible assets</b>			
(1) incorporation costs	0	0	0
(2) research, development and advertising	0	0	0
(3) industrial patents and intellectual property rights	0	0	0
(4) concessions, licenses and trademarks	0	0	0
(6) work in progress and advances	0	0	0
(7) other	0	0	0
<b>Total</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>II. Tangible assets</b>			
(1) land and buildings	329,105,450	311,708,785	17,396,665
(2) plant and machinery	3,125,465,914	2,410,199,587	715,266,327
(3) commercial and industrial equipment	12,022,499	10,903,912	1,118,587
(4) other assets	1,768,198	863,301	904,897
(5) work in progress and advances	379,975,702	317,721,236	62,254,466
<b>Total</b>	<b>3,848,337,763</b>	<b>3,051,396,821</b>	<b>796,940,942</b>
<b>III. Financial assets</b>			
(1) equity investments in:			
(a) subsidiaries	300,007,357	156,248,804	143,758,553
(b) affiliates	0	0	0
(c) Parent Company	0	0	0
(d) others	2,866,457	3,468,129	-601,672
(2) receivables from:			
(a) subsidiaries	6,012,074	289,825,446	-283,813,372
(b) affiliates	0	0	0
(c) Parent Company	0	0	0
(d) others	5,868,084	8,858,481	-2,990,397
> due within 12 months	6,444,144	290,266,554	-283,822,410
(3) other securities	0	0	0
<b>Total</b>	<b>314,753,972</b>	<b>458,400,860</b>	<b>-143,646,888</b>
<b>TOTAL FIXED ASSETS (B)</b>	<b>4,163,091,735</b>	<b>3,509,797,681</b>	<b>653,294,054</b>
<b>C) CURRENT ASSETS</b>			
<b>I. Inventories</b>			
(1) raw materials	10,039,942	8,385,769	1,654,173
(3) contract work in progress	22,612,806	19,306,148	3,306,658
(5) advances	0	0	0
<b>Total</b>	<b>32,652,748</b>	<b>27,691,917</b>	<b>4,960,831</b>

Euro	at Dec. 31, 2004	at Dec. 31, 2003	Changes for the period
<b>II. Receivables</b>			
(1) trade:			
> third parties	121,568,464	182,813,694	-61,245,230
> other Enel Group companies	17,545,098	20,181,570	-2,636,472
(2) subsidiaries	12,651,396	228,379	12,423,017
(3) affiliates	0	0	0
(4) Parent Company	143,916,271	289,269,197	-145,352,926
(4-bis) tax receivables	12,702,492	0	12,702,492
(4-ter) advanced taxes	14,837,169	22,294,583	-7,457,414
(5) others	12,779,211	15,000,164	-2,220,953
> due beyond 12 months	10,997,777	35,380,224	-24,382,447
<b>Total</b>	<b>336,000,101</b>	<b>529,787,587</b>	<b>-193,787,486</b>
<b>III. Short-term investments</b>			
(4) other equity investments	0	0	0
(6) other securities	0	0	0
<b>Total</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>IV. Cash and cash equivalents</b>			
(1) bank and post office deposits	0	0	0
(3) cash on hand	92,025	103,447	-11,422
<b>Total</b>	<b>92,025</b>	<b>103,447</b>	<b>-11,422</b>
<b>TOTAL CURRENT ASSETS (C)</b>	<b>368,744,874</b>	<b>557,582,951</b>	<b>-188,838,077</b>
<b>D) ACCRUED INCOME AND PREPAID EXPENSES</b>			
(1) accrued income	10,008,219	0	10,008,219
(2) prepaid expenses:			
> issue discounts	3,169,817	0	3,169,817
> other	8,043,301	4,206,737	3,836,564
<b>TOTAL ACCRUED INCOME AND PREPAID EXPENSES (D)</b>	<b>21,221,337</b>	<b>4,206,737</b>	<b>17,014,600</b>
<b>TOTAL ASSETS</b>	<b>4,553,057,946</b>	<b>4,071,587,369</b>	<b>481,470,577</b>

## Balance Sheet - Liabilities and Shareholders' Equity

Euro	at Dec. 31, 2004	at Dec. 31, 2003	Changes for the period
<b>A) SHAREHOLDERS' EQUITY</b>			
I. Share Capital	440,000,000	2,036,050,000	-1,596,050,000
II. Share premium reserve	0	0	0
III. Revaluation reserve	0	0	0
IV. Legal reserve	84,491,220	78,316,740	6,174,480
V. Statutory reserve	0	0	0
VI. Reserve for own shares	0	0	0
VII. Other reserves <sup>(*)</sup>	728,683,476	295,725,862	432,957,614
VIII. Retained earnings (losses) <sup>(*)</sup>	522,937	335,797	187,140
IX. Interim dividends 2004	-90,000,000	0	-90,000,000
<b>Earnings (losses) for the year</b>	<b>674,263,935</b>	<b>123,489,605</b>	<b>550,774,330</b>
<b>Total</b>	<b>1,837,961,568</b>	<b>2,533,918,004</b>	<b>-695,956,436</b>
<b>B) PROVISIONS FOR RISKS AND CHARGES</b>			
(1) retirement benefits	717,399	773,975	-56,576
(2) taxes:			
> current	0	0	0
> deferred	463,968,279	159,279,912	304,688,367
(3) others	40,090,796	59,246,224	-19,155,428
<b>Total</b>	<b>504,776,474</b>	<b>219,300,111</b>	<b>285,476,363</b>
<b>C) EMPLOYEE TERMINATION INDEMNITY</b>	<b>60,424,427</b>	<b>70,731,513</b>	<b>-10,307,086</b>
<b>D) PAYABLES</b>			
(1) bonds	1,400,000,000	0	1,400,000,000
> due beyond 12 months	1,400,000,000	0	1,400,000,000
(2) convertible bonds	0	0	0
(3) trade payables from loans	0	456,154,754	-456,154,754
(4) bank loans:			
> medium- and long-term bonds	318,215,715	325,000,000	-6,784,285
> due beyond 12 months	300,033,897	318,181,818	-18,147,921
> short-term loans	0	0	0
(5) other loans	0	0	0
(6) advances	36,171,630	47,709,419	-11,537,789
> due beyond 12 months	15,804,605	30,512,678	-14,708,073
(7) trade payables:			
> third parties	150,374,242	127,506,399	22,867,843
> due beyond 12 months	2,984,028	833,605	2,150,423
> other Enel group companies	25,882,440	29,899,194	-4,016,754
(8) payables represented by credit instruments	0	0	0
(9) payables to subsidiaries	0	0	0
(10) payables to affiliates	0	0	0
(11) payables to Parent Company	1,702,059	39,262,458	-37,560,399
(12) tax payables	16,098,080	34,746,727	-18,648,647
(13) social security payables	7,917,083	7,463,674	453,409
(14) other payables	12,748,513	30,561,790	-17,813,277
<b>Total</b>	<b>1,969,109,762</b>	<b>1,098,304,415</b>	<b>870,805,347</b>

(\*) Available reserve

Euro	at Dec. 31, 2004	at Dec. 31, 2003	Changes for the period
<b>E) ACCRUED LIABILITIES AND DEFERRED INCOME</b>			
(1) accrued liabilities	19,025,199	6,704,200	12,320,999
(2) deferred income:			
> premium on bond issues	0	0	0
> other	161,760,516	142,629,126	19,131,390
<b>Total</b>	<b>180,785,715</b>	<b>149,333,326</b>	<b>31,452,389</b>
<b>TOTAL LIABILITIES</b>	<b>2,715,096,378</b>	<b>1,537,669,365</b>	<b>1,177,427,013</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>4,553,057,946</b>	<b>4,071,587,369</b>	<b>481,470,577</b>
<b>COMMITMENTS</b>			
Guarantees granted	313,906,434	7,377,074	306,529,360
Other commitments	2,519,259,113	356,139,539	2,163,119,574
<b>Total</b>	<b>2,833,165,547</b>	<b>363,516,613</b>	<b>2,469,648,934</b>

## Income Statement

Euro	2004	2003	Changes for the period
<b>A) VALUE OF PRODUCTION</b>			
(1) revenues from sales and services:			
> network usage fees	810,779,378	782,314,486	28,464,892
> other sales and services	62,789,292	61,593,295	1,195,997
(3) change in contract works in progress	3,306,658	4,690,222	-1,383,564
(4) capitalized expenses	22,525,364	17,412,026	5,113,338
(5) other income and revenues:			
> contribution received	15,262,356	20,284,739	-5,022,383
> other	13,454,569	8,262,719	5,191,850
<b>Total value of production</b>	<b>928,117,617</b>	<b>894,557,487</b>	<b>33,560,130</b>
<b>B) OPERATING COSTS</b>			
(6) raw materials	21,670,140	20,206,333	1,463,807
(7) services	102,935,197	90,369,743	12,565,454
(8) leases and rentals	12,370,444	14,559,846	-2,189,402
(9) personnel:			
> wages and salaries	115,662,916	114,533,015	1,129,901
> social security contributions	31,392,130	31,335,493	56,637
> employee termination indemnity	8,981,616	9,703,462	-721,846
> retirement benefits	967,731	1,673,776	-706,045
> other costs	6,166,142	6,569,479	-403,337
(10) amortization, depreciation and write-downs			
> intangible assets	0	31,124	-31,124
> tangible assets	143,452,786	291,014,907	-147,562,121
> other write-downs of fixed assets	704,202	0	704,202
> writedowns of current receivables	0	1,018,552	-1,018,552
(11) change in inventories	-1,654,173	-5,826,326	4,172,153
(12) accruals to provisions for risks and charges	9,671,630	35,962,521	-26,290,891
(13) other provisions	0	0	0
(14) other operating costs	28,707,688	15,866,843	12,840,845
<b>Total operating costs</b>	<b>481,028,449</b>	<b>627,018,768</b>	<b>-145,990,319</b>
<b>OPERATING INCOME</b>	<b>447,089,168</b>	<b>267,538,719</b>	<b>179,550,449</b>
<b>C) FINANCIAL INCOME AND EXPENSE</b>			
(15) from equity investments in:			
> subsidiaries	4,882,457	0	4,882,457
> affiliates	0	0	0
> other companies	0	0	0
(16) other financial income:			
(a) from long-term receivables:			
> subsidiaries	0	0	0
> affiliates	0	0	0
> other companies	169,602	274,225	-104,623
(b) from long-term financial assets	113	993	-880
(c) from marketable securities	0	0	0
(d) other income:			
> subsidiaries	25,461,561	0	25,461,561
> affiliates	0	0	0
> Parent Company	4,353,182	15,783,429	-11,430,247
> other companies	21,609	60,149	-38,540

Euro	2004	2003	Changes for the period
(17) interest and other financial expense:			
> subsidiaries	0	0	0
> affiliates	0	0	0
> Parent Company	25,661,302	36,990,959	-11,329,657
> other Enel group companies	0	0	0
> other companies	21,505,546	14,180,961	7,324,585
(17-bis) (earnings) and losses from exchange rates	-23,254	0	-23,254
<b>Total financial income (expense)</b>	<b>-12,255,070</b>	<b>-35,053,124</b>	<b>22,798,054</b>
<b>D) ADJUSTMENTS OF FINANCIAL ASSETS</b>			
(18) revaluation:			
(a) of equity investments	0	0	0
(b) of long-term financial assets	0	0	0
(c) of marketable securities	0	0	0
(19) writedowns:			
(a) of equity investments	4,882,457	0	4,882,457
(b) of long-term financial assets	0	0	0
(c) of marketable securities	0	0	0
<b>Total adjustments of financial assets</b>	<b>4,882,457</b>	<b>0</b>	<b>4,882,457</b>
<b>E) EXTRAORDINARY ITEMS</b>			
(20) income:			
> gains on disposals of assets	0	0	0
> other	673,663,552	2,178,561	671,484,991
(21) expense:			
> losses on disposals of assets	0	0	0
> prior-year taxes	2,148,473	2,787,655	-639,182
> other	261,955,209	14,427,861	247,527,348
<b>Total extraordinary items</b>	<b>409,559,870</b>	<b>-15,036,955</b>	<b>424,596,825</b>
<b>INCOME BEFORE TAXES</b>	<b>839,511,511</b>	<b>217,448,640</b>	<b>622,062,871</b>
(22) income taxes	165,247,576	93,959,035	71,288,541
> current	104,498,489	94,174,558	10,323,931
> prepaid	7,457,414	-8,368,518	15,825,932
> deferred	53,291,673	8,152,995	45,138,678
<b>(23) EARNINGS (LOSSES) FOR THE YEAR</b>	<b>674,263,935</b>	<b>123,489,605</b>	<b>550,774,330</b>



## **Notes to the Financial Statements**



## Form and content of the Financial Statements

The form, content and classification of items in the Balance Sheet, Income Statement and the accompanying notes comply with the regulations set forth in the Italian Civil Code and with the new regulations on the matter of corporate Financial Statements as referred to in Legislative Decree no. 6 of January 17, 2003 and subsequent amendments. Said decree introduces amendments and supplements to the governing regulations which chiefly concern the elimination of tax effects. The statements also contain additional information that, although not required by law, is deemed necessary to provide a true and fair view of the Company's situation.

The statement of cash flow is included in the Report on Operations, prepared pursuant to Article 2428 of the Italian Civil Code, and in which the information prescribed by the aforesaid article can also be found.

No recourse was made to the departures provided under Article 2423, comma 4 of the Italian Civil Code.

The figures in the notes to the Balance Sheet and Income Statement are expressed in millions of euro in view of their importance.

As required by law, the Company, which holds significant controlling interests, has also prepared Consolidated Financial Statements that are presented with its Statutory Financial Statements.

## Accounting policies

The accounting policies used in the preparation of the Financial Statements at December 31, 2004 are the same as those used in the Financial Statements for the previous year with the exception of the aforesaid amendments enforced by Legislative Decree no. 6 of January 17, 2003. Such policies are in line with provisions of Article 2426 of the Italian Civil Code, amended further by the corporate law reform implemented with Legislative Decree no. 6 of January 17, 2003 and subsequent amendments, if necessary and where applicable, supplemented by the accounting principles issued by the National Council of the Italian Accounting Profession, by document no. 1 of the Italian Accounting Authority and by the IFRS. The most significant policies are illustrated below.

### Balance Sheet

#### Intangible assets

Intangible assets are recorded at purchase or realization cost inclusive of the additional expenses directly attributable and reflect the residual value of expenditures whose economic utility spans over several years. Amortization is calculated on a straight-line basis with reference to the expected useful economic life of the assets.

Incorporation and related costs are amortized over five years. The extraordinary contribution paid to INPS (the national social security institute) in 2000, 2001 and 2002 following the suppression of Electricity Sector Employee Pension Fund (FPE) pursuant to Law 488 of December 23, 1999 (the Finance Act for 2000) could be amortized over either 20 or three years, and the Company opted for the latter. The third and last installment was recognized in the Income Statement in 2002.

#### Tangible assets

Tangible assets are recorded at cost of purchase or production cost, inclusive of any additional expenses and monetary revaluations carried out by Enel SpA pursuant to the applicable regulation. The above defined cost is written down to reflect any permanent impairment in value. If the conditions causing the impairment cease to exist, the cost value (net of depreciation) is restored. Costs incurred in maintaining or restoring the efficiency and proper operation of plant, in so far as these do not modify the magnitude or potential of plant, are charged to the financial year in which the maintenance and repair work is carried out.

Tangible assets are depreciated on a straight-line basis at the following rates, which are determined based on the estimated useful life of the assets.

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## Depreciation rates

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Buildings	2.50%
Power lines	2.50%
<b>Switching substations:</b>	
> Electrical equipment	2.38%
> Other electrical equipment	3.13%
> Automation and control systems	6.70%
<b>Central systems for management and control:</b>	
> Electronic equipment	5.00%
> Computers	10.00%

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The same depreciation rates are reduced by half for assets acquired during the year.

Up to 2003 accelerated depreciation was charged, pursuant to Article 67, paragraph 3 of Presidential Decree 917/86, directly to a Shareholder's Equity reserve, determined at the time the Shareholders' Meeting appropriated the Company's earnings, with the deferred tax being recognized in the Income Statement. The reserve was progressively transferred to a distributable equity reserve upon taxation of the said accelerated depreciation charges. As from 2004, in compliance with prevailing regulations, the Company continues to calculate additional depreciation (equal to the difference between ordinary depreciation and the maximum amount that may be detracted for tax purposes). However said additional depreciation is recognized exclusively when determining the taxable income for direct tax purposes; thus from the year 2004, when appropriation of the Company's earnings is effected, this additional depreciation shall not be attributed to a specific reserve.

The higher earnings to which tax has not been applied shall be distributable only if the Shareholders' Equity holds available reserves to an amount that is at least equal to said earnings.

## Financial assets

### Equity investments

Equity investments in subsidiaries and other companies are accounted for under the cost method. The investment is written down in the event of a permanent impairment in value. If the factors causing the impairment cease to exist, the value of the equity investment is restored to the original amount and the revaluation is recognized in the Income Statement as a write-up.

## Inventories

Raw material, auxiliary and consumption goods used in the operation of plant and equipment are valued at their purchase price calculated by the weighted average method. Obsolete and slow-moving inventories are written down to their estimated realizable value, with the amount posted to a specific provision.

Contract work in progress is valued at the amounts of the contractually agreed payments, according to the percentage-of-completion method.  
Advances received from customers for contractual work not yet completed are recorded as deferred revenues.

**Receivables** Receivables are recorded at their estimated net recoverable value and classified under “Financial assets” or “Current assets”, according to their use and to the nature of the debtor.

**Accruals and deferrals** Accruals and deferrals are recorded based on the accrual method of accounting. The issue discounts and premiums, as well as other charges on loans, are systematically recorded in the Income Statement throughout the life of each loan.

**Provisions for risks and charges** **Provision for retirement benefits**  
The provision includes compensation payable in lieu of notice to employees who are entitled to the compensation under the terms of the national collective bargaining agreement and union agreements currently in force.

**Other provisions for risks and charges**

These provisions are recorded against known or probable losses and liabilities whose amount or timing is undetermined at the end of the Balance Sheet date. Amounts accrued reflect the best possible estimate based on available information.

**Provision for employee termination indemnities**

The provision covers amounts owed to employees pursuant to the Italian law and collective bargaining agreements in force at the Balance Sheet date, net of advances made and Enel Group pension fund contributions withheld.

**Accounts payable** Accounts payable are stated at face value.

**Memorandum accounts** Guarantees granted are recorded at an amount equal to the percentage of the contract guaranteed.  
Commitments with suppliers are determined on the basis of contracts in force at the end of the year that do not fall within the normal operating cycle, limited to the part of the contract not yet executed.

## Income Statement

Expenses and revenues are recognized on an accruals basis.

### Revenues

Revenues from the National Transmission Network (NTN) are recognized in accordance with the method set forth in the Operating License Agreement between the Company and the Independent System Operator (ISO also referred to as GRTN), and determined based on the tariff set by the Authority for Electricity and Gas. Other revenues are recorded at the time services are provided or when the title of ownership of the goods is transferred

### Dividends

Dividends and advances on dividends are recorded in the period in which their distribution has been approved.

### Operating grants

Grants received for the execution of specific works requested by third parties, whose value is recorded among tangible assets, are recorded (for facilities already in operation at December 31, 2002) as deferred income when legal title to the grant is recognized and the amount can be reasonably determined. Grants are deferred and recorded in the Income Statement, under other income and revenues, over the depreciable life of the assets to which they relate. As from the year 2003, grants for new plant put in service are recognized as a reduction in book value of the assets. Advance payments received are recognized in a separate item under liabilities.

<b>Income tax</b>	<p>Current taxes on income are recorded under taxes payable on the basis of estimated taxable income in conformity with tax regulations, net of advances paid.</p> <p>Deferred tax assets and liabilities are calculated on temporary differences between the values recognized in the Statutory Financial Statements and the corresponding values recognized for tax purposes, on the basis of the applicable tax rate at the time the differences are reversed.</p> <p>Deferred tax assets are carried as receivables to the extent that it is reasonably certain that they can be recovered. Deferred tax liabilities are provided to the extent such liability is expected to occur.</p>
<b>Environmental costs</b>	<p>Environmental costs refer to the prevention, reduction and monitoring of the environmental impact of production activities. If the costs are recurrent, they are recognized to Income Statement when incurred. Cost relating to increase of the useful life, capacity or safety of tangible assets, are capitalized as part of the costs of the respective assets. Provisions for risks and charges associated with disputes connected with environmental matters are accrued when it is probable or certain that a liability will be incurred and the amount can be reasonably estimated.</p>
<b>Hedging activity</b>	<p>In order to hedge against the risk of fluctuations in interest rates, the Company has entered into derivative contracts to hedge both the risk associated with specific transactions and its overall exposure.</p> <p>The interest differentials to be received or paid on derivative financial instruments are recognized under financial income or expense in a manner consistent with the charges in respect of the underlying liabilities.</p> <p>Derivatives effected for hedging purposes but for which the original asset or liability to be hedged has been redeemed in advance or is not specifically identifiable, are valued at year end as the lesser between the cost and the market value, and are recorded under financial expense.</p>

## Balance Sheet - Assets

**Share capital not paid-in** At December 31, 2004 this item had a balance of zero.

**Intangible assets** At December 31, 2004 this item had a balance of zero.

**Tangible assets** Tangible assets amount to euro 3,848.3 million (euro 3,051.4 million at Dec. 31, 2003). The following table shows the values and the changes for each category of assets:  
**Euro 3,848.3 million**

Euro	Land and buildings	Plant and machinery	Industrial and commercial equipment	Other assets	Work in progress and advances	Total
<b>A) BALANCE AT DEC. 31, 2003</b>						
1. Historical cost	463,077,087	5,482,696,546	36,626,033	11,207,197	317,721,236	6,311,328,099
2. Revaluations	60,602,305	868,532,733	153,423	27,742	0	929,316,202
3. Book value (1+2)	523,679,392	6,351,229,277	36,779,455	11,234,939	317,721,236	7,240,644,301
4. Accumulated depreciation	-211,970,607	-3,941,029,691	-25,875,543	-10,371,638	0	-4,189,247,479
<b>5. Balance A) at Dec. 31, 2003 (3-4)</b>	<b>311,708,785</b>	<b>2,410,199,586</b>	<b>10,903,912</b>	<b>863,301</b>	<b>317,721,236</b>	<b>3,051,396,821</b>
<b>B) CHANGES IN 2004</b>						
6. Capital expenditure	9,893,438	96,605,607	3,113,999	1,113,709	167,069,701	277,796,454
7. Net reclassifications:						
> Book value	9,459,361	94,600,019	4,744	22,965	-104,087,089	0
> Accumulated depreciation	0	0	-3,058	3,058	0	0
<b>Total</b>	<b>9,459,361</b>	<b>94,600,019</b>	<b>1,686</b>	<b>26,023</b>	<b>-104,087,089</b>	<b>0</b>
8. Net disposals:						
> Book value	-4,182,989	-21,370,925	-352,766	-624	-728,146	-26,635,450
> Accumulated depreciation	1,089,783	15,094,098	350,395	624	0	16,534,900
<b>Total</b>	<b>-3,093,206</b>	<b>-6,276,827</b>	<b>-2,371</b>	<b>0</b>	<b>-728,146</b>	<b>-10,100,550</b>
9. Depreciation	-11,818,293	-129,066,166	-2,074,131	-494,197	0	-143,452,786
10. Adjustment to additional depreciation	15,036,464	680,195,404	79,404	259,362	0	695,570,634
11. Book value	-2,081,098	-20,793,680	0	0	0	-22,874,777
12. Other	0	1,971	0	0	0	1,971
<b>13. Balance B)</b>	<b>17,396,667</b>	<b>715,266,328</b>	<b>1,118,587</b>	<b>904,898</b>	<b>62,254,466</b>	<b>796,940,946</b>
<b>C) BALANCE AT DEC. 31, 2004 (A+B)</b>						
14. Historical cost	476,239,722	5,639,788,341	39,396,413	12,343,247	379,975,702	6,547,743,424
15. Revaluations	60,528,382	860,481,958	149,019	27,742	0	921,187,101
16. Book value	536,768,104	6,500,270,298	39,545,432	12,370,989	379,975,702	7,468,930,525
17. Accumulated depreciation	-207,662,654	-3,374,804,384	-27,522,933	-10,602,791	0	-3,620,592,762
<b>D) BALANCE AT DEC. 31, 2004</b>	<b>329,105,450</b>	<b>3,125,465,914</b>	<b>12,022,499</b>	<b>1,768,198</b>	<b>379,975,702</b>	<b>3,848,337,763</b>

The item "Plant and machinery" includes the electricity transport network, transformer stations and centralised systems for the remote monitoring and control of equipment. In December 2004, the Company acquired plant from Enel Distribuzione SpA, in compliance with the latest Three-Year Development Plan approved by the Ministry for Productive Activities on April 26, 2004, which designated the facilities as components of the National Transmission Network (NTN) and ordered their transfer to the Company, which thus acquired around 163 kilometres of high-voltage power lines and 1 transformer station with a total value of euro 8.3 million.

The aforesaid Development Plan also provided that at the same time approximately 63 km of



Terna-owned power lines, with a value of 2.5 million, be retired from the National Transmission Network and be transferred to Enel Distribuzione.

As regards "work in progress and advances", projects for the development and upgrading of the network with a value of more than euro 5 million are indicated below.

Euro	
<b>Power lines</b>	
> kV 380 Matera-S. Sofia	64,591,008
> kV 380 Laino-Feroleto-Rizziconi	48,232,347
> kV 380 S. Fiorano-Robbia	52,942,831
<b>380 kV switching substations</b>	
> Calenzano	14,494,803
> Foggia	7,291,509
> Sorgente	6,893,006
> Fratta	5,543,430
> Carpi Fossoli	11,179,544
<b>220 kV switching substations</b>	
> Oristano	7,357,957

Changes in tangible assets occurred in the year are summarized below:

Euro	
Capital expenditure	
> Power lines	154,119,263
> Switching substations	110,904,414
> Other	12,772,777
<b>Total capital expenditure</b>	<b>277,796,454</b>
Depreciation	-143,452,786
Net disposals	-10,100,550
Tax clean up:	
Elimination previous additional depreciation	695,570,634
Operating grants relating to new plant in the year	-22,872,806
<b>TOTAL</b>	<b>796,940,946</b>

The main "capital expenditure" included the following works in progress:

- > 380 kV S. Fiorano-Robbia power line (euro 52.9 million);
- > 380 kV Laino-Feroleto-Rizziconi power line (euro 32.9 million);
- > 380 kV Candela-Foggia power line (euro 131 million);
- > 380 kV Altomonte switching station (euro 8.0 million);

- > 380 kV Carpi switching station (euro 5.3 million);
- > 220 kV Fratta switching station (euro 3.3 million);
- > 380 kV Verderio switching station (euro 3.2 million).

At December 31, 2004, accumulated depreciation accounted for 51.07% of fixed assets subject to depreciation, compared with 60.51% at December 31, 2003.

The increase in tangible assets compared to the previous year (euro 796.9 million) is chiefly attributable to the effect of application of the so-called Vietti reform and of the guidelines set forth by the IAB (Italian Accounting Board) in document no.1 concerning "The Principal Effects of the Corporate Law Reform in Drawing up Financial Statements". These effects are evident in the elimination of tax effects from the Financial Statements, and give rise to the recording of lower depreciation (only ordinary economic-technical euro -143.4 million) for the year and to the elimination of "Additional depreciation" (euro 695.5 million) net of operating grants (euro 22.8 million), the balance of which is recorded in the Income Statement under extraordinary income. The other changes in assets refer to disposals to the extent of 10.1 million and to new expenditure to the extent of 277.8 million net of operating grants for plant commencing operation in the course of the year (euro 22.9 million).

## Financial assets

Financial assets break down as follows:

**Euro 314.7 million**

Euro	Book value at Dec. 31, 2003	Increase	Decrease	Book value at Dec. 31, 2004
Equity investments:				
> in subsidiaries	156,248,804	148,641,010	4,882,457	300,007,357
> in other companies	3,468,129	0	601,672	2,866,457
<b>Total equity investments</b>	<b>159,716,933</b>	<b>148,641,010</b>	<b>5,484,129</b>	<b>302,873,814</b>
<b>Receivables from subsidiaries</b>	<b>289,825,446</b>	<b>6,012,074</b>	<b>289,825,446</b>	<b>6,012,074</b>
Receivables from others:				
> tax advance on employee termination indemnities (Law 662/1996)	5,294,449	557,410	3,474,222	2,377,637
> loans to employees and other items	3,564,032	839,051	912,636	3,490,447
<b>Total receivables from others</b>	<b>8,858,481</b>	<b>1,396,461</b>	<b>4,386,858</b>	<b>5,868,084</b>
<b>TOTAL</b>	<b>458,400,860</b>	<b>156,049,545</b>	<b>299,696,433</b>	<b>314,753,972</b>

**Equity investments**

At December 31, 2003, Terna acquired controlling interests in the following Brazilian companies from Enelpower SpA in order to leverage the Company's know-how in the operation of transmission plant and to rationalize the activities of the Enel Group. The companies, details of which are shown below, were created for the purpose of installing and operating around 2,338 kilometres of power lines in Brazil:

Name/ Registered office	Share capital (R\$ 000,000)	Shareholders' Equity at Dec. 31, 2004 (€/000,000)	Net income/loss at Dec. 31, 2004 (€/000,000)	% ownership	Book value (€/000,000)	Value as per Article 2426 point 4 of Civil Code (€/000,000)	Difference
Transmissora Sudeste Nordeste SA > Rio de Janeiro	250.0	<b>152.2</b>	<b>10.1</b>	100.00%	158.1	87.7	70.4
Novatrans Energia SA > Rio de Janeiro	373.1	<b>125.1</b>	<b>-5.0</b>	100.00%	141.9	96.2	45.7

Shareholders' Equity of Transmissora Sudeste Nordeste SA (TSN) is stated net of R\$ 34,636,186 that its Board of Directors voted to distribute in 2005, in accordance with Brazilian regulations. During 2004 the value of equity investments experienced an increase (euro 143.8 million) due to the combined effect of various factors:

- > the acquisition price of the equity investments in both subsidiaries was subjected to adjustment during 2004 (euro 10.4 million of which 4.4 million for NVT and 6 million for TSN);
- > the value of the TSN equity investment was reduced by the income distributed during 2004 (R\$ 17,713,000 equal to euro 4.9 million);
- > the value of the Novatrans equity investment was increased by euro 136.8 million following capitalization of the Shareholder Loan, converted into ordinary shares (euro 102.9 million) and into redeemable preference shares all of which subscribed by the shareholder Terna SpA (euro 33.9 million).

The shares in both subsidiaries have been pledged to Banco Nacional de Desenvolvimento Economico e Social (BNDES) as collateral for the loans granted by said bank. Shareholders of the subsidiaries retain their voting and dividend rights.

Other equity investments held by the Company total euro 2.9 million and refer to CESI SpA. The size of the investment in this company has not changed from the previous year and remains equal to 15%, while the interest held in the company Sfera has been transferred to Enel SpA (- 0.6 million).

<b>Receivables from subsidiaries</b>	<p>This item includes financial receivables of euro 6.0 million due from Novatrans Energia SA in respect of the interest accrued on the Shareholder Loan Agreement originally granted by Enelpower and taken over by Terna when it acquired its interest in the company. The loan was made to finance the construction of plant in Brazil, pending the receipt of loans from BNDES (around R\$ 550 million) and the IDB (around \$ 66 million), which were disbursed during 2004. As a result the Shareholder Loan Agreement was partially repaid by Novatrans (euro 139,915,179) and partially converted as share capital increase of the same company (euro 136,783,367).</p>
<b>Receivables from others</b>	<p>Withholding taxes on employee termination indemnities, paid pursuant to the provisions of law and remunerated at the rate used to adjust employee termination indemnities, declined by euro 2.9 million, as a result of the option granted to Company employees and executives to acquire, through the employee termination indemnity, shares offered further to the Terna and Enel IPOs implemented during the year (euro 1.6 million), as a result of normal separations (euro 1.2 million) and of revaluation for the year (euro 0.1 million).</p> <p>The increase of euro 0.1 million in other receivables refers to loans made to employees.</p>

## Current assets

### Inventories

**Euro 32.7 million**

“Contract work in progress” (euro 22.6 million) refers to long-term work carried out by Terna for various clients. Projects include: work done for the ISO to upgrade the SCTI control system (euro 12.3 million); work for Ferrovie dello Stato SpA (the state railway company) involving the upgrading and renovation of transmission plant (euro 3.6 million); work for SEAP Srl regarding the installation of an electric bus system in Chieti (euro 1.5 million); work for Energia Molise involving the construction of the 380 kV Termoli-Larino power line (euro 1.3 million); work for Enel Green Power involving the construction of delivery points for networking wind power stations in Sardinia (euro 1.2 million) and work for Ferrari and Eos Windenergy involving the construction of electricity stations (euro 1.1 million).

Inventories also include stocks of materials and equipment to be used in the operation, maintenance and construction of plant (euro 10 million). The euro 1.6 million increase in inventories is chiefly attributable to routine plant maintenance requirements. Stocks include some Company property stored at suppliers’ premises before being assigned its final destination.

Euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Raw materials	10,039,942	8,385,769	1,654,173
Contract work in progress	22,612,806	19,306,148	3,306,658
<b>Total</b>	<b>32,652,748</b>	<b>27,691,917</b>	<b>4,960,831</b>

### Receivables

**Euro 336.0 million**

A breakdown of receivables by maturity within and exceeding five years is shown in the table at the end of asset section of the Notes.

#### Trade receivables - Euro 121.6 million

Most (euro 118.6 million) of the total consists of invoices to be issued to the ISO for the National Transmission Network (NTN) usage fees for the year.

Specifically, with reference to the operating agreement signed between Terna and the ISO on December 16, 2002, the receivables mainly consist of usage fees for the last two months of 2004, falling due in January and February 2005.

The Company collected a total of around euro 74 million of these fees in January 2005.

The decrease compared with the previous year (euro 61.2 million) bears witness to the effects of the application of Resolution no. 5 of January 30, 2004, by which AEEG (the Italian Regulatory Authority for Electricity and Gas) passed the tariff regulations for the second regulatory period

2004-2007. By way of the aforesaid resolution AEEG implemented, with effect from April 2004, modification of the time-band definitions, converging the uses corresponding to the higher tariff components on the summer months. This brought about a decrease in the value of receivables relating to the last months of the year.

#### Trade receivables from other Enel Group companies - *Euro 17.5 million*

Trade receivables from Enel Group companies are as follows:

Euro	Trade receivables at Dec. 31, 2004	Trade receivables at Dec. 31, 2003	Change
Enel Distribuzione SpA	7,446,474	11,397,156	-3,950,682
Enel Produzione SpA	675,496	1,150,965	-475,469
Enel Green Power SpA	1,198,069	773,957	424,112
Enelpower SpA	341,704	209,594	132,110
Enel.it SpA	561,186	401,880	159,306
Wind Telecomunicazioni SpA	569,993	1,131,288	-561,295
Enel.Net Srl	6,680,365	4,973,857	1,706,508
Others	71,811	142,873	-71,062
<b>Total</b>	<b>17,545,098</b>	<b>20,181,570</b>	<b>-2,636,472</b>

The decline in receivables from Enel Distribuzione SpA is influenced by a combination of the following factors:

- > the acquisition of approximately 900 km of HV power lines from Enel Distribuzione SpA at year-end 2003, which has meant reduction of the operating and maintenance activity on the HV powers lines belonging to said company;
- > reduction by a month of the payments terms of the receivable invoices issued on the maintenance contract on the aforesaid power lines.

The increase in receivables from Enel.Net, concerning the laying of fiber optic lines as well as their operation, maintenance and development, relates to equalizing invoices issued during the year and not yet collected.

The relations with other Enel Group companies are detailed in the Income Statement section of these Notes to the Financial Statements.

#### Receivables from subsidiaries - *Euro 12.6 million*

This item consists of trade and financial receivables from the two Brazilian companies, Transmissora Sudeste Nordeste SA and Novatrans Energia SA. They chiefly refer to the interest on equity (euro 11.8 million), a particular form of return on internal funds, which was approved by

TSN in compliance with some conditions, and shall be paid to the Parent Company during 2005. The remaining part (euro 0.8 million) refers to services provided by Terna staff.

#### Receivables from the Parent Company - Euro 143.9 million

These consist of financial receivables relating to the current account (bearing interest of 2.046% at December 31, 2004) held with the Parent Company for the purposes of centralized treasury management.

The item also includes euro 4.4 million in interest accrued over the year.

#### Other receivables - Euro 40.3 million

This balance of this item consists mainly of deferred tax assets (euro 14.8 million), tax receivables (euro 12.7 million) and credits with the Greek revenue authorities for indirect taxes (VAT euro -10.6 million) in relation to the activities carried out by the Terna branch in Greece.

Tax receivables refer to the advance payment of VAT effected in December in compliance with Article 6 of Law 405/90 (euro 5.2 million), to receivables for tax paid in Greece on income earned by the Branch (euro 2.6 million) and in Brazil (euro 4.9 million), which can be deducted in the tax-return in Italy. Specifically, the taxes withheld by the Brazilian subsidiaries refer to the payment of receivable interest accrued *vis-à-vis* Novatrans (repayment of the Shareholder Loan) and TSN (IOE – interest on equity, year 2004).

Other minor items chiefly refer to various types of advances paid to employees and third parties.

The changes in deferred tax assets, determined in accordance with tax rates in force – 33% IRES (Corporate Income Tax) – 4.37% average – IRAP (Regional Business Tax) –, are shown below:

Euro	at Dec. 31, 2003	Change recorded in the Income Statement	at Dec. 31, 2004
Provision for early retirement incentive expense		1,605,450	1,605,450
Provisions for risks and charges	22,094,399	-9,100,019	12,994,380
Other components:			
> depreciation of buildings not used in operations	200,184	37,155	237,339
<b>Total</b>	<b>22,294,583</b>	<b>-7,457,414</b>	<b>14,837,169</b>

The decrease is largely attributable to utilization for the period concerning temporary items.

**Cash and cash  
equivalents**

*Euro 92,025 million*

This item consists entirely of cash held by the Company's eight operating facilities in Italy.

**Accrued income and  
prepaid expenses**

*Euro 21.2 million*

Euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Accrued income	10,008,219	0	10,008,219
Prepaid expenses			
> discount on loans	3,169,817	0	3,169,817
> other	8,043,301	4,206,737	3,836,564
<b>Total</b>	<b>11,213,118</b>	<b>4,206,737</b>	<b>7,006,381</b>
<b>TOTAL</b>	<b>21,221,337</b>	<b>4,206,737</b>	<b>17,014,600</b>

"Accrued income" refers exclusively to interest income accrued on derivative contracts (swaps) entered into against bond issues effected in the year and EIB loans established in previous years. "Prepaid expenses" pertain to the issue discount (euro 3.2 million) and expenses (euro 3.9 million) relating to the aforesaid issue of bonds and distributed over the life of the loan, to prepaid insurance premiums (euro 2.4 million), to prepaid charges arising from the transfer of contracts from Enel Distribuzione SpA (euro 1.2 million), and to fees paid for the use of telephone lines and radio relays.



The table below gives a breakdown of receivables and accrued income by maturity:

Euro	Within 1 year	From 2 to 5 years	Over 5 years	Total
<b>LONG-TERM FINANCIAL RECEIVABLES</b>				
Receivables from subsidiaries	6,012,074			6,012,074
Receivables from others	432,070	3,906,917	1,529,097	5,868,084
<b>Total long-term financial receivables</b>	<b>6,444,144</b>	<b>3,906,917</b>	<b>1,529,097</b>	<b>11,880,158</b>
<b>CURRENT RECEIVABLES</b>				
Trade receivables	121,568,464			121,568,464
Receivables from Parent Company	143,916,271			143,916,271
Receivables from other Enel Group companies	17,545,098			17,545,098
Receivables from subsidiaries	12,651,396			12,651,396
Tax receivables	12,702,492			12,702,492
Pre-paid tax receivables	14,837,169			14,837,169
Receivables from others	1,781,434	10,997,777		12,779,211
<b>Total current receivables</b>	<b>325,002,324</b>	<b>10,997,777</b>	<b>0</b>	<b>336,000,101</b>
<b>Accrued income</b>	<b>10,008,219</b>			<b>10,008,219</b>
<b>TOTAL</b>	<b>341,454,687</b>	<b>14,904,694</b>	<b>1,529,097</b>	<b>357,888,478</b>

The table below gives a breakdown of receivables by geographical area:

	Trade receivables	Receivables f/subsidiaries	Receivables f/Parent Company	Other receivables	Total
Italy	139.0		143.9	35.3	318.2
UE	0.1			10.9	11.0
Non-EU					
North America					
Central/South America		18.7			18.7
<b>Total</b>	<b>139.1</b>	<b>18.7</b>	<b>143.9</b>	<b>46.2</b>	<b>347.9</b>

## Balance Sheet - Liabilities and Shareholders' Equity

**Shareholders'  
Equity**  
**Euro 1,837.9  
million**

The changes in Shareholders' Equity are as follows:

Euro	Share capital	Legal reserve	Other reserves	Retained earnings	Net income	Total
<b>BALANCE AT DEC. 31, 2002</b>	<b>2,036,050,000</b>	<b>73,910,747</b>	<b>256,111,172</b>	<b>215,292</b>	<b>88,119,868</b>	<b>2,454,407,079</b>
Allocation of 2002:						
> to Legal reserve		4,405,993			-4,405,993	
> to Other reserves (accelerated depreciation)			39,614,690		-39,614,690	
> to Retained earnings				120,505	-120,505	
> to Dividends					-43,978,680	-43,978,680
Net income for 2003					123,489,605	123,489,605
<b>BALANCE AT DEC. 31, 2003</b>	<b>2,036,050,000</b>	<b>78,316,740</b>	<b>295,725,862</b>	<b>335,797</b>	<b>123,489,605</b>	<b>2,533,918,004</b>
Allocation of 2003:						
> to Legal reserve		6,174,480			-6,174,480	
> to Other Reserves (accelerated depreciation)			36,907,614		-36,907,614	
> to Retained earnings				187,140	-187,140	
> to Dividends					-80,220,371	-80,220,371
Share capital reduction	-1,596,050,000		396,050,000			-1,200,000,000
Interim dividends					-90,000,000	-90,000,000
Net income 2004					674,263,935	674,263,935
<b>BALANCE AT DEC. 31, 2004</b>	<b>440,000,000</b>	<b>84,491,220</b>	<b>728,683,476</b>	<b>522,937</b>	<b>584,263,935</b>	<b>1,837,961,568</b>

**Share capital**  
**Euro 440.0 million**

On January 28, 2004, the Shareholders' Meeting, pursuant to Article 2445 of the Italian Civil Code passed a resolution to reduce the share capital from euro 2,036.1 to euro 440 million by way of a euro 1,200 million reimbursement to the single shareholder Enel SpA and a euro 396.1 allocation to reserve subject to cancellation and consequent reduction of the number of ordinary shares comprising the share capital from 2,036,050,000 to 2,000,000,000 and simultaneous reduction of the par value of the shares from euro 1.00 (one/00) to euro 0.22 (zero/22). The resolution was filed in the register of companies on January, 29, 2004 and hence became fully effective on April 29, 2004. Further to the IPO completed on June 23, 2004, addressed to the public and to institutional investors, Enel SpA transferred 1,000,000,000 shares bringing its stake in the Company's share capital to 50%.

Allocation of net income for 2003	<p>On March 3, 2004, the Ordinary Shareholders' Meeting unanimously approved the Financial Statements and report on operations for 2003 and allocated net income as follows:</p> <ul style="list-style-type: none"> <li>&gt; euro 6,174,480, equal to 5%, to the Legal Reserve;</li> <li>&gt; euro 36,907,614 as the accrual for the year to the "Accelerated depreciation reserve";</li> <li>&gt; euro 80,220,370 for dividends in the amount of euro 0.0394 per share (2,036,050,000 shares), paid out on April 8, 2004;</li> <li>&gt; the remainder of euro 187,140 as retained earnings.</li> </ul>
Legal reserve	Legal reserve represents 19.2% of the share capital.
Other reserves	<p>Other reserves amount to euro 728.7 million and include:</p> <p>accruals made exclusively for tax purposes in the amount of euro 332.6 million; the increase compared to the previous year (euro 295.7 million) is equal to euro 36.9 million and represents accelerated depreciation net of the relative contributions, accrued in 2003 and allocated at the time of appropriation of earnings.</p> <p>The share capital reduction referred to above in the amount of 396.1 million.</p>
Interim dividend 2004	<p>On September 6, 2004, the Board of Directors, on the basis of the half-year report, voted to distribute, pursuant to Article 2433 <i>bis</i> of the Italian Civil Code and Article 26.3 of the By-laws, an <i>interim</i> dividend to shareholders for the year 2004 equal to euro 0.045 per share, for a total amount of euro 90 million.</p>
Tax clean up	The following table shows the reconciliation of net income for the period following the tax clean up:

Euro	2004 net income	net income	2003 Shareholders' Equity
<b>Income before reformation</b>	<b>253.0</b>	<b>123.5</b>	<b>2,410.4</b>
Tax effects, gross of deferred tax:			
> Additional depreciation	695.5	151.3	544.2
> Operating grants	-22.8	-5.2	-17.6
<b>Total gross effects</b>	<b>672.7</b>	<b>146.1</b>	<b>526.6</b>
Related deferred tax	-251.4	-49.2	-202.2
<b>Total effects, net of deferred tax</b>	<b>421.3</b>	<b>96.9</b>	<b>324.4</b>
<b>Income after reformation</b>	<b>674.3</b>	<b>220.4</b>	<b>2,734.8</b>

The table below provides a breakdown of the single items of the Shareholders' Equity at year-end, with specification of their origin, possible utilization, and extent to which they may be distributed:

Nature/Description Euro	Amount	Possible utilization	Available amount
Share capital	440,000,000	-	-
Legal Reserve	84,491,220	B	-
Other Reserves:			
> of Capital	396,066,445	A,B,C	396,066,445
> of Income	332,617,031	A,B	332,617,031
Retained earnings	522,937	A,B,C	522,937
<i>Interim dividends</i>	-90,000,000	-	-
<b>Net income 2004</b>	<b>674,263,935</b>	-	-
<b>Total</b>			<b>729,206,413</b>
<b>Amount not distributable</b>			<b>320,320,382</b>
<b>Remaining distributable amount</b>			<b>408,886,031</b>

Legend:

A: for capital increase

B: for hedging losses

C: for distribution to shareholders

The non-distributable amount refers to the accelerated depreciation reserve made up of income from previous years for which taxation has not been paid off.

In previous years utilizations of the reserves for hedging losses or for other purposes have not been recorded.

**Provision for risks and charges**  
Euro 504.8 million

Euro	at Dec. 31, 2003	Accruals	Utilization	at Dec. 31, 2004
Provision for retirement benefits	773,975	967,731	1,024,307	717,399
Deferred tax liabilities	159,279,912	314,900,680	10,212,313	463,968,279
Other:				
> litigation	12,189,330	1,587,885	330,817	13,446,398
> sundry risks and charges	47,056,894	10,607,076	35,884,572	21,779,398
> early retirement incentives	0	5,507,668	642,668	4,865,000
<b>Total</b>	<b>59,246,224</b>	<b>17,702,629</b>	<b>36,858,057</b>	<b>40,090,796</b>
<b>TOTAL</b>	<b>219,300,111</b>	<b>333,571,040</b>	<b>48,094,677</b>	<b>504,776,474</b>

**Provision for retirement benefits**  
Euro 0.7 million

The provision includes accruals for indemnities *in lieu* of notice and additional monthly payments accruing to personnel.

**Deferred tax liabilities**  
Euro 463.9 million

The following table shows changes in deferred tax liabilities by type of temporary difference, determined in accordance with prevailing tax rates (33% IRES; 4.37% average IRAP):

Euro	at Dec. 31, 2003	Amounts reported in the Income Statement				at Dec. 31, 2004
		Ordinary changes	Change in rate	Reformation	Total	
Additional depreciation	159,279,912	57,524,793	-4,464,063	251,396,694	304,457,424	463,737,336
Other components (write-down receivables)	0	230,943			230,943	230,943
<b>Total</b>	<b>159,279,912</b>	<b>57,755,736</b>	<b>-4,464,063</b>	<b>251,396,694</b>	<b>304,688,367</b>	<b>463,968,279</b>

Compared with 2003 the provision records a considerable increase (euro 304.7 million) largely due to the effects of the aforementioned tax clean up (euro 251.4 million), and the accelerated depreciation exceeding the ordinary depreciation rates appropriated in the current year (euro 57.5 million). The 4.5 million decrease refers to the adjustment of the provision in accordance with the tax rate in force.

<b>Provision for litigation</b> <i>Euro 13.4 million</i>	<p>The provision, broadly unchanged from the previous year (a net rise of euro 1.2 million), covers potential liabilities in respect of litigation or other disputes, relating mainly to plant supply, work and operation, based on the advice of external and internal counsel. It does not include provisions for litigation for which a positive outcome is expected, nor provisions for which a potential charge cannot reasonably be quantified. The latter are described under "Off-Balance Sheet items".</p>
<b>Provision for sundry risks and charges</b> <i>Euro 21.8 million</i>	<p>Compared to the previous year, the provision has undergone a euro 25.3 million decrease chiefly attributable to the following utilizations:</p> <ul style="list-style-type: none"> <li>&gt; euro 20.5 million effected following definition of adjustments to fees for network usage for the years 2000-2003, chiefly due to the ISO's redefinition of Terna's percentage ownership of the National Transmission Network;</li> <li>&gt; euro 3.0 million against settlement of pending disputes with third-party producers relating to operating grants received by the Company for transmission network connections;</li> <li>&gt; euro 7.5 million of which 3.8 million for retirement of plant and 3.7 million for recording the amounts proving to be in excess for the scheduled retirements in the Income Statement;</li> <li>&gt; euro 1.4 million effected for penalties to be paid for the year 2003 to Enel Distribuzione SpA and referring to "Service Quality Levels" in respect of the contract for maintenance on HV lines owned by the latter.</li> </ul> <p>The provision also records accruals made in the amount of euro 2.5 million for premiums to senior management staff linked to the possibility of exercising options on Enel shares; euro 6.1 million for adjustments to network fees for the years 2002-2003-2004 pertaining to the prevailing dispute with the self-producers of CIP 6 energy; and lastly euro 1.1 million for contractual penalties for early release of property leased to Terna.</p>
<b>Provision for early retirement incentives</b> <i>Euro 4.9 million</i>	<p>The provision for early retirement incentives represents the estimated value of the extraordinary expenses related to the early consensual termination of employment of staff members who are entitled to a pension.</p>

**Employee  
termination  
indemnity  
Euro 60.4  
million**

The changes in the balance in 2004 are shown below:

Euro	
<b>Balance at Dec. 31, 2003</b>	<b>70,731,513</b>
Accruals	8,981,616
Pension fund contributions	-2,115,869
Indemnities paid and other transactions	-18,024,463
Acquisition/sale of contracts	851,630
<b>Total</b>	<b>60,424,427</b>

The provision represents the accrued entitlement of employees for termination indemnities, net of advances and contributions to the pension funds. The amount is carried net of the 11% flat withholding tax on the revaluation of employee termination indemnities, pursuant to Legislative Decree 47/2000.

The significant decrease compared with the previous year is due to two factors: the departure of employees entitled to pension who have concluded individual early retirement agreements, and in particular to exploitation of the possibility granted to Company employees to use part of the employee termination indemnity to acquire shares offered further to the Terna and Enel IPOs implemented during the year (euro 13.6 million).

**Payables  
Euro 1,969.1  
million**

A breakdown of payables by maturity within and exceeding five years is included in a separate schedule at the end of the liabilities section of the Notes. The table below instead provides a breakdown of the global position of financial indebtedness by maturity of the single loans:

In millions of euro	Repayment period	Balance at 31.12.2004	Current portion	Long-term portion	2006	2007	2008	2009	Beyond
PO 2014	2014	600.0	0.0	600.0	0.0	0.0	0.0	0.0	600.0
PO 2024	2024	800.0	0.0	800.0	0.0	0.0	0.0	0.0	800.0
BEI no. 20271	2014	68.2	6.8	61.4	6.8	6.8	6.8	6.8	34.2
BEI no. 21159	2016	250.0	11.4	238.6	22.7	22.7	22.7	22.7	147.8
<b>Total</b>		<b>1,718.2</b>	<b>18.2</b>	<b>1,700.0</b>	<b>29.5</b>	<b>29.5</b>	<b>29.5</b>	<b>29.5</b>	<b>1,582.0</b>

**Bond issues*****Euro 1,400.0 million***

On October 28, 2004 the Company finalized two bond issues (placement coordinated by JP Morgan, Credit Suisse First Boston, UBS Investment Bank) the terms of which are provided below:

**Ten-year bond 2004-2014:**

- > nominal amount euro 600 million;
- > issue price 99.968;
- > issue discount euro 192 thousand;
- > life from October 28, 2004 to October 28, 2014;
- > fixed rate of 4.25% *p.a.* with 365/365 divisor;
- > payment annual coupon;
- > lump-sum repayment at maturity.

**Twenty-year bond 2004-2024:**

- > nominal amount euro 800 million;
- > issue price 99.624;
- > issue discount euro 3,008 thousand;
- > life from October 28, 2004 to October 28, 2024;
- > fixed rate of 4.90% *p.a.* with 365/365 divisor;
- > payment annual coupon;
- > lump-sum repayment at maturity.

Both bond issues were implemented with the aim of procuring the financial resources necessary to redeem two short-term loans raised in the first year-half of 2004 by the Company *vis-à-vis* the Parent Company Enel SpA with overall residual value equal to euro 1,400 million.

These loans granted by the Parent Company are as follows:

- > the first loan of euro 493.6 million was granted on March 1, 2004 to redeem a pre-existing financial debt transferred on October 1, 1999 from Enel SpA (at the time of assignment of business activities) of a residual amount equal to euro 456.2 million and a further debt, also transferred from Enel SpA in the same circumstances, equal to euro 37.4 million and relating to Additional Corporate Benefits for senior management. On May 31, 2004 the Company effected early redemption of a portion of this loan for an amount of 293.6 million;
- > the second loan of euro 1,200 million disbursed on April 30, 2004 and used by Terna to reimburse the Parent Company for the share capital reduction of the same amount passed by Shareholders' Meeting resolution on January 28, 2004.



Between June and August 2004 the Company concluded transactions in derivative instruments for a total amount of euro 650 million (interest rate swaps for euro 450 million and collars for euro 200 million) for the purposes of fixing the ceiling rate of part of the new loan.

Upon bond issues, euro 200 million were maintained at fixed rate with ten-year maturity while the remaining euro 1,200 million were swapped from fixed to floating.

Assuming that the aforesaid derivatives totaling euro 650 million refer exclusively to the twenty-year B.I. for euro 800 million, approximately 81% of said loan is quantified at fixed rate, while approximately 33% of the ten-year B.I. for euro 600 million is quantified at fixed rate.

**Medium/long-term  
bank loans**  
*Euro 318.2 million*

The total value of this item is euro 318.2 million and refers to two EIB loans denominated in euro and includes a debt with San Paolo/IMI for a prime rate loan (granted by the Val d'Aosta Independent Region) equal to euro 34 thousand.

The first EIB loan was granted on October 22, 1999 for the "Italy-Greece electricity network interconnection" project, with an initial value of euro 75 million, and has the following terms:

- > floating interest rate with a ceiling equal to Euribor + 0.15% (2.15% at the end of 2004);
- > interest payments made on a half-yearly basis (March 15 and September 15);
- > repayment of principal: in 22 equal instalments paid half-yearly from March 15, 2004 to September 15, 2014.

On March 15, 2004 and September 15, 2004 repayment of the first two instalments was effected for a total of euro 3.4 million.

The loan is completely hedged against fluctuations in interest rate by derivative instruments.

The second EIB loan, of euro 250 million, was granted on July 6, 2001 for the design, building and bringing into service of around 200 electricity transmission facilities, and has the following terms:

- > floating interest rate with a ceiling equal to Euribor + 0.24% (2.24% at the end of 2004);
- > interest payments made on a half-yearly basis (June 15 and December 15);
- > repayment of principal: in 22 equal instalments paid half-yearly from December 15, 2005 to June 15, 2016.

This loan is hedged by interest rate swaps with a nominal value of euro 217.5 million, leaving 13% of the total loan exposed to interest rate risk.

At year-end, taking into account the transactions performed in derivative instruments, 66% of the entire medium/long-term indebtedness (equal to euro 1,718 million) and 72% of the net payables of Terna SpA (equal to euro 1,568 million) is thus quantified at fixed rate.

**Breakdown and terms of the euro 500 million "Facility"**

On December 13, 2004 the Company took up a fifteen-year revolving credit line for euro 500 million, organized and managed by Mediobanca, in the capacity of Agent and Bookrunner. In addition to Mediobanca the following banks intervened in the capacity of Mandated Lead Arranger: Banca Intesa, BBVA, BNL, Capitalia, MPS, San Paolo/IMI and UBM. The credit line was subscribed for the purpose of guaranteeing financial hedging of short-term requirements and those ensuing from any extraordinary transactions scheduled in the next 12-18 months. At year-end the credit line had yet to be used.

Any utilization shall be remunerated with a margin above Euribor equal to 17.5 base points. This spread may vary according to the Company's rating (currently AA- for Standard&Poor and Aa3 for Moody's).

The non-utilization commission is equal to an annual 30% of the margin. The commission for use is equal to 2.5 basis points if the overall amount of utilization is between 1/3rd and 2/3rds of the total credit line and 5 basis points for utilization equal to or exceeding 2/3rds of the total credit line.

**Advances  
Euro 36.2 million**

Advances include contributions received for work underway at December 31, 2004 for connections to the network as well as for works for third parties:

A breakdown of advances is provided below:

- > contributions on expected costs of connections to high-voltage network (euro 15.8 million);
- > supply of a new integrated control system for the ISO (euro 10.7 million);
- > renewal and upgrading of various plant for RFI (euro 2.4 million);
- > construction of the new Termoli-Larino 380 kV electric power line (euro 1.4 million).

Compared with 2003 (euro 47.7 million) the item records a net decrease of approximately 11.5 million, which reflects the entry into service of plant in 2004 (-14.7 million) and the balance between new and completed contracts (+ 3.2 million).

**Trade payables  
Euro 150.4 million**

Trade payables regard invoices received and to be received for contracts, services and purchases of material and equipment. The increase is a direct result of the sharp rise in capital expenditure in technical intangible assets in the current year compared to 2003, and also reflects the intensification of purchases and services rendered in the last quarter of the year.

The item reflects payables to Enel.Factor for the non-recourse assignment of some company trade payables, totaling euro 34.9 million.

**Payables to other  
Enel Group  
companies**  
*Euro 25.9 million*

The following table shows payables for services rendered by other companies in the Enel Group:

Euro	Trade payables at Dec. 31, 2004	Trade payables at Dec. 31, 2004	Change
Wind Telecomunicazioni SpA	12,695,191	10,702,450	1,992,741
Enel Distribuzione SpA	3,181,402	6,187,875	- 3,006,473
Enelpower SpA	22,000	5,087,763	- 5,065,763
Enel Facility Management SpA	5,667,970	4,265,753	1,402,217
Enel.it Srl	2,770,714	2,147,235	623,479
Ape Gruppo Enel Srl	688,596	732,021	- 43,425
Enel Produzione SpA	461,977	346,544	115,433
Sfera Srl	263,432	250,068	13,364
Other	131,158	179,485	- 48,327
<b>Total</b>	<b>25,882,440</b>	<b>29,899,194</b>	<b>- 4,016,754</b>

The euro 4.0 million decrease is largely attributable:

- > for -5.1 million to lower exposure in respect of Enelpower SpA following redemption of the payable for an adjustment to the Shareholder Loan to Novatrans;
- > for -3.0 million (to Enel Distribuzione SpA) to settlement of the invoices relating to investment activity, implemented during the last quarter of the previous year. It also records the adjustment, in Terna's favour, to the transfer price of plant acquired by Enel Distribuzione on December 29, 2004 (euro 1.1 million).

Lastly an increase is recorded in payables to Wind SpA, which chiefly refers to the services rendered for adjustment of electrical supply systems of the network infrastructures (euro 1.2 million).

**Payables to Parent Company**  
Euro 1.7 million

The payables to Enel SpA consist of the following:

Euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
<b>Trade payables</b>	<b>1,112,904</b>	<b>1,016,197</b>	<b>96,707</b>
<b>Financial payables</b>	<b>0</b>	<b>493,709,810</b>	<b>- 493,709,810</b>
> Enel pension fund	0	37,555,056	- 37,555,056
> Loans and financing	0	456,154,754	- 456,154,754
<b>Sundry payables</b>	<b>589,155</b>	<b>691,205</b>	<b>- 102,050</b>
<b>Total</b>	<b>1,702,059</b>	<b>495,417,212</b>	<b>- 493,715,153</b>

The “trade payables” are mainly made up of fees for management, communication and e-procurement services.

**Tax payables**  
Euro 16.1 million

The tax payables item for 2004 shows the Company's tax liability in respect of euro 85.1 million for Corporate Income Tax (IRES) and 19.4 million in local tax (IRAP) , net of the advances totaling euro 92.3 million paid in June and November 2004. It also includes a payable of around euro 3.9 million in tax withheld by the Company.

**Social security payables**  
Euro 7.9 million

The item refers to payables to INPS for the month of December 2004. The item also includes contributions paid on staff incentives to be distributed in the following financial year.

**Other payables**  
Euro 12.7 million

The table below provides a breakdown of sundry payables:

Euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Payables to employees	12,173,262	25,745,647	-13,572,385
Payables to third parties for amounts withheld from employees' pay	316,045	332,478	-16,433
Other payables	259,206	4,483,665	-4,224,459
<b>Total</b>	<b>12,748,513</b>	<b>30,561,790</b>	<b>-17,813,277</b>

Sundry payables equal to euro 12.7 million (euro 30.6 million at December 31, 2003) chiefly reflect the payables to employees for staff termination indemnities, to be paid out to by December 31, 2004 in addition to the staff incentives that will be distributed in 2005. The sharp decrease recorded, equal to euro 17.8 million, relates to the payment of the staff termination indemnities representing the exposure at December 31, 2003, as well as redemption of the payables to some self-producers which was effected during the year.

**Accrued liabilities and deferred income** Accrued liabilities and deferred income consist of the following:  
**Euro 180.8 million**

Euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Interest payables on loans	18,389,060	5,399,809	12,989,251
Other accrued liabilities	636,139	1,304,391	- 668,252
Capital contributions	161,187,666	142,051,584	19,136,082
Other deferred income	572,850	577,542	- 4,692
<b>Total</b>	<b>180,785,715</b>	<b>149,333,326</b>	<b>31,452,389</b>

This item shows a sharp increase on the previous year (euro 31.5 million), partly attributable to interest payable on loans (euro +13.0 million), which reflect the charges related to the bond issues as well as the transactions in underlying derivative instruments, as detailed in the section "Bond Issues". The further euro 18.5 million increase is due to the recording of deferred income concerning the surplus capital contributions (euro 22.8 million) following the tax clean up effected on the Financial Statements.

The following table provides a breakdown of payables and accrued liabilities by maturity.

Euro	Within 1 year	From 2 to 5 years	Over 5 years	Total
<b>FINANCIAL PAYABLES TO THIRD PARTIES</b>				
Payables to third parties for bonds			1,400,000,000	1,400,000,000
Medium- and long-term bank loans	18,181,818	118,181,820	181,852,077	318,215,715
<b>Total financial payables</b>	<b>18,181,818</b>	<b>118,181,820</b>	<b>1,581,852,077</b>	<b>1,718,215,715</b>
<b>OTHER PAYABLES</b>				
Advances	20,367,025	15,804,605		36,171,630
Trade payables	147,390,214	2,984,028		150,374,242
Payables to Parent Company	1,702,059			1,702,059
<b>Total payables to Parent Company</b>	<b>1,702,059</b>			<b>1,702,059</b>
Payables to other Enel Group companies	25,882,440			25,882,440
Tax payables	16,098,080			16,098,080
Social security payables	7,917,083			7,917,083
Other payables	12,748,513			12,748,513
<b>Total other payables</b>	<b>232,105,414</b>	<b>18,788,633</b>		<b>250,894,047</b>
<b>Accrued liabilities</b>	<b>19,025,199</b>			<b>19,025,199</b>
<b>TOTAL</b>	<b>269,312,431</b>	<b>136,970,453</b>	<b>1,581,852,077</b>	<b>1,988,134,961</b>

The table below provides a breakdown of payables by geographical area.

Euro	Bonds	Bank loans	Third party advances	Trade payables	Payables to Parent Com.	Other payables	Total
Italy	444.0		36.2	170.1	1.7	36.7	688.7
EU	798.0	318.2		3.8			1,120.0
Non-EU	70.0			2.4			72.4
North America	46.0						46.0
Asia	6.0						6.0
Others	36.0						36.0
<b>Total</b>	<b>1,400.0</b>	<b>318.2</b>	<b>36.2</b>	<b>176.3</b>	<b>1.7</b>	<b>36.7</b>	<b>1,969.1</b>

## Commitments

Commitments include amounts relating to guarantees, risks and other commitments, as detailed below:

Euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Guarantees granted:			
> guarantees given to third parties	13,899,077	7,377,074	6,522,003
> equity participations pledged to third parties	300,007,357	-	300,007,357
<b>Total</b>	<b>313,906,434</b>	<b>7,377,074</b>	<b>306,529,360</b>
Other commitments:			
> hedging derivatives	2,135,681,818	-	2,135,681,818
> Commitments with suppliers for purchase of:			
- Sundry supplies	219,080,840	193,437,214	25,643,626
- Contract work	164,496,455	162,702,325	1,794,130
<b>Total</b>	<b>383,577,295</b>	<b>356,139,539</b>	<b>27,437,756</b>
<b>TOTAL</b>	<b>2,833,165,547</b>	<b>363,516,613</b>	<b>2,469,648,934</b>

The guarantees given refer to shares of the subsidiaries TSN and Novatrans, owned by Terna, pledged to the banks (BNDES-IDB) providing loans for the investments in Brazil and to the guarantees granted to third parties in respect of contracts for works and services rendered by the Company.

The notional value of the financial interest rate derivatives is recorded in commitments and risks and emerges as positive by euro 11.3 million at December 31, 2004. Specifically, hedging on the EIB loans feature a negative value of euro 19.7 million, while hedging on the bond issues record a current positive value of euro 31 million.

The commitments to suppliers refer to the total of orders/contract work commissioned, net of supplies and services already invoiced.

## Off-Balance Sheet items

### Environmental litigation

Environmental litigation relates to the installation and operation of electrical plant, and, especially, the effects of electrical and magnetic fields.

Terna is a defendant in a number of civil and administrative proceedings requesting the relocation of power lines or changes in operational conditions. The claims are based on the alleged health hazards posed by the power lines, even though they have been installed in full compliance with regulatory requirements. Only a very limited number of suits have been filed against the Company seeking damages for personal injury caused by electromagnetic fields.

On July 8, 2003, a Prime Minister's Decree was enacted to complete the implementation of framework Law 36 of February 22, 2001. It establishes values for three parameters (exposure limits, thresholds of concern and quality targets) that electrical plant must meet. The decree had a favorable impact on pending disputes, because the scope of the framework law was limited to laying down general principles only.

Only a few adverse rulings have been issued against the Company in this area, and these have all been appealed (the cases are still pending). No claim for damages for personal injury has ever been upheld.

Finally, it should be noted that, in addition to Terna, the ISO has increasingly been called as a defendant in these proceedings, because the ISO is legally responsible for all matters relating to energy flows transiting on the network owned by Terna.

### Legislation concerning electrical and magnetic fields

The relevant framework law, enacted on February 22, 2001, entrusts the State with the task of defining, through specific orders, the reference parameters (exposure limits, thresholds of concern and quality targets) with which electrical plant must comply.

Attention is drawn in this regard to the framework law on reclamation which establishes a mechanism for recovery of related expenses according to criteria defined by the Authority for Electricity and Gas, pursuant to Law no. 481/95, given that costs are incurred for common benefit. On August 29, 2003 the Prime Minister's Decree of July 8, 2003 for the "Definition of exposure limits, thresholds of concern and quality targets for the protection of the population from exposure to electrical and magnetic fields at network frequency (50 Hz) generated by power lines" which established the values for the three parameters provided by the framework law, was published in the Official Gazette of the Italian Republic.

According to Company assessments, an estimated cost of over euro 400 million shall be incurred in implementing appropriate investments. The relevant interventions are expected to commence in 2007 and continue until at least 2014.

On regional legislation level, some regional governments have formulated bills governing the



matter, which establish more restrictive limits compared to those prescribed by Prime Minister's Decree 1992, and by the more recent Prime Minister's Decree of July 8, 2003.

However it must be noted that on October 7, 2003 judgment no 307 of the Constitutional Court was published and this declared some regional laws on the matter of electromagnetic fields to be constitutionally unlawful (amongst which the law of the Campania regional government no. 13 of November 24, 2001). It also established the principle that derogation from the State law is not permitted, even where this may involve higher standards being implemented by regional laws, as public health must be uniformly guaranteed throughout Italian territory.

#### Other pending litigation

A number of legal disputes are pending in relation to urban planning and environmental issues associated with the construction and operation of a number of transmission lines. Adverse rulings could have repercussions, but since the impact cannot be quantified at present they have not been included under the "provisions for litigations". An assessment of the suits, which included taking advice from external legal counsel, suggests that unfavourable rulings are remote, though for a limited number of cases this cannot be ruled out completely. The effects of an adverse ruling could include not only the payment of damages but also the costs involved in modifying power lines and the temporary unavailability of the lines.

In any case, an adverse outcome would not jeopardize the operation of the power lines.

## Income Statement

### Value of production

The item comprises the following:

#### Revenues from sales and services

They include the following:

*Euro 873.6 million*

Euro	2004	2003	Change
NTN usage fees	810,779,378	782,314,486	28,464,892
Other sales and services	62,789,292	61,593,295	1,195,997
<b>Total</b>	<b>873,568,670</b>	<b>843,907,781</b>	<b>29,660,889</b>

“Revenues from sales and services” totaled euro 873.6 million and largely consist (euro 810.8 million) of fees paid to the Company for the use of the National Transmission Network. The total also includes euro 10.1 million collected by the Greek branch as its share of the fees paid for the use of plant in Greece. The euro 29.7 million increase on the previous year is largely due to the difference between lower revenues for the revision, according to provisional data, of the National Transmission Network ownership percentage (euro - 21.0 million) and the increase ensuing from the application, as from February, of the new tariffs, and as from April, of the new time-bands established by Authority resolution no. 5/04 of January 31, 2004 (euro + 49.5 million).

“Revenues from other sales and services” amount to euro 62.8 million, of which euro 46.1 million from the sale of goods and services to companies in the Enel Group, euro 1.4 million from services invoiced to subsidiaries and euro 15.3 million from services provided to third party customers (euro 13,7 million in 2003). The Company increased its market share in the delivery of specialized engineering services relating to high-voltage plant.

In respect of services rendered to Group companies, revenues were essentially in line with 2003 (- 1.1 million in total). In detail, the revenues generated from the contract for the maintenance of high-voltage lines owned by Enel Distribuzione SpA stood at euro 27.1 million (compared to euro 28.6 million in 2003), while revenues invoiced to Enel.Net Srl for the laying of fiber optic lines and the maintenance and development of the same featured a rise (euro 11.7 million against 9.0 million invoiced in 2003). Revenues from housing equipment for remote transmission/telephony invoices to Wind Telecomunicazioni SpA declined by euro 0.5 million.

**Change in contract work in progress**  
**Euro 3.3 million**

The change in contract work in progress is the net result of work still pending at December 31, 2004 (euro 6.8 million) and work completed and tested in the year (euro -3.5 million). The main increases regarded the creation of the Termoli-Larino 380 kV power line on behalf of Energia Molise (+1.3 million), the up-dating of the SCTI control system on behalf of ISO (+ 1.3 million), the construction of power stations on behalf of Ferrari (+ 0.6 million) and EOS Windenergy (+ 0.5 million) and a series of power line renovations on behalf of RFI – Rete Ferroviaria Italiana (+ 1.2 million). The Company also carried out work for the creation of a number of delivery points for the networking of wind power stations in Sardinia on behalf of Enel Green power (+ 0.9 million). The negative changes in contract work included, in particular, the completion of works for the energy conduction of hydroelectric plants of Edipower SpA (euro - 1.8 million), the creation of the Tula (SS) delivery point on behalf of Enel Green Power (- 0.7 million) and the construction of a transformer station for Sarpom (- 0.4 million).

**Increase in capitalized expenses for internal projects**  
**Euro 22.5 million**

Capitalized costs refer to labour costs (euro 12.6 million) and the consumption of materials and machinery (euro 9.9 million). The item records a euro 5.1 million increase on last year which is largely attributable to the consumption of materials.

**Other income and revenues**  
**Euro 28.7 million**

Other income and revenues is detailed below:

Euro	2004	2003	Change
Fees for high-voltage connections	15,262,356	20,284,739	-5,022,383
Damages and similar compensation	2,679,701	1,828,585	851,116
Sundry sales	2,971,705	4,192,031	-1,220,326
Other revenues and prior year gains	7,803,163	2,242,103	5,561,060
<b>Total</b>	<b>28,716,925</b>	<b>28,547,458</b>	<b>169,467</b>

This item records a euro 5.0 million decline in fees for connections to the National Transmission Grid. The other revenues reflect the higher insurance indemnities for damage caused by third parties to Company plant and the ordinary prior year gains.

Specifically, the latter reflect the recording in the Income Statement of the provision for disposal of surplus plant compared to the real usage implemented during the year (euro 3.7 million) and the positive balance concerning the network fees for the year 2000 paid by ISO (euro 1.2 million).

## Operating costs

### Raw materials

*Euro 21.7 million*

The item consists of the costs incurred for the purchase of various materials and equipment used for the operation and maintenance of facilities. The total shows a rise of around 7% compared with 2003.

### Services

*Euro 102.9 million*

The item consists of the following:

Euro	2004	2003	Change
Maintenance and repairs	22,435,822	21,223,500	1,212,322
Insurance	5,084,051	5,128,803	-44,752
Transport and leasing	817,950	795,561	22,389
Other services	16,133,899	12,799,470	3,334,429
Services from other Enel Group companies	58,463,475	50,422,409	8,041,066
<b>Total</b>	<b>102,935,197</b>	<b>90,369,743</b>	<b>12,565,454</b>

A slight increase is recorded in respect of contracts with third parties concerning the routine maintenance and repair activities for upholding the efficiency of plant (+ 1.2 million). The sharp increase in other services and in services from other Group companies refers chiefly to the services and costs incurred for the Company's stock exchange listing which was implemented in 2004. Specifically, for the IPO costs for "Other third party services" are recorded in the amount of euro 1.9 million and other services invoiced to the Parent Company Enel equal to euro 8.4 and largely attributable to the activity of providing institutional notice.

Services received from other Enel Group companies include charges for IT, telecommunications and general services. The total shows a considerable decrease with respect to the previous year, attributable to IT and telephony services.

**Leases and rentals**  
**Euro 12.4 million**

The item primarily consists of property rent payable to third parties (euro 3.7 million), leasing costs (euro 3.4 million) and miscellaneous fees (euro 1.8 million). With respect to Group companies, the Company incurred further costs, which feature a drop compared to last year, for property rental of euro 2.0 million, and paid government telephone licensing fees of euro 0.7 million.

**Personnel**  
**Euro 163.2 million**

Personnel costs record a slight decrease (- 0.6 million) but remain essentially in line with the previous year. The total also includes the additional costs sustained in the period for staff incentives.

Euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Wages and salaries	115,662,916	114,533,015	1,129,901
Social security contributions	31,392,130	31,335,493	56,637
Employee termination indemnity	8,981,616	9,703,462	-721,846
Other costs	7,133,873	8,243,255	-1,109,382
<b>Total</b>	<b>163,170,535</b>	<b>163,815,225</b>	<b>-644,690</b>

Both the average number of employees by category of employment and their number at December 31, 2004 are shown in the table below, with comparison to the previous year:

	Average number 2004	Number at Dec. 31, 2004	Number at Dec. 31, 2003
Senior management	35	34	30
Middle management	210	221	204
Office staff	1,464	1,467	1,422
Workers	1,173	1,149	1,165
<b>Total</b>	<b>2,882</b>	<b>2,871</b>	<b>2,821</b>

Compared with 2003 the Company increased staff by 50.

Amortization,  
depreciation and  
write-downs  
*Euro 144.2 million*

**Depreciation of tangible assets**

This item includes accruals for the year (euro 143.4 million) calculated on the basis of the depreciation rates representing the remaining useful life of the Company's plant (in 2003: euro 139.6 million for ordinary depreciation in addition to euro 151.4 million for additional depreciation).

**Write-downs of fixed assets**

These amount to euro 0.7 million and refer to the release of work in progress and advances for abandoned projects.

Change in  
inventories  
*Euro -1.7 million*

This shows the net positive change in inventories during the year.

Provisions for risks  
and charges  
*Euro 9.7 million*

These include accruals made at December 31, 2004, as described in greater detail in the section on the "provision for risks and charges".

Other operating  
costs  
*Euro 28.7 million*

This item records a euro 12.8 million increase compared with 2003 due to adjustments charged to the Company by ISO in respect of lower finalized volumes of energy drawn by distributors for the year 2002/2003 (euro 14.8 million). It also includes losses due to retirement of power lines (euro 2.5 million), discounts on electricity supplied to retired personnel (euro 1.9 million) and sundry local indirect taxes (euro 3.4 million).

Lastly it records expenses incurred in the year for the remuneration of the members of the Board of Statutory Auditors and the Board of Directors, which is summarized in the table below.

The table has been drawn up with reference to the period of office and on an accruals basis:

Surname	Name	Office held	Period of office		Expiry of office	Office emolument	Bonuses and other incentives	Total
Conti *	Fulvio	Director	03/2004	12/2004	Approval Fin. Stats. 2006	25,000.00		25,000.00
Mobili	Sergio	Chief Executive Officer	01/2004	12/2004	Approval Fin. Stats. 2006	309,999.99	320,000.00**	629,999.99
Arnaboldi	Luca	Director	09/2004	12/2004	Approval Fin. Stats. 2006	10,873.23		10,873.23
Cantarella	Paolo	Director	09/2004	12/2004	Approval Fin. Stats. 2006	12,157.38		12,157.38
Croff	Davide	Director	05/2004	12/2004	Approval Fin. Stats. 2006	21,920.22		21,920.22
Gnudi ***	Piero	Director	01/2004	03/2004	Approval Fin. Stats. 2003	6,250.00		6,250.00
Machetti *	Claudio	Director	03/2004	12/2004	Approval Fin. Stats. 2006	25,000.00		25,000.00
Machi	Salvatore	Director	09/2004	12/2004	Approval Fin. Stats. 2006	11,073.23		11,073.23
Romano *	Massimo	Director	03/2004	12/2004	Approval Fin. Stats. 2006	25,000.00		25,000.00
Ruzzini*	Paolo	Director	03/2004	12/2004	Approval Fin. Stats. 2006	25,000.00		25,000.00
Sardo*	Salvatore	Director	03/2004	12/2004	Approval Fin. Stats. 2006	25,000.00		25,000.00
Tamburi ***	Carlo	Director	01/2004	05/2004	Approval Fin. Stats. 2006	10,416.66		10,416.66
Total Directors remuneration						507,690.71	320,000.00	827,690.71
Ferreri	Giovanni	Chairman Board of Stat. Auditors	01/2004	12/2004	Approval Fin. Stats. 2004	46,500.00		46,500.00
Franceschetti	Bruno	Auditor	01/2004	12/2004	Approval Fin. Stats. 2004	36,000.00		36,000.00
Corvace	Giancarlo	Auditor	01/2004	12/2004	Approval Fin. Stats. 2004	36,000.00		36,000.00
Total Auditors remuneration						118,500.00		118,500.00
FINAL TOTAL						626,190.71	320,000.00	946,190.71

\* The parties concerned waived the emoluments for the offices held up to June 23, 2004 for an amount equal to euro 11,900.70 each. The remaining amount of euro 13,099.30 relating to the period June 24, 2004-December 31, 2004 was attributed to Enel SpA.

\*\* This amount comprises:

- to the extent of euro 150,000, the variable part of the fees referring to the year 2004, approved and disbursed in the course of 2004;
- to the extent of euro 170,000, the bonus awarded for the results achieved in the placement of Terna shares effected by Enel SpA in June 2004.

\*\*\* The parties concerned waived the emoluments for the offices held.

## Financial income and expense

### Euro -12.3 million

**Other financial income** A breakdown of other financial income is provided below:

Euro	2004	2003	Change
Income from investments	4,882,457	0	4,882,457
Other financial income	191,324	335,367	-144,043
Interest on current account with Parent Company	4,353,182	15,783,429	-11,430,247
Interest on loans to subsidiaries	11,598,170	0	11,598,170
Interest on equity from Parent Company	13,863,391	0	13,863,391
<b>Total</b>	<b>34,888,524</b>	<b>16,118,796</b>	<b>18,769,728</b>

Among the financial income from subsidiaries attention is drawn to the item “Interest on Equity”, a specific form of return on internal funds, provided for by prevailing Brazilian legislation, and passed by the subsidiary TSN for the year 2004 in favour of the Parent Company.

#### Interest and other financial expense

A breakdown of “Interest and other financial expense” is provided below:

Euro	2004	2003	Change
Interest on loans from Parent Company	25,278,319	36,961,128	-11,682,809
Interest on current account with Parent Company	382,983	29,831	353,152
Interest on EIB financing	7,036,272	8,019,618	-983,346
Financial expense on derivatives (swaps)	2,552,143	6,138,743	-3,586,600
Interest on Bond Issue	11,521,918	0	11,521,918
Other interest and financial expense	395,213	22,600	372,613
Profit and loss on foreign exchange trading	-23,254	0	-23,254
<b>Total</b>	<b>47,143,594</b>	<b>51,171,920</b>	<b>-4,028,326</b>

Interest on loans from the Parent Company has decreased to the same extent to which interest on the bond issue has increased (euro 11.5 million). Interest on the EIB financing has also decreased (euro 1 million) as has the financial expense on derivatives (euro 3.6 million).

#### Value adjustments to invested income Euro 4.9 million

This item reflects the decrease in the TSN investment with respect to the dividend distributed to Terna during 2004 (R\$ 17,713,000 equal to euro 4,9 million).

#### Extraordinary items Euro 409.6 million

The rise in net extraordinary income is largely attributable to the effects of the tax clean up linked to the application of the so-called Vietti reform, which also takes into account the guidelines set forth in document no. 1 of the Italian Accounting Authority. These effects are visible in the income deriving from the reversal of the provision for additional depreciation (euro 695.5 million) net of the relative operating grants (euro 22.8 million) and in the expense for calculation of the relative deferred taxes (euro 251.4 million).



The table below provides a breakdown of the effects of the tax clean up, which has already been illustrated in the report on operations, on the Company's Income Statement:

Euro	
Tax effects, gross of deferred taxes:	
> additional depreciation	695,570,634
> operating grants	-22,847,342
<b>Total gross interference</b>	<b>672,723,292</b>
Related deferred taxes	-251,396,694
<b>Net effect of tax clean up</b>	<b>421,326,598</b>

The "other extraordinary income items" amount to euro 0.9 million and derive from excess income taxes recorded in the previous year in relation to the liability recognized in the Company's accounts (euro 0.8 million) as well as from legal expenses recovered thanks to court rulings in the Company's favor (euro 0.1 million).

"Extraordinary expenses" totaled euro 12.7 million and regard the tax amnesty for the year 2002 (euro 2.2 million) pursuant to Law 289/2002 and subsequent modifications, and to early retirement agreements with employees (euro 10.5 million) who are entitled to a pension.

## Income taxes

*Euro 165.2 million*

Euro	2004	2003	Change
Current taxes:			
> IRES	85,139,673	75,185,039	9,954,634
> IRAP	19,358,816	18,989,519	369,297
Prepaid taxes	7,457,414	-8,368,518	15,825,932
Deferred taxes	53,291,673	8,152,996	45,138,677
<b>Total</b>	<b>165,247,576</b>	<b>93,959,036</b>	<b>71,288,540</b>

Taxes for the year, which net of the effects of the tax clean up, amount to 39.52% of pre-tax income (43.21% in 2003) rose by euro 10.3 million owing entirely to the increase in the pre-tax profit.

Changes in income tax (IRES) from the previous year are shown in the reconciliation between the expected and the effective income taxes as below:

Millions of euro	2004
Statutory income	839.5
> Tax clean up	- 421.3
> Additional depreciation	- 153.9
> Changes in provisions	- 19.2
> Other increases/decreases	12.9
<b>Taxable income</b>	<b>258.0</b>
<b>Tax expense (33%) for the year</b>	<b>85.1</b>

The breakdown of "Prepaid taxes" is represented by provisions for:

- > tax recovered amounting to euro 13.7 million, due to the use of provisions taxed in previous years to cover adjustment to previous years' network fees, retirement of plant and the coverage of exceptional events on plant;
- > tax prepayments relating to temporary differences of euro 6.3 million that emerged in the year for accruals to the risk provision for litigation and the provisions for future risks and charges.

"Deferred taxes" relate to the portion of depreciation in excess of the ordinary depreciation rate, calculated net of grants, accrued for tax purposes. The total (euro 63.5 million) adjusted to reflect the realignment of the deferred tax provision to the prevailing tax rate (euro - 4.5 million) and the utilizations arising from the taxation of depreciation in excess of the deductible limit (euro 5.7 million), is quantified on the basis of the current tax rate in the financial year in which reversal will take place.

#### Transactions with related parties

Transactions involving Terna and related parties concern the exchange of goods and services with companies of the Enel Group, all of which are governed by specific contracts stipulated between the parties in accordance with the market conditions that would have been applied between two independent parties. All the transactions implemented were performed for Terna's benefit. Contracts with the Parent Company Enel SpA generating expenses for Terna relate primarily to:

- > provision of institutional or on-request assistance and consulting services;
- > communication services;
- > two short-term loans opened during the first year-half and used to redeem the pre-existing financial loan and to refund the share capital reduction of equal amount approved by Shareholders' Meeting. During the third quarter, the two bond issues raised sufficient financial resources to allow the integral repayment of the aforesaid loans.

As for other Group companies, contracts producing expenses related primarily to:

- > providing meals in the Company restaurants (canteens)-(Enel Facility Management SpA);
- > building maintenance services (Enel Facility Management SpA);
- > providing meals other than in canteens (tickets)-(Ape Gruppo Enel Srl);
- > human resource management services (Ape Gruppo Enel Srl);
- > supply and management of IT services (Enel.it srl);
- > supply of telephony and telecommunication services (Wind Telecomunicazioni SpA);
- > staff training services (Sfera Srl);
- > rental of buildings (NewReal SpA), deconsolidated from July 2004;
- > repayment of discounts on electricity to current and retired employees (Enel Distribuzione SpA);
- > transfer of lines, stations and disconnecting plant (Enel Distribuzione SpA);

contracts generating revenues related to:

- > operation and maintenance of high-voltage network (Enel Distribuzione SpA);
- > development, laying and maintenance of fiber optics (Enel.Net Srl);
- > transfer of power lines and stations (Enel Distribuzione SpA).

As for subsidiaries, contracts generating revenues related to:

- > supply of Terna staff (TSN e Novatrans);
- > interest on loans (Novatrans);
- > interest on Equity (TSN).

The following table shows expenses and revenues for the year, in millions of euro.

Company	Expenses	Revenues
Ape Gruppo Enel Srl	4.6	0.0
Enel Distribuzione SpA	4.2	30.2
Enel Green Power SpA	0.1	1.1
Enel Produzione SpA	0.4	1.6
Enel Facility Management SpA	5.7	0.1
Enel.it Srl	7.8	0.1
Enel.Net Srl	0.4	11.7
Enelpower SpA	0.0	0.5
Sfera Srl	0.8	0.0
Enel SpA	39.7	5.1
Novatrans Energia SA	0.0	12.3
TSN Transmissora Sudeste Nordeste SA	0.0	14.6
Newreal SpA	2.0	0.0
Wind Telecomunicazioni SpA	24.3	1.7
Dalmazia Trieste Srl	0.3	0.1
Deval Spa	0.0	0.1
Enel.si Srl	0.0	0.1
<b>Total</b>	<b>90.3</b>	<b>79.3</b>

## Other informaton

The table below outlines, pursuant to Article 2497 *bis* of the Italian Civil Code, the key figures from the latest Financial Statements approved by the Parent Company Enel SpA (in millions of euro). Enel SpA is responsible for directing and co-ordinating Terna and at year it holds an ownership percentage equal to 50% of the share capital:

BALANCE SHEET 2003		Millions of euro
<b>Assets</b>		
Share capital not paid in		0
Long-term assets		23,420
Current assets		5,965
Accruals and deferral		136
<b>TOTAL ASSETS</b>		<b>29,521</b>
<b>Liabilities</b>		
Shareholders' Equity		
Share capital		6,063
Reserves		5,327
Net income for the year		607
<b>TOTAL SHAREHOLDERS' EQUITY</b>		<b>11,997</b>
Provision for risks and charges		446
Provision for employee termination indemnities		11
Payables		16,904
Accruals and deferrals		163
<b>TOTAL LIABILITIES</b>		<b>29,521</b>
<b>Commitments and other risks</b>		<b>22,655</b>
<b>INCOME STATEMENT 2003</b>		
Production value		1,143
Operating costs		916
Financial income and expense		1,505
Value adjustments to investments		(1,290)
Extraordinary items		433
Income tax for the year		268
<b>NET INCOME FOR THE YEAR</b>		<b>607</b>

**Pension fund expense**

The charge taken in respect of the extraordinary contribution due upon the suppression of the Electricity Sector Employee Pension Fund with Law 488 of December 23, 1999 (the Finance Act for 2000), which was originally recognized as an intangible asset, has been nil since 2002 because the Company opted to amortize it in income over three years (2000, 2001 and 2002), in accordance with the provisions of the same law. If the Company had opted to amortize the charge over 20 years, which was also an option under the law and in line with that of the Parent Company, intangible assets would have shown an additional liability of around euro 75 million at December 31, 2004 (about euro 80 million at December 31, 2003).

## Reports

## Report of the Board of Statutory Auditors to the Shareholders' Meeting of Terna SpA pursuant to Article 2429, par. 2, of the Italian Civil Code and Article 153 of Legislative Decree 58/1998

To the Shareholders' Meeting of Terna SpA.

Shareholders,

Pursuant to Article 153 of Legislative Decree 58/1998, we inform you that in the year ended December 31, 2004, the Board of Statutory Auditors performed the monitoring activities provided for by law, in accordance with the guidelines issued by the National Council of the Italian Accounting Profession.

In particular the Board:

- > participated in all meetings of the Board of Directors, receiving from the Board periodic information on its activities and major economic, financial and equity operations carried out by the Company, ensuring that the related resolutions were not only implemented but also complied with the provisions of law and the By-laws and were not manifestly imprudent or excessively risky, did not give rise to potential conflicts of interest or conflict with the resolutions of the Shareholders' Meeting;
- > monitored the various phases of the procedure for Terna's listing on the Italian Stock Exchange, and examined the evolution of the process, which is currently in progress, to unify the property and management of the National Transmission Network, pursuant to Law 290/03;
- > gathered information and monitored, within the scope of our responsibilities, the Company's organizational structure, observing the adequacy of the same in view of the modifications implemented further to the procedure for the Company's listing on the stock exchange;
- > monitored the administrative and accounting system, assessing the reliability of the latter in providing an accurate representation of the Company's operations and the application of sound management criteria. These activities were conducted both through direct observation and information gathered from management;
- > held meetings, pursuant to Article 150 of Legislative Decree 58/98, with the Independent Auditors, exchanging information with them on a reciprocal basis. Over the course of the various meetings no facts requiring discussion in this report emerged;
- > assessed and monitored the internal control system through information received from management, including the specific report prepared periodically by the head of the internal control department, from which no facts requiring discussion in this report emerged, thus proving the adequacy of the existing control system;
- > verified, through direct checks and information obtained from the Independent Auditors, compliance with the provisions of law regarding the preparation of the financial statements, with a particular focus on the form of presentation, content and accounting policies adopted. We also verified the completeness of the report on operations prepared pursuant to Article 2428 of the Italian Civil Code and the adequacy of the same in describing the transactions with related parties and other Group companies implemented in 2004.

The only significant developments that the Board of Statutory Auditors feels should be reported regard:

- > the elimination, in compliance with the provisions of the corporate law reform, of tax effects from the Statutory Financial Statements referring to additional depreciation, net of operating grants, reclassified under “Extraordinary Income” with subsequent calculation of deferred tax (extraordinary expenses);
- > the increase in the value of the equity investments in the Brazilian companies TSN and Novatrans, due to payment of the adjustment to the acquisition price and, for Novatrans, to the capitalization of the Shareholder Loan, converted into ordinary shares;
- > the ordinary contingent liabilities resulting from the adverse adjustments determined by ISO for the years 2002/2003.

No objections are raised in the Independent Auditors’ Report on the Financial Statements 2004, but attention is drawn to the following aspects:

- > the existence of disputes and other uncertainties relating primarily to environmental and urbanistic matters, the outcome of which could result in charges for the Company, at present not objectively quantifiable;
- > the economic and financial effects ensuing from the new regulations governing Financial Statements introduced by Legislative Decree 6/2003;
- > the effects of the accounting of the extraordinary charge due upon suppression of the Electricity Sector Employee Pension Fund;
- > and of the application of the equity method in accounting for the subsidiaries;
- > inclusion in the Notes to the Financial Statements of the key figures of the latest Financial Statements of Enel SpA, in view of the latter exercising guidance and coordination over the Company. KPMG’s opinion does not however encompass said figures.

The Board has no remarks to make with regard to the above-mentioned aspects.

In the course of the monitoring activity described above and, on the basis of information obtained from the Independent Auditors and from the Managers of Terna, no omissions, reprehensible facts, irregularities or significant events have emerged that would need to be reported to the appropriate authorities or mentioned in the present report.

We also report that:

- > the Board of Directors meet twelve times and the Board of Statutory Auditors attended all meetings. In 2004 the Board of Statutory Auditors met nine times;
- > during 2004 the Board of Statutory Auditors did not issue any opinions. On the contrary, the Independent Auditors issued a single opinion for the distribution of *interim* dividends, pursuant to Article 2433 *bis* of the Italian Civil Code;
- > no report pursuant to Article 2408 of the Italian Civil Code was received, nor was any complaint filed by third parties;
- > the Company has adopted a Corporate Governance system consistent with the recommendations contained in the Self-Disciplinary Code provided by Borsa Italiana SpA.

Furthermore, and once again in line with the provisions set forth by Borsa Italiana, the Company has adopted:



- an adequate Code of Conduct for handling and conveying to the market information relating to transactions on financial instruments, issued by Terna or by its subsidiaries, performed by persons vested with the relevant decisional powers within the corporate framework and with access to price sensitive information;
- adequate internal Regulations setting forth provisions relating to the management and handling of confidential information and describing the procedures to be observed in disclosing documents and information concerning the Company and its subsidiaries to external parties, with particular reference to the price sensitive information referred to in Article 114, paragraph 1, of Legislative Decree 58/98.

Lastly to comply in full with the recommendations set forth in CONSOB notice of April 6, 2001, we report the following:

1. during 2004 no irregular or unusual transactions were implemented with related companies, other Group companies or third parties;
2. with reference to routine transactions between Group companies, these primarily relate to the operation and maintenance of high-voltage power lines, the development, laying and maintenance of fiber optics, services received (information technology, telecommunications, staff training, leasing of buildings, etc.) while those with related parties mainly refer to institutional consulting or assistance and other assistance on request, communication services and transactions of a financial nature.

On the basis of sample checks carried out by the Board of Statutory Auditors, and of disclosures received, these transactions prove to be in line with the interests of the Company;

3. as indicated in a specific declaration issued by the Partner of the Independent Auditors, in addition to the auditing assignment, KPMG provided the following services:
  - activities associated with the stock exchange listing for euro 520,000;
  - issue of the opinion concerning the interim dividend for euro 30,000;
  - issue of the comfort letter concerning the bond issue for euro 30,000;
  - translation of documents into English for euro 5,000.

Other than the activities listed, from the information in our possession, further assignments do not appear to have been entrusted to subjects associated with the Independent Auditors.

In view of the foregoing, the Board of Statutory Auditors, within the scope of its responsibility, finds no impediment to the approval of the Financial Statements of the Company proposed by the Board of Directors.

Rome, March 11, 2005

The Board of Statutory Auditors  
Giovanni Ferreri  
Bruno Franceschetti  
Giancarlo Russo Corvace



**KPMG S.p.A.**  
**Revisione e organizzazione contabile**  
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(Translation from the Italian original which remains the definitive version)

## **Report of the auditors in accordance with article 156 of legislative decree no. 58 of 24 February 1998**

To the shareholders of  
Terna S.p.A.

- 1 We have audited the financial statements of Terna S.p.A. as at and for the year ended 31 December 2004. 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 audit.
- 2 We conducted our audit in accordance with the auditing standards recommended by Consob, the Italian Commission for Listed Companies and the Stock Exchange. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and are, as a whole, reliable. 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 audit provides a reasonable basis for our opinion.

Reference should be made to the report dated 27 February 2004 for our opinion on the prior year figures which are presented for comparative purposes as required by law.

- 3 In our opinion, the financial statements of Terna S.p.A. as at and for the year ended 31 December 2004 comply with the Italian regulations governing their preparation; therefore they are clearly stated and give a true and fair view of the financial position and results of the company.
- 4 We draw your attention to the following disclosures that the directors have provided in the notes to the financial statements:
  - 4.1 The company has a number of legal disputes and further uncertain situations, mainly in relation to urban planning and environmental issues. Adverse rulings could lead to significant charges for the company, which cannot however be presently measured objectively.

- 4.2 As described in the notes to the financial statements, following the new regulations governing financial statements introduced by Legislative decree no. 6 of 17 January 2003, the company has eliminated fiscally-driven adjustments and provisions made in previous years which, from 1 January 2004, are no longer allowed.

The effects of such change and the related deferred taxation have been taken to the profit and loss account under extraordinary income and expense, respectively, and are described in the notes to the financial statements.

- 4.3 The notes to the financial statements show the effects on the financial statements of the application of Law no. 488/1999, governing the recognition of the extraordinary expense that arose as a result of the suppression of the Electricity Sector Employee Pension Fund.

- 4.4 The company holds controlling interests in a number of companies and, in accordance with current legislation, has prepared consolidated financial statements. Such statements are presented in addition to its own financial statements in order to furnish adequate information on the financial position and results of both the company and the group. We have audited the consolidated financial statements and these (with our audit report thereon) are presented together with the statutory financial statements.

The notes disclosed the effects that would have impacted the financial statements had the company accounted for its investment in subsidiaries using the equity method.

- 4.5 As required by the law, the company disclosed the key figures from the latest financial statements of the company that manages and coordinates it in the notes to its own financial statements. Our opinion on the financial statements of Terna S.p.A. does not extend to such data.

Rome, 11 March 2005

KPMG S.p.A.

(Signed on the original)

Bruno Mastrangelo  
*Director of Audit*

## **Consolidated Financial Statements of the Terna Group**



## **Report on operations of the Terna Group**

## Introduction

The present report on operations, drawn up to accompany the Financial Statements for the year as at 31 December 2004, provides the information required under Article 2428 of the Italian Civil Code as well as the information considered necessary for completeness and to supply an adequate explanatory note on the Company.

Pursuant to Article 82 of the CONSOB Resolution no. 11971/1999, the Company availed of the exemption from publishing the quarterly report as of December 31, 2004.

For the purposes of a more uniform comparison of the economic figures relating to the previous year, which in the 2003 Consolidated Income Statement did not include the results of the Brazilian companies in which investments are held since the related equity investments had been acquired as of December 31, 2003, certain *pro forma* economic balances have been stated relating to the corresponding period in 2003 which represent the theoretical economic effects of the transactions for the reduction of Terna's share capital and the acquisition of the Brazilian subsidiaries as if these had taken place on January 1, 2003. As far as the most significant events in 2004, Corporate Governance, and other information is concerned, reference should be made to the Report on Operations accompanying the Financial Statements of Terna SpA.

### Subsidiary companies

During the year, Terna carefully defined the organizational structure tasked with activities in Brazil. This structure, functional in type, organizes the staff in five divisions common to TSN and Novatrans, and determines the responsibilities and tasks, whilst the strategy, co-ordination and control role continues to be performed by Terna's divisions.

On November 10, Terna acquired all the shares in TSN belonging to Inepar Energia SA and one share of a minority shareholder, thus increasing its holding in the company to 100%. These shares were subsequently afforded as collateral in favor of BNDES, in addition to all the ordinary and preference TSN shares, with the exception of the individual shares belonging to the members of the Board of Directors.

### Brazilian legislative and regulatory scenario

On March 15, 2004, Law no. 10,848 was issued, implementing the new model of the Electricity Sector, involving effects on the generation and distribution and sale activities. The transmission area was not affected, with sole exceptions relating to the grantor power-related prerogatives of the Ministry for Mines and Energy and the Electricity Agency ("ANEEL") and the composition of the Management Body of the National Electricity System Operator ("ONS").

### ANEEL resolutions and authorizations

On March 10, by means of the Authorizing Resolution no. 83 ANEEL approved addendum no. 2 to concession agreement 095/2000 with Novatrans, thus ratifying the transfer of corporate control to

Terna and extending the contractual start date of the commercial operation of all the North-South II line from February 8, 2004 until April 8, 2004. The extension was requested as a result of the delays in construction caused by events outside the company's control. This addendum was signed on April 29 by Novatrans, Terna and ANEEL.

On June 30, ANEEL issued Legislative Resolution no. 70 which established the new values of the Concession Fee (RAP) in force as from July 1, 2004 until June 30, 2005.

The TSN fee was set at R\$ 224.6 million, reflecting the adjustment for inflation (IGPM rate) accumulated between June 2003 and May 2004, equating to 7,030%; likewise, the Novatrans fee was fixed at R\$ 246.9 million. In addition, Novatrans was acknowledged an additional one-off payment of R\$ 279,766.24 which reflects the IGPM accumulated on the invoicing of several project elements which was delayed because the necessary certification (Termos de Liberação) for the start-up of commercial operations by ONS was lacking.

The fee review did not include the rise of the fee in order to compensate the increase in the values of the PIS and COFINS rates, which for the PIS rose from 0.65% of the fee to 1.65% in January 2003 and for the COFINS from 3% of the fee to 7.6% in February 2004. Such compensation was anticipated in the concession agreement. The companies requested ANEEL that their rights to be compensated be recognized and they presented the related request to obtain a fee review. On December 3, ANEEL acknowledged them "a definite and liquid right" to obtain compensation for the increase in the PIS/COFINS rates, which made it possible to record related revenues in the accounts of R\$ 18.5 million in 2004 (R\$ 8.5 million for TSN and R\$10 million for Novatrans). ANEEL has indicated that it is currently drawing up specific regulations with regard to this matter which will be subject to public consultation (Audiencia Pública). It is therefore reasonable to assume that the compensation will be paid during the next fee review (July 1, 2005, in other words during the 2005/2006 cycle).

## Operations

### TSN

During the period, the Sudeste Nordeste kV 500 transmission line, with an extension of 1,062 km<sup>(1)</sup>, from Serra da Mesa (Goiás State) to Sapeaçu (Bahia State), including the intermediate sub-stations at Rio das Eguas, Bom Jesus da Lapa and Ibicoara, was fully operational, resulting (figures relating to 2003 in brackets) in the following ratios relating to availability and the fault rate during 2004:

<sup>(1)</sup> "As Built" length of the 500 kV lines (compared with 1,050 km in the concession agreement), which join the 15 km relating to 230 kV double-circuit stretches (taking them as two individual circuits) for a total of 1,077 km.



	Availability (%)	Fault rate
Power Line	99.90 (97.37)	0.85 (1.74)
Reactors	99.99 (99.23)	0.00 (0.50)
ATR	99.94 (98.49)	0.25 (1.02)
SVC	99.83 (96.20)	5.01 (11.23)

### Novatrans

During the second quarter of the year, the North-South II kV 500 transmission line, with an extension of 1,278 km, from Samambaia (Federal District) to Imperatriz (Maranhão State) with the intermediate sub-stations of Serra da Mesa, Gurupí, Miracema and Colinas became fully operational for commercial purposes since the third and last stretch (Miracema-Colinas-Imperatriz) and the related substations were completed and received the ONS certificates (Termos de Liberação) which authorized the start-up of invoicing for each of the elements which were not yet operative (with effect as of April 7, 8, 9 and May 7).

With regard to construction activities, shareholders are informed of the realization of connections and the activation of the battery chargers and the DC distribution panels which made independence from the power supplies of Furnas and Eletronorte possible. Generators were provided for the Samambaia station. Civil engineering activities were started for the installation of the reserve reactors at the Samambaia and Serra da Mesa stations, while installation activities were launched for the emergency satellite link.

The ratios relating to availability and the fault rate for all of 2004 are indicated below.

	Availability	Fault rate
Line	99.94%	1.04
Reactors	99.98%	2.00
FSC	96.66%	18.62
TCSC	93.85%	41.94

## Operating and financial review

The Consolidated Financial Statements as of December 31, 2004 closed with net income of euro 236.0 million, after having provided amortization and depreciation on fixed assets totaling approximately euro 160.9 million, net financial expense of euro 79.5 million, net extraordinary expense of euro 22.7 million and income taxes amounting to euro 173.4 million.

The value of production amounted to around euro 1,045.3 million, of which euro 990.5 million for sales and services mainly referable to the payment of the Parent Company for use of the National Transmission Network. More specifically, on the basis of the calculations deriving from the application of the Electricity and Gas Authority's Resolution no. 05/04 and taking into account the matters laid down in the operating Agreement entered into with the ISO SpA, fees for network usage have been assessed for a total of around euro 810.8 million, up by around euro 28.5 million (+ 3.6%) when compared with the same period in 2003. The contribution of the subsidiary companies comes to euro 118.2 million (of which euro 57.4 million for Novatrans and euro 60.9 million for TSN).

Production costs amounted to around euro 533.7 million of which euro 165.0 million relating to staff and euro 160.9 to amortization/depreciation.

Net extraordinary income totaling approximately euro 22.7 million, entirely attributable to the Parent Company, was essentially due (euro 11 million) to the differences emerging at the time of application of the new corporate and tax law provisions, pertaining to the amortization of operating grants exceeding the depreciation rates and relating to the accounting periods prior to 2003, while euro 10.5 concerned early retirement incentives.

Income taxes for the period, amounting to euro 173.4 million, included euro 165.2 million relating to the Parent Company, euro 3.1 million relating to Novatrans and euro 5.1 million relating to TSN.

The Balance Sheet discloses net tangible fixed assets amounting to euro 4,313.6 million, net employed capital of euro 3,685.2 million covered by Shareholders' Equity amounting to euro 1,819.9 million (49.4%, compared with 83.0% as of December 31, 2003) and by net financial debt of euro 1,865.3 million (50.6%, compared with 17.0% as of December 31, 2003).

Shareholders are reminded that the 2003 balances do not include the economic results of the Brazilian subsidiaries, therefore for an improved comparison the *pro forma* comparative balances are shown which include both the economic results of the subsidiaries as if they had been acquired as of January 1, 2003, and the financial expenses which the Company would have incurred if the share capital reduction had taken place as of January 1, 2003.

In order to provide a summary reconciliation of the aforementioned effects between the 2003 Consolidated Income Statement result and the 2003 *pro forma* Consolidated Income Statement result, the following schedule is attached:

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### Amounts in millions of euro

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Consolidated Income Statement as of December 31, 2003	220.4
2003 result contributed by the Brazilian subsidiaries	- 28.1
Amortization of the goodwill paid for the acquisition of the equity investments	- 4.1
Financial effects of the acquisition of the Brazilian equity investments and reduction of the share capital	- 15.4
<i>Pro forma</i> Consolidated Income Statement as of December 31, 2003	172.8

The reclassified Income Statement of the Terna SpA Group, for 2004 and 2003, is presented below.

## Income Statement

In millions of euro	2004	2003	Change		2003 <i>Pro forma</i>	<i>Pro forma</i>	Change	
				%				%
Revenues:								
> NTN usage fees	929.1	782.3	146.8	18.8	829.3	99.8	12.0	
> Other sales and services	61.4	61.6	(0.2)	(0.3)	61.6	(0.2)	(0.3)	
> Change in contract work in progress	3.3	4.7	(1.4)	(29.6)	4.7	(1.4)	(29.6)	
> Other sundry revenues and income	29.0	23.2	5.8	25.1	23.0	6.0	25.9	
<b>Total revenues</b>	<b>1,022.8</b>	<b>871.8</b>	<b>151.0</b>	<b>17.3</b>	<b>918.6</b>	<b>104.2</b>	<b>11.3</b>	
Operating costs:								
> Payroll and related costs	165.0	163.8	1.2	0.7	164.9	0.1	0.1	
> Goods and services and use of third-party assets	127.4	104.9	22.5	21.4	113.4	14.0	12.3	
> Materials	20.1	14.4	5.7	39.8	14.2	5.9	41.5	
> Other costs	49.8	15.9	33.9	213.8	20.3	29.5	145.3	
> Capitalized costs	(22.5)	(17.4)	(5.1)	29.2	(17.4)	(5.1)	29.2	
<b>Total operating costs</b>	<b>339.8</b>	<b>281.6</b>	<b>58.2</b>	<b>20.7</b>	<b>295.4</b>	<b>44.4</b>	<b>15.0</b>	
<b>GROSS OPERATING MARGIN</b>	<b>683.0</b>	<b>590.2</b>	<b>92.8</b>	<b>15.7</b>	<b>623.2</b>	<b>59.8</b>	<b>9.6</b>	
Amortization, depreciation and accruals:								
> Depreciation and amortization	161.0	139.6	21.4	15.3	150.2	10.8	7.2	
> Provisions and writedowns	10.4	37.0	(26.6)	(71.9)	37.1	(26.7)	(72.0)	
<b>Total amortization, depreciation and accruals</b>	<b>171.4</b>	<b>176.6</b>	<b>(5.2)</b>	<b>(2.9)</b>	<b>187.3</b>	<b>(15.9)</b>	<b>(8.5)</b>	
<b>OPERATING INCOME</b>	<b>511.6</b>	<b>413.6</b>	<b>98.0</b>	<b>23.7</b>	<b>435.9</b>	<b>75.7</b>	<b>17.4</b>	
Net financial income (expense)	(79.5)	(35.1)	(44.5)	126.8	(116.2)	36.7	(31.6)	
Income (expense) from equity investments	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
<b>RESULT PRIOR TO EXTRAORDINARY ITEMS AND TAXATION</b>	<b>432.1</b>	<b>378.6</b>	<b>53.5</b>	<b>14.1</b>	<b>319.7</b>	<b>112.4</b>	<b>35.1</b>	
Net extraordinary income (expense)	(22.7)	(15.0)	(7.7)	50.9	(15.0)	(7.7)	51.3	
<b>INCOME BEFORE TAXES</b>	<b>409.4</b>	<b>363.5</b>	<b>45.9</b>	<b>12.6</b>	<b>304.7</b>	<b>104.7</b>	<b>34.3</b>	
Income taxes for the period	(173.4)	(143.1)	(30.3)	21.2	(131.9)	(41.5)	31.5	
<b>NET INCOME PERTAINING TO THE GROUP AND TO MINORITY SHAREHOLDERS</b>	<b>236.0</b>	<b>220.4</b>	<b>15.6</b>	<b>7.1</b>	<b>172.8</b>	<b>63.2</b>	<b>36.6</b>	
Income (loss) pertaining to minority shareholders		0.0	0.0	0.0	0.0	0.0	0.0	
<b>GROUP NET INCOME</b>	<b>236.0</b>	<b>220.4</b>	<b>15.6</b>	<b>7.1</b>	<b>172.8</b>	<b>63.2</b>	<b>36.6</b>	

*Revenues* for 2004, amounting to euro 1,022.8 million (euro 904.2 million for the Parent Company and euro 118.6 million for the Brazilian subsidiaries), disclosed an increase of euro 104.2 million (+ 11.3% with respect to the euro 919 million 2003 *pro forma* figure). The increase derives mainly from the NTN usage fee amounting to approximately euro 99.8 million, including around euro 28.5 million for the Parent Company – an amount deriving from the difference between the lower revenues due to the review, according to provisional figures, of the NTN ownership percentage (euro - 21 million) and the increases deriving from the application as from February 2004 of the new tariffs and, as from April 2004, of the new time bands established by the Electricity and Gas Board Resolution no. 05/04 (euro + 49.5 million) – and around euro 71 million for the Brazilian subsidiaries as a result of the line belonging to Novatrans becoming fully operational in 2004.

*Operating costs* amounted to euro 339.8 million (euro 305 million for the Parent Company and euro 35 million for the subsidiaries) and disclosed a rise of 15% (euro + 44.4 million) when compared with the 2003 *pro forma* figure (euro 295 million), reflecting the growth in activities reported during the period with particular reference to the full operations of the Brazilian subsidiaries (approximately euro 16.5 million). Furthermore, additional costs were recorded in relation to the IPO (around euro 10 million), which join out-of-period expense pertaining to the Parent Company for adjustments on the NTN usage fee referring to the accounting periods 2002 and 2003 (for a total of euro 15 million).

The EBITDA (*gross operating margin*) came to euro 683 million, up euro 59.8 million when compared with the 2003 *pro forma* figure (+ 9.6%). The Brazilian subsidiaries contributed euro 84.1 million, compared with euro 33 million in the same 2003 *pro forma* period.

EBIT (*operating income*) came to euro 511.6 million, up euro 75.7 million (+ 17.4%) when compared with euro 435.9 million in the 2003 *pro forma* period, and benefits not only from the increase in the EBITDA, but also from the substantial decrease (euro 26.6 million) in the item provisions and writedowns of the Parent Company essentially attributable to lower provisions following the review of the NTN ownership percentages. Amortization and depreciation, by contrast, disclosed an increase with respect to 2003 of euro 10.8 million due essentially (euro 13.2 million) to the amortization and depreciation charges of the subsidiary companies.

*Net income* amounted to euro 236 million (up 36.6% when compared with euro 173 million in the 2003 *pro forma* period) after net financial expense of euro 79.5 million and income taxes totaling euro 173.4 million, including euro 53.3 million for net deferred taxation and euro 8.2 million referring to the Brazilian companies.

The incidence of income taxes on pre-tax income came to 42.4%.

## Balance Sheet

The Terna Group's Balance Sheet for 2004 and 2003 is summarized below, obtained by reclassifying the Balance Sheet balances.

In millions of euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
<b>Reclassified Balance Sheet</b>			
Net fixed assets:			
> Tangible and intangible	4,424.8	4,311.3	113.5
> Long-term financial assets	9.3	12.8	(3.5)
<b>Total</b>	<b>4,434.1</b>	<b>4,324.1</b>	<b>110.0</b>
Net current assets:			
> Trade receivables	154.8	226.7	(71.9)
> Inventories	42.2	34.9	7.3
> Other assets	35.3	19.7	15.6
> Net tax assets (payables)	(8.6)	(40.1)	31.5
> Trade payables	(183.0)	(184.8)	1.8
> Other liabilities	(238.5)	(245.1)	6.6
<b>Total</b>	<b>(197.8)</b>	<b>(188.7)</b>	<b>(-9.1)</b>
<b>Gross capital employed</b>	<b>4,236.3</b>	<b>4,135.4</b>	<b>100.9</b>
Sundry provisions	(551.1)	(563.6)	12.5
<b>Net capital employed</b>	<b>3,685.2</b>	<b>3,571.8</b>	<b>113.4</b>
Shareholders' Equity	1,819.9	2,966.2	(1,146.3)
Shareholders' Equity pertaining to minority shareholders	0.0	0.2	(0.2)
Net financial debt	1,865.3	605.4	1,259.9
<b>TOTAL</b>	<b>3,685.2</b>	<b>3,571.8</b>	<b>113.4</b>

Net financial debt is analyzed as follows:

Net financial debt*	2004	2003	Change
Bond issue	1,400.0	0.0	1,400.0
ENEL debt undertaken	0.0	456.2	(456.2)
EIB loans	318.2	325.0	(6.8)
BNDES/IDB loans	378.9	164.2	214.7
Cash and on hand	(231.8)	(340.0)	108.2
<b>Total</b>	<b>1,865.3</b>	<b>605.4</b>	<b>1,259.9</b>

*Tangible and intangible fixed assets* rose by euro 113.5 million, of which around euro 109 million relating to the algebraic effect of investments, amortization/depreciation and disposals during the period and the differences due to the appreciation of the BR/Euro exchange rate which as of December 31, 2003 passed from BR 3.6627 to 3.61433 per Euro as of December 31, 2004.

By contrast long-term financial assets decreased by euro 3.5 million, essentially as a result of the Parent Company with particular reference to financial receivables due from employees.

*Net current assets* came to euro -197.8 million. The increase on 2003, amounting to euro 9.1 million, derives from a decrease in net assets of euro 49 million attributable to:

- > a drop in trade receivables equating to euro 71.9 million nearly entirely attributable to the Parent Company relating to a decrease in amounts due from the ISO (approximately euro 64 million) as a result of the new time band breakdown as per Resolution no. 05/04 which in contrast to 2003 is more remunerative in the Summer months, as well as of the adjustments to the NTN ownership percentage;
- > a rise in inventories amounting to around euro 7.3 million essentially attributable to the Parent Company (around euro 5 million) relating to inventories of work in progress with particular reference to the SCTI project;
- > the increase of approximately euro 15.6 million in other assets mainly attributable to the Parent Company and identifiable in the item accrued income and prepaid expenses totaling around euro 17 million (of which euro 10 million in accrued income on derivative products, euro 3.2 million for issue discounts and euro 3.9 million in issue costs) deriving from the bond issue totaling euro 1,400 million.

*Net tax liabilities* fell by around euro 32 million. This decrease, essentially attributable to the Parent Company, derives from:

- > the increase in amounts receivable for euro 12.7 million, of which euro 7.4 million in receivables for taxes paid abroad, in relation to which recovery is permitted in Italy in order to avoid double taxation taking place and euro 5.2 million for the VAT credit being the excess between the tax liability emerging at the time of settlement for December and the advance payment made;
- > the decrease in taxes payable of around euro 19.2 million is essentially due (as per the underlying table) to the lower advance paid over in 2003 as a result of lower taxes due for 2002 following the so-called Tremonti tax concessions.

The decrease of euro 1.8 million in *trade payables* is essentially the result of the algebraic sum of the increase of around euro 19 million for the Parent Company relating to the additional activities carried out at the end of the accounting period and a decrease of approximately euro 21 million concerning the Brazilian companies mainly due to the completion of Novatrans power line.

The decrease in *sundry provisions* amounting to around euro 12.5 million is essentially due to the Parent Company and reflects:

- > the increase in the Provision for net deferred taxation amounting approximately to euro 53.3 million for changes in the balance during the period (essentially amortization/depreciation in

- excess of the amortization rates);
- > the decrease of euro 37.6 relating to the complete extinction of the Supplementary Welfare Reserve for Enel Executives (PIA);
  - > the decrease of euro 10.3 million in the provision for employee termination indemnities as a result of the increase following the provision for the year of around euro 9 million and utilization totaling euro 19.3 million (euro 13.6 million for concessions to staff for the Terna and Enel 3 placement transactions and euro 2.1 million intended for pension funds);
  - > the decrease of euro 19.1 million in other provisions for risks and charges as a result of the increases and utilizations during the period (respectively, euro 17.7 and euro 36.8 million).

The substantial reduction in the *Shareholders' Equity* is attributable not only to the changes during the period but also the aforementioned reduction of the Parent Company's share capital equating to euro 1.2 billion.

## Investments in tangible fixed assets

The breakdown of investments made in 2004 by plant type is presented as follows:

<b>Total investments</b>		
In millions of euro	2004	2003
Power lines	154.1	106.1
Transformer stations	110.9	127.2
Other	12.8	7.5
Brazil	25.4	n.a.
<b>Total</b>	<b>303.2</b>	<b>240.8</b>

## Plant and equipment

The Group's plant is illustrated in the table below:

	Terna		TSN		Novatrans	
	no.	km	no.	km	no.	km
Stations	300		5		-	
Transformers	569		14		-	
Bays	3,902		29		10	
Lines		34,958		1,077		1,278
Double circuit lines	1,931	38,696	12	1,077	5	1,278

The main changes during 2004 resulted from:

> the acquisition by Terna of:

- approximately 168 km of power lines, 1 132 kV station in Alessandria (Alessandria) and 2 overhead cable sectioning plants in Tolle Alta (Livorno) and Cala Telegrafo (Livorno) previously owned by Enel Distribuzione and included by the ISO, when drawing up the last Three-year Growth Plan subsequently approved, as part of the National Transmission Network;
- the 150 kV Agip Gela-C.P. San Cono power line, measuring approximately 30.4 km, already forming part of the NTN but previously owned by EniPower Trasmissione;

> the transfer to Enel Distribuzione of around 65 km of lines previously owned by Terna and sold off from the NTN upon the ISO's proposal since they were considered to be no longer directly functional for the electricity transmission service. At the time of this transfer, and following the interest shown by Enel Distribuzione, Terna also sold to the latter several network components, constructed previously as the result of certain connection requests made by several independent producers which had never been included within the sphere of the NTN perimeter and therefore were not subject to specific remuneration by the ISO. This concerned 2 power lines (132 kV branch for the connection of the Tecnoborgo power station and 132 kV Jesi-Jesi Energia line) stretching in total approximately 5.4 km and 4 150-132 kV stations at Tecnoborgo (Piacenza), Pietracatella (Campobasso), Avigliano (Potenza) and Forenza Maschito (Potenza);

> Terna's execution of the development activities resolved by the ISO. With regard to these activities, shareholders are informed in particular of the start-up during the year of the following plants:

- 380 kV power lines: Altomonte-Laino (42 km), S. Giacomo-Teramo (15 km), Candela-Foggia (39 km);
- 380 kV station in Mantua (Mantua), 380 kV station in Chivasso Termica (Turin), 380 kV station in Teramo (Teramo), 380 kV station in Altomonte (Cosenza), 220 kV station in S. Benedetto del Querceto (Bologna), 220 kV station in Busachi (Oristano), 150 kV station in Nurri (Nuoro), 132 kV station in Tassara (Brescia) and 132 kV station in Pinasca (Turin);

> the shutdown of the 150 kV station at S. Chiara Tirso (Oristano) and the demolition or shutdown of several stretches of 220 kV and 132 kV line for a total of approximately 100 km.

In conclusion, the program for the replacement of existing transformers with higher power versions continued during 2004, and together with the installation of new transformers took the value of the total switching capacity to 108,749 MVA as of December 31, 2004 compared with 107,485 MVA as of December 31, 2003.



## Financial flows

### Cash flow

<b>Statement of cash flows</b>			
In millions of euro	2004	2003	Change
<b>A) OPENING SHORT-TERM FINANCIAL DEBT (-) ASSETS (+)</b>	<b>340.0</b>	<b>583.6</b>	<b>-243.6</b>
Cash and Banks	50.7	0.1	50.6
Intercompany current account	289.3	583.5	-294.2
<b>B) CASH FLOW FROM OPERATIONS</b>			
Net income	236.0	220.4	15.6
Amortization and depreciation	160.9	139.6	21.3
Net change in provisions	-2.4	67.9	-70.3
Net change in employee termination indemnity provision	-10.3	-5.0	-5.3
Net loss (gain) on the disposal of assets	1.9	1.4	0.5
<b>Cash generated by operations</b>	<b>386.1</b>	<b>424.3</b>	<b>-38.2</b>
Change in net current assets			
> (increase) decrease in net current assets	55.3	22.9	32.4
> increase (decrease) in payables	-44.7	-21.3	-23.4
> Changes in other Balance Sheet items	-1.5	13.2	-14.7
<b>Total B) – Cash flow from operations</b>	<b>395.2</b>	<b>439.1</b>	<b>-43.9</b>
<b>C) CASH FLOW FROM (FOR) INVESTMENT ACTIVITIES</b>			
> Investments in tangible fixed assets	-303.2	-240.8	-62.4
> Investments in intangible fixed assets	0	-115.5	115.5
> Other changes in tangible fixed assets	14.8	19.8	-5
> Other changes in long-term financial assets	2.9	-449.3	452.2
> Changes in equity investments	0.6	5.2	-4.6
<b>Total C)</b>	<b>-284.9</b>	<b>-780.6</b>	<b>495.7</b>
<b>D) CASH FLOW FROM (FOR) FINANCING ACTIVITIES</b>			
> New medium- and long-term loans	3,308.3	164.3	3,144.0
> Repayment of medium and long-term loans	-2,156.6	-22.4	-2,134.2
> Dividends and other capital transactions	-1,370.2	-44.0	-1,326.2
<b>Total D)</b>	<b>-218.5</b>	<b>97.9</b>	<b>-316.4</b>
<b>E) CASH FLOW GENERATED FOR THE PERIOD</b>	<b>-108.2</b>	<b>-243.6</b>	<b>135.4</b>
<b>F) CLOSING NET SHORT-TERM DEBT (-) ASSETS (+)</b>	<b>231.8</b>	<b>340.0</b>	<b>-108.2</b>
Cash and Banks	87.9	50.7	37.2
Intercompany current account	143.9	289.3	-145.4

## Net debt position

In millions of euro	2004	2003
<b>Opening net financial debt</b>	<b>- 605.4</b>	<b>- 220.0</b>
<b>Liquidity generated by operations</b>	<b>395.2</b>	<b>439.1</b>
Investments in tangible and intangible assets	- 303.2	- 805.6
Purchases/increases of equity investments	0.0	5.2
Disposals of equity investments	0.6	0.0
Other changes in fixed assets	17.7	19.9
<b>Liquidity absorbed by investment activities</b>	<b>- 284.9</b>	<b>- 780.5</b>
Dividends distributed/collected	- 170.2	- 44.0
Increases/decreases in the share capital	- 1,200.0	0.0
<b>Shareholders' Equity flows</b>	<b>- 1,370.2</b>	<b>- 44.0</b>
Change in financial debt	- 1,259.9	- 385.4
<b>Closing balance of net financial debt</b>	<b>- 1,865.3</b>	<b>- 605.4</b>

The *liquidity generated by operations* during the period came to approximately euro 395.2 million and is mainly attributable to cash generated by operation during the period (income, amortization/depreciation, provisions) as well as the increase in current assets.

*Investment activities* absorbed financial resources for around euro 284.9 million and concerned investments in tangible fixed assets during the period; other increases concerned operating grants and the disposal of assets.

*Flows of Shareholders' Equity* also absorbed liquidity, for approximately euro 1,370.2 million, as a consequence of the reimbursement of the share capital to Enel SpA and the distribution of dividends to shareholders during the period.

These flows together with those absorbed by investment activities led to a total requirement of euro 1,655.1 million covered by liquidity generated by operations for euro 395.2 million while the remaining balance of euro 1,259.9 million was covered by the change in net long-, medium- and short-term debt.

*Net financial debt* (euro 1,865.3 million) as of December 31, 2004 and the related maturities are as follows:

In millions of euro	Total	Current portion	Non-current portion
EIB loans	318.2	18.2	300.0
Bond issues	1,400.0		1,400.0
BNDES/IDB loans	378.9	28.8	350.1
Cash	-231.8	-207.8	-24.0
<b>Total</b>	<b>1,865.3</b>	<b>-160.8</b>	<b>2,026.1</b>

### Financial results by geographic area

The following table shows the breakdown of key data related to Group results for Italian and Brazilian operations.

In millions of euro	2004	Italy 2003 <i>Pro forma</i>	2004	Brazil 2003 <i>Pro forma</i>	2004	Total 2003 <i>Pro forma</i>
Financial data						
Revenues	904.2	871.6	118.6	47.0	1,022.8	918.6
Gross operating margin	599.6	590.3	83.4	32.9	683.0	623.2
Operating income (loss)	441.5	409.5	70.1	26.4	511.6	435.9
Net income	224.8	200.9	11.2	-28.1	236.0	172.8
Shareholders' Equity and financial data						
Gross capital employed	3,755.0		481.3		4,236.3	
Net capital employed	3,204.7		480.5		3,685.2	
Net financial debt	1,574.2		291.1		1,865.3	
Investments in tangible fixed assets	277.8	240.8	25.4	n.a.	303.2	240.8

For the commentary, see the Report on operations and Notes to the Financial Statements.

## Research and Development

As far as research activities which require specific professional skills were concerned, Terna avails of the collaboration of CESI SpA in which it holds a 15% equity investment.

The research project of greatest interest during 2004 concerned:

- > the implementation of an expert system supporting the power line and station maintenance activities, entitled MBI, which besides being a technical database, supports the proposals and the handling of the maintenance operations plans.

The related costs incurred during the year amounted to approximately euro 2.2 million.

The following activities are planned for 2005:

- > the study and set-up of on-line diagnostic systems for power line insulators;
- > the research and set-up of innovative solutions for reducing electromagnetic fields.

## Human Resources

The following table shows a breakdown of the workforce by category.

Breakdown of the workforce	Italy		Brazil		Total		Change
	at Dec. 31, 2004	at Dec. 31, 2003	at Dec. 31, 2004	at Dec. 31, 2003	at Dec. 31, 2004	at Dec. 31, 2003	
<b>Total</b>	<b>2,871</b>	<b>2,821</b>	<b>58</b>	<b>16</b>	<b>2,929</b>	<b>2,837</b>	<b>92</b>
Senior management	34	30			34	30	4
Middle management	221	204	3	3	224	207	17
Office staff	1,467	1,422	55	13	1,522	1,435	87
Workers	1,149	1,165			1,149	1,165	-16

The figures for both years are net of leavers as of December 31 (amounting to 25 as of December 31, 2004 and 227 as of December 31, 2003).

The increase in the headcount during 2004 was mainly the result of the almost complete achievement of the intake plan put together in 2003 in face of the need to handle the turnover, so as to guarantee the maintenance and development of the Company's distinctive expertise, and to permit a generation changeover partly supporting the technological evolution underway within the core processes.

## Transactions with related parties

Related parties were identified taking as reference the provisions of the CONSOB Communication no. 2064231 dated September 30, 2002.

With regard to the Terna Group's transactions during the 2004 accounting period, they are represented by transactions with subsidiary companies and companies belonging to the Enel Group.

The transactions carried out by Terna with related parties mainly concern the exchange of goods, the provision of services, the borrowing and lending of financial resources, the coverage of insurance risks and up to the moment of listing for assistance activities concerning staff organization, as well as administrative, tax, legal and corporate assistance.

All the transactions form part of the ordinary operations and are regulated on an arm's length basis, in other words at conditions which would be applied between two independent parties.

Lastly, shareholders are reminded that within the sphere of the corporate governance regulations which the Terna Group has adopted and which are detailed in the specific section of this Report on Operations, the conditions have been anticipated for ensuring that the transactions with related parties are carried out in observance of the criteria of procedural and substantive correctness.

The transactions with related parties are indicated in the Notes to the Financial Statements within the commentary to the individual Balance Sheet items as summarized in the table below:

Main Income Statement items	In millions of euro	Company and nature of transaction
Revenues for other sales and services	30.2	Enel Distribuzione SpA – Services for the running and maintenance of the HV lines belonging to Enel Distribuzione SpA, as well as for the sale to the same of power lines not belonging to the NTN.
	11.7	Enel.Net Srl – services relating to the support of the F.O. on plants belonging to Terna as well as the running, maintenance and development of the same.
	0.7	Enel SpA – IPO consultant fees.
	1.1	Enel Green Power – Services relating to jobs for the construction of plants, and other sundry services.
	1.6	Enel Produzione SpA – Services relating to jobs for the construction of plants, as well as sundry services and maintenance on Enel Produzione SpA plants.
	1.7	Wind Telecomunicazioni SpA – Servicing for teletransmission and telephone equipment housing activities.
	0.5	Enelpower SpA – Sundry maintenance and services on Enelpower SpA plants.
Costs for services	24.3	Wind Telecomunicazioni SpA – Telecommunications services and services for the development of special projects (SCTI).
	7.8	Enel.it Srl – Services for the realization and the maintenance of IT projects, for the operating of applications and connections to the Internet and to databases, electronic mail and the Intranet, hire and management of PCs.
	5.7	Enel Facility Management SpA – Services for: – Catering service by means of the provision of meals in company restaurants (canteens) to Terna staff – Property service (cleaning, ordinary maintenance and operating of installations, security, etc.) in the buildings occupied by Terna staff.
	4.6	Ape Srl – Services relating to: – the provision of meals replacing the canteen service (luncheon vouchers) to services for the management/administration of Terna staff.
	4.2	Enel Distribuzione SpA – Reimbursement of the discounts on supplies of electricity to employees and pensioners as well as sundry services on plants.
	14.5	Enel SpA – Sundry services for stockmarket listing (euro 10 million) and Management Fees (euro 4 million)
Financial income and expense – Other financial income from Parent Companies	4.4	Enel SpA – Interest income on Intercompany bank account.
	25.2	Enel SpA – Charges relating to interest expense on medium/long-term loans and on derivative products relating to the same.

## **Significant events subsequent to the end of the accounting period, outlook for 2005 and other information**

The main events following the end of the accounting period, are described as follows:

**Publication of the Electricity and Gas Authority Resolution no. 15/05 relating to the implementation of Article 1 of the Prime Minister's Decree dated May 11, 2004, in other words concerning the definition of the revenues due to the ISO business segment being transferred to Terna**

This resolution set the tariff intended to cover the costs of the part of the ISO which will not be transferred to Terna (the so-called ISO-CIP6) at 0.0095 euro cents/kWh.

In this resolution, the Electricity and Gas Authority also clarified the allocation of certain economic items present in the 2004 accounts of ISO SpA establishing in particular that, by means of separate measures, it will adopt the necessary provisions so that:

- a) the amounts set aside as of December 31, 2004 by ISO in the reserve for management margin on cross-border interconnection guarantees are destined to reduce the payments for the purveying of the resources on the market for the dispatching service;
- b) the revenue from infrazone congestion set aside by ISO as of December 31, 2004, or rather the amounts corresponding to the CCT 2004 margin, are destined to reduce the charges for the energy transmission service.

Lastly, again in the decree in question, the Authority announces that by means of a specific resolution it will adopt the provisions aimed at regulating the financial flows generated by the tariff proceeds destined to cover the costs acknowledged the two bodies emerging from the re-unification (Terna TSO and ISO-CIP6).

**Amendments to the Articles of Association required by the Prime Minister's Decree dated May 11, 2004, in view of the unification of the ownership and management of the NTN**

On January 31, 2005, Terna's extraordinary Shareholders' Meeting resolved, by means of the approval of the amendments proposed by the Board of Directors on December 14, 2004, the adaptation of the Articles of Association to the provisions of the Prime Minister's Decree dated May 11, 2004, containing "Criteria, methods and conditions for the unification of the ownership and the management of the National Transmission Network".

The most significant changes to the Articles of Association among those approved by the Shareholders' Meeting included:

- > the corporate name, changed to «TERNA – Rete Elettrica Nazionale Società per Azioni» (in abbreviated form Terna SpA);
- > the corporate purpose, changed so as to ensure consistency also with the ownership and the operation by Terna of the functions as operator of the National Electricity Transmission Network;
- > the fixing of a limit, equating to 5% of the share capital, to the charge of the electricity sector operators in relation to the exercise of the voting right when appointing the Directors;
- > the introduction of special requirements for covering the role of Directors.



The aforementioned changes to the By-laws will become applicable only as from the date of transfer to Terna of the activities of the business segment owned by ISO, in accordance with the matters anticipated by the aforementioned Prime Minister's Decree.

#### Terna-ISO unification

On February 28, 2005 Terna SpA and ISO SpA, in observance of the matters laid down by the Prime Minister's Decree dated May 11, 2004, signed the agreement for the transfer to Terna of the ISO business segment, comprising the activities, functions, assets and legal relationships as indicated by the same Prime Minister's Decree.

The purpose of the agreement is to integrate the ownership and management of the NTN.

The business segment being transferred includes approximately 580 resources, and includes the following activities:

- > the dispatching activities, or rather the management of the flows introduced and withdrawn from the NTN in order to balance electricity supply and demand;
- > the planning and development activities, or rather the definition of the investment programs for enhancing the NTN.

The parties have agreed a price of euro 68.3 million for the transfer of the business segment, net of approximately euro 112 million in trade payables due to Terna. The overall valorization of the business segment transferred therefore amounts to euro 180 million.

The date of efficacy of the unification between the ownership and management of the NTN is deferred until the occurrence of the following abeyance conditions:

- > the new concession by the Ministry of Production Activities for the performance of the electricity transmission and dispatching activities within the national territory belonging to Terna;
- > the approval, by the Ministry of Productive Activities and the Energy Authority, of the Network Code anticipated by the Prime Minister's Decree;
- > the issue by the Antitrust Authority of a favorable opinion on the transaction.

#### Outlook for operations in 2005

During the next accounting period the matters anticipated by the Prime Minister's Decree dated May 11, 2004 will be implemented, specifically in relation to the unification between the ownership and management of the national transmission network.

Consolidation will also follow of the Company's leadership within the sphere, of the development and maintenance of the NTN and, from an operational point of view, the technological innovation and the growth of the staff in terms of professionalism and consolidation of the widespread "managerial nature". Such action, which the Company intends to pursue, aims to ensure and safeguard the creation of value for the shareholder.

As part of the quantitative-qualitative overseeing of the corporate professionalism and the management of the turnover with a view to the generation changeover, the intake plan may be

expanded and a voluntary early retirement plan implemented in continuity with the matters already carried out in 2003-2004.

In relation to the process for integration with the ISO and the creation of a new body, the commitment will be targeted at the re-definition of policies and plans of action consistent with the changed context.

Internal communication events and initiatives will be implemented during the pre and post integration phase so as to permit the maximum involvement of the staff in the process of change.

## Other information

### Adoption of the international accounting standards

European Ruling no. 1606/2002 anticipates that, as from the 2005 accounting period, all the companies listed on organized markets in the EU shall adopt the "International Financial Reporting Standard" (IFRS) accounting standards for drawing up Consolidated Financial Statements.

The Italian legislator, within the sphere of the authority granted by said Ruling, by means of the EC Law 2003 (Law no. 306 dated October 31, 2003) extended this obligation to the Statutory Financial Statements of listed companies as well.

During the session held on November 26, 2004, the Cabinet approved the outline of the Legislative Decree bearing the "exercise of the options anticipated by Article 5 of the Ruling (EU) no. 1606/2002, concerning international accounting standards". The Legislative Decree was forwarded, for the prescribed opinion, to the competent parliamentary commissions.

This Legislative Decree lays down that companies issuing financial instruments listed on organized markets, have the faculty to draw up the Statutory Financial Statements using the new regulations as early as from 2005 and on a compulsory basis as from 2006. The obligation for the preparation of the Consolidated Financial Statements however is applicable as from 2005.

To-date, the Legislative Decree is being discussed and compared with the professional categories and the associations concerned.

Coinciding with this, the IASB (International Accounting Standard Board) has planned a series of projects aimed at the implementation of the international standards assimilated by the EU, including therein the regulation of transactions currently not disciplined. Some of these projects have already been concluded while others are being defined.

During 2004, in collaboration with the Group companies which also include Terna, Enel launched a specific process for the analysis and evaluation of the main differences between the accounting

standards adopted at present and those affected by the introduction of the IFRS.

The problems associated with the processes and the computerized information system have also been planned and adaptation activities started which are expected to be completed by Spring of 2005.

With respect to the accounting standards currently adopted by Terna, the greatest impacts are recognized:

- > in the provision according to which goodwill is not subject to amortization and its ability to be recovered must be verified, at least annually, for the purposes of the identification of a possible loss in value (impairment test);
- > in the utilization of actuarial techniques for the valuation of the employee leaving indemnity and other staff indemnities, including benefits for electricity at reduced tariffs granted to employees and pensioners;
- > in the adoption of the fair value for the valuation of derivative instruments.

Code concerning  
the protection of  
personal details  
(Italian Legislative  
Decree no. 196  
dated June 30,  
2003)

During 2003, Terna SpA drew up the Programmatic Security Document in accordance with Italian Presidential Decree no. 318/1999.

The document will be updated in compliance with Italian Legislative Decree no. 196 dated June 30, 2003 by the legal deadline anticipated as June 30, 2005.

## **Consolidated Financial Statements**

## Balance Sheet - Assets

In millions of euro	at 31.12.2004	at 31.12.2003	Changes for the period
<b>A) SHARE CAPITAL NOT PAID-IN</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>B) FIXED ASSETS</b>			
<b>I. Intangible assets</b>			
(1) incorporation costs	0.0	0.0	0.0
(2) research, development and advertising	0.0	0.0	0.0
(3) industrial patents and intellectual property rights	0.0	0.0	0.0
(4) concessions, licenses and trademarks	0.0	0.0	0.0
(5) consolidation difference-goodwill	111.2	115.5	-4.3
(6) work in progress and advances	0.0	0.0	0.0
<b>Total</b>	<b>111.2</b>	<b>115.5</b>	<b>-4.3</b>
<b>II. Tangible assets</b>			
(1) land and buildings	329.1	326.7	2.4
(2) plant and machinery	3,590.5	3,419.9	170.6
(3) commercial and industrial equipment	12.0	11.0	1.0
(4) other assets	2.0	1.1	0.9
(5) work in progress and advances	380.0	437.1	-57.1
<b>Total</b>	<b>4,313.6</b>	<b>4,195.8</b>	<b>117.8</b>
<b>III. Financial assets</b>			
(1) equity investments in:			
(a) subsidiaries	0.0	0.0	0.0
(b) affiliates	0.0	0.0	0.0
(c) Parent Company	0.0	0.0	0.0
(d) others	2.9	3.5	-0.6
(2) receivables from:			
(a) subsidiaries	0.0	0.0	0.0
(b) affiliates	0.0	0.0	0.0
(c) Parent Company	0.0	0.0	0.0
(d) others	6.4	9.3	-2.9
> due within 12 months	0.4	0.4	0.0
(3) other securities	0.0	0.0	0.0
<b>Total</b>	<b>9.3</b>	<b>12.8</b>	<b>-3.5</b>
<b>TOTAL FIXED ASSETS (B)</b>	<b>4,434.1</b>	<b>4,324.1</b>	<b>110.0</b>
<b>C) CURRENT ASSETS</b>			
<b>I. Inventories</b>			
(1) raw materials	19.6	15.6	4.0
(3) contract work in progress	22.6	19.3	3.3
(5) advances	0.0	0.0	0.0
<b>Total</b>	<b>42.2</b>	<b>34.9</b>	<b>7.3</b>

In millions of euro	at 31.12.2004	at 31.12.2003	Changes for the period
<b>II. Receivables</b>			
(1) trade:			
> third parties	138.0	190.8	-52.8
> other Enel Group companies	17.6	20.2	-2.6
(2) subsidiaries	0.0	0.0	0.0
(3) affiliates	0.0	0.0	0.0
(4) Parent Company	143.9	289.3	-145.4
(4-bis) tax receivables	16.3	0.0	16.3
(4-ter) advanced taxes	14.8	22.3	-7.5
(5) others	13.1	30.5	-17.4
> due beyond 12 months	11.0	35.4	-24.4
<b>Total</b>	<b>343.7</b>	<b>553.1</b>	<b>-209.4</b>
<b>III. Short-term investments</b>			
(4) other equity investments	0.0	0.0	0.0
(6) other securities	0.0	0.0	0.0
<b>Total</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>IV. Cash and cash equivalents</b>			
(1) bank and post office deposits	87.8	50.6	37.2
(3) cash on hand	0.1	0.1	0.0
<b>Total</b>	<b>87.9</b>	<b>50.7</b>	<b>37.2</b>
<b>TOTAL CURRENT ASSETS (C)</b>	<b>473.8</b>	<b>638.7</b>	<b>-164.9</b>
<b>D) ACCRUED INCOME AND PREPAID EXPENSES</b>			
(1) accrued income	10.0	0.0	10.0
(2) prepaid expenses:			
> issue discounts	3.2	0.0	3.2
> other	8.5	4.9	3.6
<b>TOTAL ACCRUED INCOME AND PREPAID EXPENSES (D)</b>	<b>21.7</b>	<b>4.9</b>	<b>16.8</b>
<b>TOTAL ASSETS</b>	<b>4,929.6</b>	<b>4,967.7</b>	<b>-38.1</b>

## Balance Sheet - Liabilities and Shareholders' Equity

In millions of euro	at 31.12.2004	at 31.12.2003	Changes for the period
<b>A) SHAREHOLDERS' EQUITY</b>			
I. Share Capital	440.0	2,036.1	-1,596.1
II. Share premium reserve	0.0	0.0	0.0
III. Revaluation reserve	0.0	0.0	0.0
IV. Legal reserve	84.5	78.3	6.2
V. Statutory reserve	0.0	0.0	0.0
VI. Reserve for own shares	0.0	0.0	0.0
VII. Other reserves:	0.0	0.0	0.0
> capital reserve	396.1	0.0	396.1
> accelerated depreciation reserve	332.6	295.7	36.9
> consolidation reserve	420.2	335.6	84.6
VIII. Retained earnings (losses)	0.5	0.1	0.4
IX. Interim dividends 2004	-90.0	0.0	-90.0
<b>Group's earnings (losses)</b>	<b>236.0</b>	<b>220.4</b>	<b>15.6</b>
<b>Group consolidated Shareholders' Equity</b>	<b>1,819.9</b>	<b>2,966.2</b>	<b>-1,146.3</b>
IX. Share capital and third parties' reserve	0.0	0.2	-0.2
<b>Consolidated Shareholders' Equity of the Group and of Third parties</b>	<b>1,819.9</b>	<b>2,966.4</b>	<b>-1,146.5</b>
<b>B) PROVISIONS FOR RISKS AND CHARGES</b>			
(1) retirement benefits	0.7	0.8	-0.1
(2) taxes and deferred taxes	463.9	417.2	46.7
(3) others	40.9	59.7	-18.8
<b>Total</b>	<b>505.5</b>	<b>477.7</b>	<b>27.8</b>
<b>C) EMPLOYEE TERMINATION INDEMNITY</b>	<b>60.4</b>	<b>70.7</b>	<b>-10.3</b>
<b>D) PAYABLES</b>			
(1) bonds	1,400.0	0.0	1,400.0
> due beyond 12 months	1,400.0	0.0	1,400.0
(2) convertible bonds	0.0	0.0	0.0
(3) trade payables from loans	0.0	456.2	-456.2
(4) bank loans:			
> medium- and long-term bonds	697.1	489.2	207.9
> due beyond 12 months	650.1	480.7	169.4
> short-term loans	0.0	0.0	0.0
(5) other loans	0.0	0.0	0.0
(6) advances	36.2	47.7	-11.5
> due beyond 12 months	15.8	30.5	-14.7
(7) trade payables:			
> third parties	152.6	149.5	3.1
> due beyond 12 months	3.0	0.8	2.2
> other Enel group companies	29.3	35.3	-6.0
(8) payables represented by credit instruments	0.0	0.0	0.0
(9) payables to subsidiaries	0.0	0.0	0.0
(10) payables to affiliates	0.0	0.0	0.0
(11) payables to Parent Company	1.7	39.2	-37.5
(12) tax payables	25.1	40.2	-15.1
(13) social security payables	8.1	7.5	0.6
(14) other payables	12.9	33.5	-20.6
<b>Total</b>	<b>2,363.0</b>	<b>1,298.3</b>	<b>1,064.7</b>

In millions of euro	at 31.12.2004	at 31.12.2003	Changes for the period
<b>E) ACCRUED LIABILITIES AND DEFERRED INCOME</b>			
(1) accrued liabilities	19.0	6.7	12.3
(2) deferred income:			
> premium on bond issues	0.0	0.0	0.0
> other	161.8	148.0	13.8
<b>Total</b>	<b>180.8</b>	<b>154.7</b>	<b>26.1</b>
<b>TOTAL LIABILITIES</b>	<b>3,109.7</b>	<b>2,001.3</b>	<b>1,108.4</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>4,929.6</b>	<b>4,967.7</b>	<b>-38.1</b>
<b>COMMITMENTS</b>			
Guarantees granted	313.9	7.4	306.5
Other commitments	2,519.3	356.1	2,163.2
<b>Total</b>	<b>2,833.2</b>	<b>363.5</b>	<b>2,469.7</b>



## Income Statement

In millions of euro	2004	2003	Changes for the period
<b>A) VALUE OF PRODUCTION</b>			
(1) revenues from sales and services:			
> network usage fees	929.1	782.3	146.8
> other sales and services	61.4	61.6	-0.2
(3) change in contract works in progress	3.3	4.7	-1.4
(4) capitalized expenses	22.5	17.4	5.1
(5) other income and revenues:			
> contribution received	15.3	14.9	0.4
> other	13.7	8.3	5.4
<b>Total value of production</b>	<b>1,045.3</b>	<b>889.2</b>	<b>156.1</b>
<b>B) OPERATING COSTS</b>			
(6) raw materials	21.8	20.2	1.6
(7) services	114.7	90.4	24.3
(8) leases and rentals	12.7	14.5	-1.8
(9) personnel:			
> wages and salaries	116.9	114.5	2.4
> social security contributions	31.9	31.3	0.6
> employee termination indemnity	9.0	9.7	-0.7
> retirement benefits	1.0	1.7	-0.7
> other costs	6.2	6.6	-0.4
(10) amortization, depreciation and write-downs			
> intangible assets	4.2	0.0	4.2
> tangible assets	156.7	139.6	17.1
> other write-downs of fixed assets	0.7	0.0	0.7
> write-downs of current receivables	0.0	1.0	-1.0
(11) change in inventories	-1.7	-5.8	4.1
(12) accruals to provisions for risks and charges	9.7	36.0	-26.3
(13) other provisions	0.0		0.0
(14) other operating costs	49.9	15.9	34.0
<b>Total operating costs</b>	<b>533.7</b>	<b>475.6</b>	<b>58.1</b>
<b>OPERATING INCOME</b>	<b>511.6</b>	<b>413.6</b>	<b>98.0</b>
<b>C) FINANCIAL INCOME AND EXPENSE</b>			
(15) from equity investments in:			
> subsidiaries	0.0	0.0	0.0
> affiliates	0.0	0.0	0.0
> other companies	0.0	0.0	0.0
(16) other financial income:			
(a) from long-term receivables:			
> subsidiaries	0.0	0.0	0.0
> affiliates	0.0	0.0	0.0
> other companies	0.2	0.3	-0.1
(b) from long-term financial assets	0.0	0.0	0.0
(c) from marketable securities	6.8	0.0	6.8
(d) other income:			
> subsidiaries	0.0	0.0	0.0
> affiliates	0.0	0.0	0.0
> Parent Company	4.4	15.8	-11.4
> other companies	0.0	0.0	0.0

In millions of euro	2004	2003	Changes for the period
(17) interest and other financial expense:			
> subsidiaries	0.0	0.0	0.0
> affiliates	0.0	0.0	0.0
> Parent Company	25.7	37.0	-11.3
> other Enel Group companies	0.0	0.0	0.0
> other companies	50.3	14.2	36.1
(17-bis) (earnings) and losses from exchange rates	14.9	0.0	14.9
<b>Total financial income (expense)</b>	<b>-79.5</b>	<b>-35.1</b>	<b>-44.4</b>
<b>D) ADJUSTMENTS OF FINANCIAL ASSETS</b>			
(18) revaluation:			
(a) of equity investments	0.0	0.0	0.0
(b) of long-term financial assets	0.0	0.0	0.0
(c) of marketable securities	0.0	0.0	0.0
(19) writedowns:			
(a) of equity investments	0.0	0.0	0.0
(b) of long-term financial assets	0.0	0.0	0.0
(c) of marketable securities	0.0	0.0	0.0
<b>Total adjustments of financial assets</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>E) EXTRAORDINARY ITEMS</b>			
(20) income:			
> gains on disposals of assets	0.0	0.0	0.0
> other	0.9	2.2	-1.3
(21) expense:			
> losses on disposals of assets	0.0	0.0	0.0
> prior-year taxes	2.1	2.8	-0.7
> other	21.5	14.4	7.1
<b>Total extraordinary items</b>	<b>-22.7</b>	<b>-15.0</b>	<b>-7.7</b>
<b>INCOME BEFORE TAXES</b>	<b>409.4</b>	<b>363.5</b>	<b>45.9</b>
(22) income taxes	173.4	143.1	30.3
> current	112.7	94.2	18.5
> prepaid	7.4	-8.4	15.8
> deferred	53.3	57.3	-4.0
<b>INCOME FOR THE YEAR (third parties shares included)</b>	<b>236.0</b>	<b>220.4</b>	<b>15.6</b>
Third parties' earnings (losses) for the year	0.0	0.0	0.0
<b>GROUP EARNINGS (LOSSES)</b>	<b>236.0</b>	<b>220.4</b>	<b>15.6</b>



## **Notes to the Consolidated Financial Statements**

## Form, structure and scope of consolidation

The Consolidated Financial Statements have been prepared in compliance with the provisions of Legislative Decree 127/1991 and consist of the Balance Sheet and the Income Statement, which have been prepared using the formats envisaged by the relevant legislation, and of the accompanying notes, supplemented by a number of schedules that are an integral part of the notes and have been prepared in compliance with the relevant legislation. A Report on operations has also been drawn up in compliance with Article 2428 of the Italian Civil Code.

The figures of the Consolidated Financial Statements at December 31, 2003 have been appropriately reclassified so that they comply with the new Balance Sheet formats as provided by the new specifications of Article 2424 of the Italian Civil Code.

The consolidated statement of cash flows is included in the Report on operations.

As regards information on Group activities, significant events subsequent to the Balance Sheet date and transactions with related parties, please refer to the Report on operations accompanying the Consolidated Financial Statements.

All amounts are stated in millions of euro.

The scope of consolidation includes the Parent Company, Terna SpA, and the companies Transmissora Sudeste Nordeste SA and Novatrans Energia SA in which it directly or indirectly holds a majority of voting rights or exercises control at ordinary Shareholders' Meeting as defined by Article 2359 of the Italian Civil Code.

## Method of consolidation

The Consolidated Financial Statements have been prepared using the approved Financial Statements at December 31, 2004 of the consolidated subsidiaries. The figures have been adjusted where necessary to comply with the accounting policies of Terna SpA. Where applicable, the consolidated companies have recognized the effects of the tax clean up introduced by current corporate law and tax law provisions in their accounting statements for this year. Thus it no longer proves necessary to perform the adjustments to eliminate tax effects.

The main consolidation principles and procedures are as follows:

- > the difference between the acquisition cost of the interests and the related portion of Shareholders' Equity at the time of purchase adjusts the specific asset and liability items on the basis of the valuation conducted at the time of purchase or acquisition of control, if obtained as the result of subsequent acquisitions. Any positive differences are recorded as "Goodwill"; negative differences are booked under the "Consolidation reserve" in the consolidated Shareholders' Equity;
- > minority interests in the income and Shareholders' Equity of consolidated subsidiaries are recorded in a specific item of the Income Statement and Shareholders' Equity in the Balance Sheet;
- > significant unrealized gains and losses from transactions between Group companies as well as receivables and payables, costs and revenues generated between consolidated companies are eliminated;
- > dividends distributed between Group companies are eliminated from income and reallocated to initial equity reserves;
- > balance sheet items of companies operating in countries outside the euro area are translated into euro at the exchange rate applicable at the balance sheet date (Brazilian real = 3.61433). Income Statement items are translated at the average exchange rate for the year (Brazilian real = 3.63353). Exchange rate differences arising from the application of this method are posted under a specific equity item.

The Group does not currently operate in hyperinflationary countries.

## Accounting policies

The accounting policies used in the preparation of the Consolidated Financial Statements for 2004 are consistent with those used for the Consolidated Financial Statements for 2003 and are in conformity with Article 2426 of the Italian Civil Code, as amended further to the corporate law reform implemented by Legislative Decree no. 6 of January 17, 2003, and are supplemented by the accounting principles of the National Council of the Italian Accounting Profession, by document no. 1 of the Italian Accounting Authority and, where necessary and applicable, by the International Financial Reporting Standards (IFRS) issued by the ISAB.

The most significant policies are illustrated below.

### Balance Sheet

<b>Intangible assets</b>	<p>Intangible assets are recorded at purchase or realization cost inclusive of the additional expenses directly attributable and reflect the residual value of expenditures whose economic utility spans over several years. The cost defined as above is written down to reflect any impairment in value. If the conditions causing the impairment cease to exist, the cost value (net of depreciation) is restored. Amortization is calculated on a straight-line basis with reference to the expected useful economic life of the assets. Goodwill is recognized under assets if acquired for consideration and is amortized on a straight-line basis over 30 years, a period that is deemed to be representative of its effective economic utility. The same policy is used for goodwill arising on consolidation.</p>
<b>Tangible assets</b>	<p>Tangible assets are recorded at cost of purchase or production cost inclusive of any additional expenses incurred and monetary revaluations carried out by Enel SpA pursuant to the applicable regulation. The above defined cost is written down to reflect any permanent impairment in value. If the conditions causing the impairment cease to exist, the cost value (net of depreciation) is restored.</p> <p>The value of tangible assets excludes costs incurred in maintaining or restoring the efficiency and proper operation of plant. As these expenses do not modify the magnitude or potential of plant, they are charged to the financial year in which the maintenance and repair work is carried out. Tangible assets are depreciated on a straight-line basis at the following rates, which are determined based on the estimated useful life of the assets.</p>

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## Depreciation rates

	Terna	Foreign subsidiaries
Buildings	2.50%	4.00%
Power lines	2.50%	2.50 – 4.50%
<b>Switching substations:</b>		
> Electrical equipment	2.38%	2.00 – 3.00%
> Other electrical equipment	3.13%	2.80 – 4.50%
> Automation and control systems	6.70%	5.00 – 6.70%
<b>Central systems for management and control:</b>		
> Electronic equipment	5.00%	-
> Computers	10.00%	-

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The same depreciation rates are reduced by half for assets acquired during the year.

Up to 2003 accelerated depreciation was charged, pursuant to Article 67, paragraph 3 of Presidential Decree 917/86, directly to a Shareholder's Equity reserve, determined at the time the Shareholders' Meeting appropriated the company's earnings, with the deferred tax being recognized in the Income Statement. The reserve was progressively transferred to a distributable equity reserve upon taxation of the said accelerated depreciation charges. As from 2004, in compliance with prevailing regulations, the Company continues to calculate additional depreciation (equal to the difference between ordinary depreciation and the maximum amount that may be detracted for tax purposes). However said additional depreciation is recognized exclusively when determining the taxable income for direct tax purposes; thus from the year 2004, when appropriation of the Company's earnings is effected, this additional depreciation shall not be attributed to a specific reserve. The higher earnings to which tax has not been applied shall be distributable only if the Shareholders' Equity holds available reserves to an amount that is at least equal to said earnings.

## Financial assets

### Equity investments

Equity investments in other non-consolidated companies are accounted for at purchase or subscription cost, in so far as they are of minor relevance. The investment is written down in the event of a permanent impairment in value. If the factors causing the impairment cease to exist, the value of the equity investment is restored to the original amount and the revaluation is recognized in the Income Statement as a write-up.



<b>Inventories</b>	<p>Raw material, auxiliary and consumption goods used in the operation of plant and equipment are valued at their purchase price calculated by the weighted average method. Obsolete and slow-moving inventories are written down to their estimated realizable value, with the amount posted to a specific provision.</p> <p>Contract work in progress is valued at the amounts of the contractually agreed payments, according to the percentage-of-completion method.</p> <p>Advances received from customers for contractual work in progress are recorded under a liability item.</p>
<b>Receivables</b>	<p>Receivables are recorded at their estimated net recoverable value and classified under "Financial assets" or "Current assets", according to their use and to the nature of the debtor.</p>
<b>Accruals and deferrals</b>	<p>Accruals and deferrals are recorded based on the accrual method of accounting.</p> <p>The issue discounts and premiums, as well as other charges on loans, are systematically recorded in the Income Statement throughout the life of each loan.</p>
<b>Provisions for risks and charges</b>	<p><b>Provision for retirement benefits</b></p> <p>The provision includes compensation payable <i>in lieu</i> of notice to employees who are entitled to the compensation under the terms of the national collective bargaining agreement and union agreements currently in force.</p> <p><b>Other provisions for risks and charges</b></p> <p>These provisions are recorded against known or probable losses and liabilities whose amount or timing is undetermined at the end of the Balance Sheet date. Amounts accrued reflect the best possible estimate based on available information.</p> <p><b>Provision for employee termination indemnities</b></p> <p>The provision covers amounts owed to employees pursuant to the Italian law and collective bargaining agreements in force at the Balance Sheet date, net of advances made and pension fund contributions withheld.</p>

**Accounts payable**

Accounts payable are stated at face value.

**Memorandum  
accounts**

Guarantees in respect of the successful completion of works are recorded at the contractually agreed amount.

Commitments with suppliers are determined on the basis contractually agreed purchase commitments at the end of the year that do not fall within the normal operating cycle, limited to the part of the contract not yet executed.

**Income  
Statement**

Expenses and revenues are recognized on an accruals basis.

**Revenues****Regulated activities in Italy**

Revenues from the National Transmission Network (NTN) are recognized in accordance with the method set forth in the Operating License Agreement between the Parent Company and the Independent System Operator (Gestore della Rete di Trasmissione Nazionale SpA-ISO), and determined based on the tariff set by the Authority for Electricity and Gas.

**Regulated activities in Brazil**

Revenues are determined on the basis of the fixed fee established in the license for the operation of transmission lines issued by the local energy authority (ANEEL).

**Other revenues**

Other revenues are recorded at the time services are provided or when the title of ownership of the goods is transferred.

**Capital grants**

Grants received for the execution of specific works requested by third parties, whose value is recorded among tangible assets, are recorded, for facilities already in operation at December 31, 2002, as deferred income, for newly acquired facilities as from January 1, 2003, as a reduction in the book value of the assets, when legal title to the grant is recognized and the amount can be reasonably determined. Grants are deferred and recorded in the Income Statement, under other income and revenues, over the depreciable life of the assets to which they relate.

Advance payments received are recognized in a separate item under liabilities.

<b>Income taxes</b>	<p>Current taxes on income are recorded under tax liabilities and calculated by applying the respective estimated annual tax rate to the pre-tax profit for the year of each consolidated company.</p> <p>Deferred tax assets and liabilities are calculated on temporary differences between the values recognized in the Statutory Financial Statements and the corresponding values recognized for tax purposes, on the basis of the applicable tax rate at the time the differences are reversed.</p> <p>Deferred tax assets are carried as receivables to the extent that it is reasonably certain that they can be recovered.</p> <p>Deferred tax liabilities are provided to the extent such liability is expected to occur.</p>
<b>Translation of foreign currency accounts</b>	<p>Receivables and payables denominated in currency other than euro are translated into euro at the exchange rate at the time of the transaction. At the end of the year, they are translated into euro at the exchange rates at the balance sheet date, and differences are recorded in the Income Statement under financial income, taking account of any hedges.</p>
<b>Environmental costs</b>	<p>Environmental costs refer to the prevention, reduction and monitoring of the environmental impact of production activities. If the costs are recurrent, they are recognized to Income Statement when incurred. Cost relating to increase of the useful life, capacity or safety of tangible assets, are capitalized as part of the costs of the respective assets. Provisions for risks and charges associated with disputes connected with environmental matters are accrued when it is probable or certain that a liability will be incurred and the amount can be reasonably estimated.</p>
<b>Hedging activity</b>	<p>In order to hedge against the risk of fluctuations in interest rates, the Company has entered into derivative contracts to hedge both the risk associated with specific transactions and its overall exposure.</p> <p>The interest differentials to be received or paid on derivative financial instruments are recognized under financial income or expense in a manner consistent with the charges in respect of the underlying liabilities.</p>

## Balance Sheet - Assets

### Share capital not paid-in

At December 31, 2004 this item had a balance of zero (at December 31, 2003 this item had a balance of zero).

### Intangible assets Euro 111.2 million

The intangible assets are shown below:

Euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Others: > goodwill arising on consolidation	111.2	115.5	-4.3
<b>Total</b>	<b>111.2</b>	<b>115.5</b>	<b>-4.3</b>

The "goodwill arising on consolidation" recognized following the acquisition of the equity investments in TSN and Novatrans, implemented on December 31, 2003, regards the difference between the price paid and the Shareholders' Equity. The goodwill will be amortized over the residual term of the concession, originally set at 30 years, with effect from the year 2004. The difference between the balance at December 31, 2004 and that at December 31, 2003 is due to the amortization for the year.

### Tangible assets Euro 4,313.6 million

Tangible assets amount to euro 4,313.6 million (euro 4,195.8 million at Dec. 31, 2003).

The following table shows the values and the changes for each category of assets:

Millions of euro	at Dec. 31, 2003	Expenditure	Transfers in the year	Depreciation	Retirement other changes	at Dec. 31, 2004
Land and buildings	326.7	9.9	9.5	-11.8	-5.2	329.1
Plant and machinery	3,419.9	96.6	238.8	-142.4	-22.4	3,590.5
Ind. and commercial equipment	11.0	3.1	0.0	-2.1	0.0	12.0
Other assets	1.1	1.1	0.0	-0.5	0.3	2.0
<b>Total assets</b>	<b>3,758.7</b>	<b>110.7</b>	<b>248.3</b>	<b>-156.8</b>	<b>-27.3</b>	<b>3,933.6</b>
Work in progress and advances	437.1	192.5	-248.3	0.0	-1.3	380.0
<b>TOTAL</b>	<b>4,195.8</b>	<b>303.2</b>	<b>0.0</b>	<b>-156.8</b>	<b>-28.6</b>	<b>4,313.6</b>

The item "Plant and machinery" includes the electricity transport network, transformer stations and centralized systems for the remote monitoring of equipment in Italy and Brazil. In December 2004, the Parent Company acquired plant from Enel Distribuzione SpA, in compliance with the latest Three-Year Development Plan drawn up by the ISO and approved by the Ministry for Productive Activities on April 26, 2004, which designated the facilities as components of the National Transmission Network (NTN) and ordered their transfer to the Parent Company, which thus acquired around 163 kilometres of high-voltage power lines and one transformer station with a total value of euro 8.3 million.

The aforesaid Development Plan also provided that at the same time approximately 63 km of Terna-owned power lines, with a value of 2.8 million, be retired from the National Transmission Network and be transferred to Enel Distribuzione.

The Brazilian assets include the Sudeste Nordeste transmission line, which has a nominal voltage of 500 kV and is about 1,062 km long, beginning at the Serra da Mesa substation, in the state of Goiás, and ending at the Sapeaçu substation, in the state of Bahia (began operations in March 2003), and the North-South II Transmission line, which has a nominal voltage of 500 kV and is about 1,280 km long, beginning at the Imperatriz substation, in the state of Maranhão, and ending at the Samambaia substation, in the Federal District. The first segment of the latter entered into service in June 2003, while the remainder is due to be completed in April 2004.

The euro 16.3 million increase in net assets in Brazil is due to the following factors:

- > expenditure: euro 25.4 million;
- > depreciation: euro 13.3 million;
- > write-down of work in progress in 2003 (redefinition of the EPC contract with Enelpower) for euro 1.8 million;
- > real-euro exchange-rate appreciation at year-end generating approximately euro 6 million.

The following table shows the book values at December 31, 2004 of assets subject to depreciation, the related accumulated depreciation and the resulting net values. It also gives the percentage incidence of depreciation with respect to book values:

Millions of euro	Book value	Accumulated depreciation	Net value	Percentage incidence of depreciation at Dec. 31, 2004
Land and buildings	536.8	207.7	329.1	38.7%
Plant and machinery:				
> Italian assets	6,500.3	3,374.8	3,125.5	51.9%
> Brazilian assets	484.2	19.2	465.0	4.0%
Industrial and commercial equipment	39.5	27.5	12.0	69.6%
Other assets	12.6	10.6	2.0	84.1%
<b>Total</b>	<b>7,573.4</b>	<b>3,639.8</b>	<b>3,933.6</b>	<b>48.1%</b>

As regards work in progress and advances, projects for the development and upgrading of the network with a value of more than euro 5 million are indicated below;

#### Millions of euro

##### Power lines

> kV 380 Matera-Sofia	64.6
> kV 380 Laino-Feroleto-Rizziconi	48.2
> kV 380 S.Fiorano-Robbia	52.9

##### 380 kV switching substations

> Calenzano	14.5
> Foggia	7.3
> Sorgente	6.9
> Fratta	5.5
> Carpi Fossoli	11.2

##### 220 kV switching substations

> Oristano	7.4
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Changes in tangible assets occurred in the year are summarized below:

#### Millions of euro

##### Capital expenditure

> Power lines	166.5
> Switching substations	123.6
> Other	13.1
<b>Total capital expenditure</b>	<b>303.2</b>

##### Depreciation

-156.8

##### Disposals and other changes

-28.6

#### TOTAL

117.8

The Group Parent's main "capital expenditure" during the year regarded the following 380 kV power lines: S. Fiorano-Robbia (euro 52.9 million), Laino-Feroleto-Rizziconi (euro 32.9 million), Candela- Foggia (euro 13.1 million).

### Financial assets Euro 9.3 million

Financial assets break down as follows:

Millions of euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Equity investments:			
> in other companies	2.9	3.5	-0.6
<b>Total equity investments</b>	<b>2.9</b>	<b>3.5</b>	<b>-0.6</b>
Receivables from others:			
> tax advance on employee termination indemnities (Law 662/1996)	2.4	5.3	-2.9
> loans to employees and other items	3.5	3.6	-0.3
> others	0.5	0.4	0.3
<b>Total receivables from others</b>	<b>6.4</b>	<b>9.3</b>	<b>-2.9</b>
<b>TOTAL</b>	<b>9.3</b>	<b>12.8</b>	<b>-3.5</b>

### Equity investments Euro 2.9 million

Other equity investments held total euro 2.9 million and refer to CESI SpA. The size of the investment in this company has not changed from the previous year and remains equal to 15%, while the interest held in the company Sfera has been transferred to Enel SpA (euro - 0.6 million).

### Receivables from others Euro 6.4 million

Withholding taxes on employee termination indemnities, paid pursuant to the provisions of law and remunerated at the rate used to adjust employee termination indemnities, declined by euro 2.9 million, as a result of the option granted to Company employees and executives to acquire, through the employee termination indemnity, shares offered further to the Terna and Enel IPOs implemented during the year (euro 1.6 million), as a result of normal separations (euro 1.2 million) and of revaluation for the year (euro 0.1 million).

The increase of euro 0.1 million in other receivables refers to loans made to employees.

## Current assets

### Current assets

#### Inventories

Inventories break down as follows:

*Euro 42.2 million*

Millions of euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Raw materials	19.6	15.6	4.0
Contract work in progress	22.6	19.3	3.3
<b>Total</b>	<b>42.2</b>	<b>34.9</b>	<b>7.3</b>

Contract work in progress (euro 22.6 million) has risen by euro 3.3 million compared with December 31, 2003 and refers to long-term work carried out by the Group Parent for various clients. Projects include: work done for the ISO to upgrade the SCTI control system (euro 12.3 million); work for Ferrovie dello Stato SpA (the state railway company) involving the upgrading and renovation of transmission plant (euro 3.6 million); work for Energia Molise involving the construction of the 380 kV Termoli-Larino power line (euro 1.3 million); work for Enel Green Power involving the construction of delivery points for networking wind power stations in Sardinia (euro 1.2 million) and work for Ferrari and Eos Windenergy involving the construction of electricity stations (euro 1.1 million).

Inventories also include stocks of materials and equipment to be used in the operation, maintenance and construction of plant for euro 19.6 million (euro 15.6 million at December 31, 2003). The euro 4.0 million increase in inventories is chiefly attributable to routine plant maintenance requirements in both Italy and Brazil. Stocks include some Parent Company properties stored at suppliers' premises before being assigned its final destination.

#### Receivables

Receivables brake down as follows:

*Euro 343.7 million*

Millions of euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Trade receivables	138.0	190.8	-52.8
Receivables from other Enel Group companies	17.6	20.2	-2.6
Receivables from subsidiaries	143.9	289.3	-145.4
Sundry receivables	44.2	52.8	-8.6
<b>Total</b>	<b>343.7</b>	<b>553.1</b>	<b>-209.4</b>



A breakdown of receivables by maturity within and exceeding five years is shown in the table at the end of asset section of the Notes.

**Trade receivables – Euro 138.0 million**

Most (euro 118.6 million) of the total consists of invoices to be issued by the Group Parent to the ISO for the National Transmission Network (NTN) usage fee the year.

Specifically, with reference to the operating agreement signed between Terna and the ISO on December 16, 2002, the receivables mainly consist of usage fees for the last two months of 2004, falling due in January and February 2005.

They also include the share of fees for the operation of the Brazilian lines, both invoiced and to be invoiced (euro 16.4 million).

The decrease compared with the previous year (euro 52.8 million) mainly bears witness, as far as Italy is concerned (euro 61.2 million), to the effects of the new procedures for invoicing the ISO and to the determination on the latter's part of the definitive percentage of network owned by Terna (approximately 92% compared to the 94.136% provisionally established by the Authority):

- > by resolution no. 6 of January 30, 2004, the Authority modified, with effect from April 2004, the definition of time-bands, converging the uses corresponding to the higher tariff components on the Summer months. This has led to the issuing and collection of the relative invoices, while the year-end receivables show the effects of the lower remuneration in the last months of the year;
- > the redefinition of Terna's percentage of ownership of the NTN has led the ISO to request an adverse adjustment for the period 2002-2003 equal to approximately euro 15.1 million.

Receivables relating to the concession fees recognized to the Brazilian companies (RAP) have risen compared to 2003 (euro 8.4 million) further to the entry into service of the whole of the Novatrans-owned line and to the RAP inflation adjustment (IGPM tax), established by ANEEL Regulatory Resolution no. 70 for the period July 2004-June 2005.

**Trade receivables from other Enel Group companies - Euro 17.6 million**

Trade receivables from Enel Group companies are as follows:

Millions of euro	Trade receivables at Dec. 31, 2004	Trade receivables at Dec. 31, 2003	Change
Enel Distribuzione SpA	7.4	11.4	-4.0
Enel.Net Srl	6.7	5.0	1.7
Enel Produzione SpA	0.7	1.2	-0.5
Wind Telecomunicazioni SpA	0.6	1.1	-0.5
Enel Green Power SpA	1.2	0.8	0.4
Enel.it Srl	0.6	0.4	0.2
Enelpower SpA	0.3	0.2	0.1
Other	0.1	0.1	0.0
<b>Total</b>	<b>17.6</b>	<b>20.2</b>	<b>-2.6</b>

The decline in receivables from Enel Distribuzione is influenced by a combination of the following factors:

- > the acquisition of approximately 900 km of HV power lines from Enel Distribuzione at year-end 2003, which has meant reduction of the operating and maintenance activity on the HV powers lines belonging to said company;
- > reduction by a month of the payments terms of the receivable invoices issued on the maintenance contract on the aforesaid power lines.

The increase in receivables from Enel.Net Srl, concerning the laying of fiber optic lines as well as their operation, maintenance and development, relates to equalizing invoices issued during the year and not yet collected.

The relations with other Enel Group companies are detailed in the Income Statement section of these Notes to the Financial Statements.

#### **Receivables from the Parent Company - Euro 143.9 million**

These consist of financial receivables relating to the current account (bearing interest of 2.046% at December 31, 2004) held with the Parent Company for the purposes of centralized treasury management.

The item also includes euro 4.4 million in interest accrued over the year.

#### **Other receivables - Euro 44.2 million**

This balance of this item consists mainly of deferred tax assets (euro 14.8 million), tax receivables (euro 16.3 million) and credits with the Greek revenue authorities for indirect taxes (VAT euro - 10.6 million) in relation to the activities carried out by the Terna branch in Greece.

Tax receivables refer to the advance payment of VAT effected in December in compliance with Art. 6 of Law 405/90 (euro 5.2 million), to receivables for tax paid in Greece on income earned by the Branch (euro 2.6 million) and in Brazil (euro 4.9 million), which can be deducted in the tax-return in Italy. Specifically, the taxes withheld by the Brazilian subsidiaries refer to the payment of receivable interest accrued *vis-à-vis* Novatrans (repayment of the Shareholder Loan) and TSN (IOE–interest on equity, year 2004).

Other minor items chiefly refer to various types of advances paid to employees and third parties.

Changes in respect of tax advances are shown below:

Millions of euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Taxed provisions for risks and charges	14.6	22.1	-7.5
Other components: > depreciation of buildings not used in operations	0.2	0.2	0.0
<b>Total</b>	<b>14.8</b>	<b>22.3</b>	<b>-7.5</b>

**Cash  
and cash equivalents**  
*Euro 87.9 million*

The balance of this item is equal to euro 87.9 million (euro 50.7 million at December 31, 2003) and largely comprises the credit balances of the current accounts held by the Brazilian companies, of which euro 24.0 million are held in fixed deposit accounts for project financing purposes.

**Accrued income  
and prepaid  
expenses**  
*Euro 21.7 million*

Accrued income and prepaid expenses break down as follows:

Millions of euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
<b>Accrued income</b>	<b>10.0</b>	<b>0.0</b>	<b>10.0</b>
<b>Prepaid expenses</b>			
> discount on loans	3.2	0.0	3.2
> other	8.5	4.9	3.6
<b>Total</b>	<b>11.7</b>	<b>4.9</b>	<b>6.8</b>
<b>TOTAL</b>	<b>21.7</b>	<b>4.9</b>	<b>16.8</b>

“Accrued income” refers exclusively to interest income accrued on derivative contracts (swaps) stipulated on the underlying euro 1,400 million bond issue effected in the year and the EIB loans established in previous years. “Prepaid expenses” pertain to the issue discount (euro 3.2 million) and expenses (euro 3.9 million) relating to the aforesaid bond issue and distributed over the life of the loan, to prepaid insurance premiums (euro 2.4 million), to prepaid charges arising from the transfer of contracts from Enel Distribuzione (euro 1.2 million), and to fees paid for the use of telephone lines and radio relays.

The table below gives a breakdown of receivables and accrued income by maturity:

Millions of euro	Within 1 year	From 2 to 5 years	Over 5 years	Total
<b>LONG-TERM FINANCIAL RECEIVABLES</b>				
Receivables from others	0.4	4.5	1.5	6.4
<b>Total long-term financial receivables</b>	<b>0.4</b>	<b>4.5</b>	<b>1.5</b>	<b>6.4</b>
<b>CURRENT RECEIVABLES</b>				
Trade receivables	138.0			138.0
Receivables from Parent Company	143.9			143.9
Receivables from other Enel Group companies	17.6			17.6
Receivables from subsidiaries	0.0			0.0
Tax receivables	16.4			16.4
Pre-paid tax receivables	14.8			14.8
Receivables from others	2.0	11.0		13.0
<b>Total current receivables</b>	<b>332.7</b>	<b>11.0</b>		<b>343.7</b>
<b>Accrued income</b>	<b>10.0</b>			<b>10.0</b>
<b>TOTAL</b>	<b>343.1</b>	<b>15.5</b>	<b>1.5</b>	<b>360.1</b>

The table below gives a breakdown of receivables by geographical area:

	Trade receivables	Receivables f/Parent Company	Other receivables	Total
Italy	139.0	143.9	35.3	318.2
EU	0.1		10.9	11.0
Central/South America	16.5		4.4	20.9
<b>Total</b>	<b>155.6</b>	<b>143.9</b>	<b>50.6</b>	<b>350.1</b>

## Balance Sheet - Liabilities and Shareholders' Equity

### Shareholders' Equity Euro 1,819.9 million

The changes in Shareholders' Equity are as follows:

Millions of euro	Share capital	Legal reserve	Other reserves		Consol.n reserve	Retained earnings	Interim Dividends	Net income	Total
			Capital reserve	Accelerated depreciation					
<b>BALANCE AT DEC. 31, 2003</b>	<b>2,036.1</b>	<b>78.3</b>	<b>0,0</b>	<b>295.7</b>	<b>335.6</b>	<b>0.1</b>		<b>220.4</b>	<b>2,966.2</b>
Allocation of 2003:									
> to Legal reserve		6.2						-6.2	0.0
> to Other reserves (accelerated depreciation 2003)				36.9				-36.9	0.0
> to Retained earnings						0.2		-0.2	0.0
> to Dividends								-80.2	-80.2
Other changes					-12.3	0.2			-12.1
Allocation to Consolid. reserve					96.9			-96.9	0.0
Share capital reduction	-1,596.1		396.1						-1,200.0
Interim dividends							-90.0		-90.0
Net income								236.0	236.0
<b>BALANCE AT DEC. 31, 2004</b>	<b>440.0</b>	<b>84.5</b>	<b>396.1</b>	<b>332.6</b>	<b>420.2</b>	<b>0.5</b>	<b>-90.0</b>	<b>236.0</b>	<b>1,819.9</b>

### Share capital Euro 440.0 million

On April 29, 2004 the resolution for reduction of the share capital from euro 2,031.1 to euro 440 million (by way of a euro 1,200 million reimbursement to the single shareholder Enel SpA and a euro 396.1 allocation to reserve) was implemented following approval, pursuant to Article 2445 of the Italian Civil Code, on the part of the Shareholders' Meetings of January 28, 2004. As a result the Terna SpA share capital is now represented by 2,000,000,000 ordinary shares with a par value of euro 0.22 each held by Enel SpA in a 50% stake. The remaining 50% interest (1,000,000,000 shares) has been parcelled out further to the IPO of June 23, 2004, addressed to the public and institutional investors.

### Legal reserve Euro 84.5 million

Legal reserve represents 19.2% of the share capital of the Group Parent.

**Other reserves**  
**Euro 1,148.9 million**

Other reserves amount to euro 1,148.9 million and include:

- > the Parent Company's euro 396.1 million share capital reduction;
- > progressive accruals made by the Parent Company exclusively for tax purposes in the amount of euro 332.6 million (euro 295.7 million at December 31, 2003); the euro 36.9 million variation is the result of the accelerated depreciation for 2003 being allocated to reserve at the time of appropriation of 2003 earnings;
- > elimination of the tax effects present in the Group Parent's Balance Sheet at January 1, 2004 and ensuing from the accelerated depreciation accrued by the Group Parent up to 2003, net of the capital grants and relative deferred taxes (euro 421.3 million);
- > further consolidation differences chiefly consisting of surplus operating grants (euro -10.9 million) recorded, in the absence of specific regulation, among items of Shareholders' Equity in drawing up the Consolidated Financial Statements 2003.

**Retained earnings (losses)**  
**Euro 0.5 million**

This item is entirely attributable to the changes implemented by the Group Parent.

**Interim dividends 2004**  
**Euro 90.0 million**

On September 6, 2004, the Board of Directors of the Group Parent, on the basis of the half-year report, voted to distribute an interim dividend to shareholders for the year 2004 equal to euro 0.045 per share, for a total amount of euro 90 million. This item is entirely attributable to the changes implemented by the Group Parent.

Reconciliation of the Shareholders' Equity of the Group Parent and consolidated equity:

Millions of euro	Net income at Dec. 31, 2004	Shareholders' Equity at Dec. 31, 2004	Net income at Dec. 31, 2003	Shareholders' Equity at Dec. 31, 2003
<b>Group Parent Financial Statements</b>	<b>674.3</b>	<b>1,838.0</b>	<b>123.5</b>	<b>2,533.9</b>
Net income and equity of consolidated companies	-1.8	170.8	-	41.0
Elimination of book value of consolidated equity investments	-	-300.0	-	-156.2
Goodwill arising on consolidation	-4.2	111.2	-	115.4
Minority interests	-	0	-	-0.2
Goodwill arising on consolidation in respect of accelerated depreciation	-11.0	-	96.9	432.3
Elimination of tax effects	-421.3			
Other goodwill		-0.1		
<b>Consolidated Financial Statements</b>	<b>236.0</b>	<b>1,819.9</b>	<b>220.4</b>	<b>2,966.2</b>

## Provision for risks and charges

### Euro 505.5 million

Millions of euro	at Dec. 31, 2003	Accruals	Utilization and other changes	at Dec. 31, 2004
Provision for retirement benefits	0.8	0.9	1.0	0.7
Deferred tax liabilities	417.2	63.5	16.8	463.9
Other:				
> litigation	12.2	2.0	0.3	13.9
> sundry risks	47.5	16.5	37.0	27.0
<b>Total</b>	<b>59.7</b>	<b>18.5</b>	<b>37.3</b>	<b>40.9</b>
<b>TOTAL</b>	<b>477.7</b>	<b>82.9</b>	<b>55.1</b>	<b>505.5</b>

#### Provision for retirement benefits

#### Euro 0.7 million

The provision includes accruals made by the Group Parent for indemnities *in lieu* of notice and additional monthly payments accruing to employees.

#### Tax liabilities, including deferred tax

#### Euro 463.9 million

Changes in the provision for deferred tax liabilities are detailed below:

Millions of euro	at Dec. 31, 2003	Accruals	Utilization	Other changes	at Dec. 31, 2004
Current tax	0.0	-	-		0.0
Deferred tax	417.2	63.5	10.3	-6.5	463.9
<b>Total</b>	<b>417.2</b>	<b>63.5</b>	<b>10.3</b>	<b>-6.5</b>	<b>463.9</b>

At December 31, 2004 this item records only deferred tax liabilities, as the estimated current taxes are recorded under tax payables.

Deferred tax liabilities are recorded as equal to euro 463.9 million (euro 417.2 at December 31 in 2003), of which euro 251.4 million refer to the deferred tax liabilities on prior years' accelerated depreciation (before 2004) accrued by the Group Parent and reclassified to Shareholders' Equity

reserve as detailed above, and are unchanged from December 31, 2003, while euro 212.5 million (euro 159.3 million in 2003) refer to deferred tax liabilities resulting from accelerated/additional depreciation accrued by the Group Parent. The euro 46.7 million increase is largely due to the accrual for deferred tax liabilities relating to accelerated and additional depreciation (net of the relative operating grants) net of utilization.

**Provision  
for litigation**  
*Euro 13.9 million*

The provision covers potential liabilities in respect of litigation or other disputes, relating mainly to plant supply, work and operation, based on the advice of external and internal counsel. It does not include provisions for litigation for which a positive outcome is expected, nor provisions for which a potential charge cannot reasonably be quantified. The latter are described under "Off-balance sheet items". The provision is up by euro 1.7 million compared with 2003.

**Provision for sundry  
risks and charges**  
*Euro 27.0 million*

This provision stands at euro 27.0 million (euro 47.5 million at December 31, 2003) and records a substantial reduction (-20.5 million), largely due to the utilization implemented during the year by the Parent Company further to definition of the adjustment to network fees resulting from the lowering of Terna's percentage ownership of the NTN and relating to the years prior to 2004. The provision also includes accruals for further adjustments owing to ISO and relating to the litigation with the CIP6 self-producers, in which the Authority resolution no. 228/01 was contested before an administrative magistrate and network owners consequently required to pay euro 15.0 million for the years 2002-2003-2004. It also records the estimate of extraordinary charges associated with the early retirement agreements with employees, accruals for contractual penalties charged to the Parent Company by the Enel Group relating to the maintenance contract for the HV lines of Enel Distribuzione (euro 1.5 million for 2004) and to the early release of property owned by the company Immobiliare Foro Bonaparte (euro 1.1 million) and leased to Terna.



**Employee  
termination  
indemnity  
Euro 60.4  
million**

This provision pertains exclusively to the Group Parent. The changes in the balance in 2004 are shown below:

Euro	
<b>Balance at Dec. 31, 2003</b>	<b>70.7</b>
Accruals	9.0
Pension fund contributions	-2.1
Indemnities paid and other transactions	-18.0
Acquisition/sale of contracts	0.8
<b>Total</b>	<b>60.4</b>

The provision represents the accrued entitlement of employees for termination indemnities, net of advances and contributions to the pension funds. The amount is carried net of the 11% flat withholding tax on the revaluation of employee termination indemnities, pursuant to Legislative Decree 47/2000.

The significant decrease compared with the previous year is due to two factors: the departure of employees entitled to pension who have concluded individual early retirement agreements and, in particular, to the exploitation of the possibility granted to company employees to use part of the employee termination indemnity to acquire shares offered further to the Terna and Enel IPOs implemented during the year (euro 13.6 million).

**Payables  
Euro 2,363.0  
million**

Payables break down as follows:

Millions	Dec. 31, 2004	Dec. 31, 2003	Change
Bond issue	1,400.0	0.0	1,400.0
Medium/long-term bank loans	697.1	489.2	207.9
Advances	36.2	47.7	-11.5
Trade payables	181.9	184.8	-2.9
Payables to Parent Company	1.7	495.4	-493.7
Other payables	46.1	81.2	-35.1
<b>Total</b>	<b>2,363.0</b>	<b>1,298.3</b>	<b>1,064.7</b>

A breakdown of payables by maturity within and exceeding five years is included in a separate schedule at the end of the liabilities section of the notes.

**Medium/long-term financial payables** The table below provides a breakdown of the financial payables of the Terna Group, of which the bond issues and the EIB loans refer to the Parent Company, while the BNDES/IDB loans concern the Brazilian subsidiaries:  
**Euro 2,097.1 million**

Millions of euro	Repayment period	Balance at Dec. 31, 2004	Current portion	Long-term portion	2006	2007	2008	2009	Beyond
PO 2014	2014	600.0	0.0	600.0	0.0	0.0	0.0	0.0	600.0
PO 2024	2024	800.0	0.0	800.0	0.0	0.0	0.0	0.0	800.0
BEI no. 20271	2014	68.2	6.8	61.4	6.8	6.8	6.8	6.8	34.2
BEI no. 21159	2016	250.0	11.4	238.6	22.7	22.7	22.7	22.7	147.8
BNDES	2016	331.6	22.3	309.3	21.0	23.3	25.9	28.6	210.5
IDB	2016	47.3	6.5	40.8	4.9	4.1	4.5	4.9	22.4
<b>Total</b>		<b>2,097.1</b>	<b>47.0</b>	<b>2,050.1</b>	<b>55.4</b>	<b>56.9</b>	<b>59.9</b>	<b>63.0</b>	<b>1,814.9</b>

**Bond issues** On October 28, 2004 the Company finalized two bond issues (placement coordinated by JP Morgan, Credit Suisse First Boston, UBS Investment Bank) the terms of which are provided below:  
**Euro 1,400.0 million**

**Ten-year bond 2004-2014:**

- > nominal amount euro 600 million;
- > issue price 99.968;
- > issue discount euro 192 thousand;
- > life from October 28, 2004 to October 28, 2014;
- > fixed rate of 4.25% *p.a.* with 365/365 divisor;
- > payment annual coupon;
- > lump-sum repayment at maturity.

**Twenty-year bond 2004-2024:**

- > nominal amount euro 800 million;
- > issue price 99.624;
- > issue discount euro 3,008 thousand;
- > life from October 28, 2004 to October 28, 2024;
- > fixed rate of 4.90% *p.a.* with 365/365 divisor;
- > payment annual coupon;
- > lump-sum repayment at maturity.

Both bond issues were implemented with the aim of procuring the financial resources necessary to redeem two short-term loans raised in the first year-half of 2004 by the Parent Company *vis-à-vis* the Group Parent Enel SpA with overall residual value equal to euro 1,400 million.

These loans granted by the Parent Company are as follows:

- > the first loan of euro 493.6 million was granted on March 1, 2004 to redeem a pre-existing financial debt transferred on October 1, 1999 from Enel SpA (at the time of assignment of business activities) of a residual amount equal to euro 456.2 million and a further debt, also transferred from Enel SpA in the same circumstances, equal to euro 37.4 million and relating to Additional Corporate Benefits for senior management. On May 31, 2004 the Company effected early redemption of a portion of this loan for an amount of 293.6 million;
- > the second loan of euro 1,200 million disbursed on April 30, 2004 and used by Terna to reimburse the Parent Company for the share capital reduction of the same amount passed by Shareholders' Meeting resolution on January 28, 2004.

Between June and August 2004 Terna concluded transactions in derivative instruments for a total amount of euro 650 million (interest rate swaps for euro 450 million and collars for euro 200 million) for the purposes of fixing a part of the new loan. Upon bond issues, euro 200 million of the ten-year loan were maintained at fixed rate while the remaining euro 1,200 million were swapped from fixed to floating. Assuming that the aforesaid hedging activity exclusively affects the twenty-year B.I. for euro 800 million, approximately 81% of said loan is quantified at fixed rate, while approximately 33% of the ten-year B.I. for euro 600 million is quantified at fixed rate.

**Medium/long-term  
bank loans**  
*Euro 318.2 million*

The total value of this item is euro 318.2 million and refers to two EIB loans denominated in euro and contracted by the Parent Company and includes a debt with San Paolo/IMI for a prime rate loan (granted by the Val d'Aosta Independent Region) equal to euro 34 thousand.

The first EIB loan was granted on October 22, 1999 for the "Italy-Greece electricity network interconnection" project, with an initial value of euro 75 million, and has the following terms:

- > floating interest rate with a ceiling equal to Euribor + 0.15% (2.15% at the end of 2004);
- > interest payments made on a half-yearly basis (March 15 and September 15);
- > repayment of principal: in 22 equal installments paid half-yearly from March 15, 2004 to September 15, 2014.

On March 15, 2004 and September 15, 2004 repayment of the first two installments was effected for a total of euro 3.4 million.

The loan is completely hedged against fluctuations in interest rate by derivative instruments.

The second EIB loan, of euro 250 million, was granted on July 6, 2001 for the design, building and

bringing into service of around 200 electricity transmission facilities, and has the following terms:

- > floating interest rate with a ceiling equal to Euribor + 0.24% (2.24% at the end of 2004);
- > interest payments made on a half-yearly basis (June 15 and December 15);
- > repayment of principal: in 22 equal installments paid half-yearly from December 15, 2005 to June 15, 2016.

This loan is hedged by interest rate swaps with a nominal value of euro 217.5 million, leaving 13% of the total loan exposed to interest rate risk.

**Medium/long-term  
bank loans of the  
subsidiary TSN**  
*Euro 178.8 million*

At December 31, 2004, the balance of the TSN project financing scheme, signed on October 23, 2002 and entirely disbursed by BNDES, stands at BR 646.4 million of which BR 149.6 million relate to a real-denominated capital which is adjusted on a daily basis to cover the variation of the real compared with a basket of foreign currencies (83.83% US\$, 10.48% yen, 5.48% euro and 0.21% other currencies) in which BNDES has funding. The financing scheme has the following terms:

- > interest on the real portion of the loan is equal to the TJPL rate increased by a 3.5% margin. If the TJPL exceeds 6%, the interest due on the surplus is capitalized and refunded in accordance with the amortization schedule of the remaining debt;
- > interest on the portion of the loan indexed to the basket is equal to the floating interest rate based on the average cost incurred by BNDES for the purchase of foreign currency +3.50% spread;
- > interest payments made on a monthly basis;
- > repayment of principal: in 144 monthly installments from October 15, 2004.

The loan is guaranteed by pledge on the shares which the Group Parent holds in TSN.

**Medium/long-term  
bank loans of the  
subsidiary  
Novatrans  
Euro 200.1 million**

Novatrans has two project financing schemes with BNDES and IDB.

The first loan which is denominated in real, was signed on April 19, 2004 and was entirely disbursed by BNDES and at December 31, 2004 has a balance of BR 552 million. The principal terms are as follows:

- > interest equal to the TJPL Brazilian interest rate increased by a 4.5% margin. If the TJPL exceeds 6%, the interest due on the surplus is capitalized and refunded in accordance with the amortization schedule of the remaining debt;
- > 12-year repayment period, in monthly installments from November 15, 2004;
- > guarantees (Carta de Fiança) of Terna SpA, which is scheduled to be redeemed at project completion.

The second loan, signed on July 8, 2004 and entirely provided by IDB in a single tranche (September 15, 2004) presents a balance at December 31, 2004 of US\$ 64.5, of which US\$ 29.3 million relate to the IDB tranche A and US\$ 35.1 to the IDB tranche B. The principal terms of the IDB loan are as follows:

- > fixed interest rate with rising spread, defined for the entire life of the loan (12 years for A Loan and 11 years for B Loan). The sum of the rate and spread applied up to November 15, 2006 is 8.665% for A Loan and 8.59% for B Loan;
- > payment of principal and interest is due in 24 half-yearly installments (12 years) for the IDB A and in 22 half-yearly installments for the IDB B. In both cases payments commence on November 15, 2004;
- > sponsor support agreement provided by Terna SpA, in favor of IDB and valid up to project completion.

Both loans are guaranteed by pledge on the shares which the Group Parent holds in Novatrans.

The table below shows the breakdown by reference currency at December 31, 2004:

Millions of euro	Repayment period	Average interest rate at Dec. 31, 2004	Balance at Dec. 31, 2004
Euro area currencies	2004-2024	4.18%	1,718.2
Other currencies	2004-2016	12.02%	378.9
<b>Total</b>		<b>5.60%</b>	<b>2,097.1</b>

Considering the hedging that has been implemented on the Parent Company's debt, the average interest rate at December 31, 2004, is equal to 2.9%.

**Advances****Euro 36.2 million**

Advances include contributions received by the Group Parent for work underway at December 31, 2004 as well as for advances on works performed for third parties.

The decrease compared with 2003 (euro -11.5 million) reflects the value of the grants issued for entry into service of plant in 2004 (euro - 14.7 million) and the balance between new and completed contracts (euro + 3.2 million).

**Trade payables****Euro 181.9 million**

This item includes trade payables to third party suppliers for euro 152.6 million and payables to other Enel Group companies for euro 29.3.

Payables to third party suppliers have largely remained at the same level as the 2003 year-end value (euro 149.5 million).

Trade payables regard invoices received and to be received for contracts, services and purchases of material and equipment for the routine activity of plant operation and maintenance.

Payables to other Enel Group companies break down as follows:

Millions of euro	Trade payables at Dec. 31, 2004	Trade payables at Dec. 31, 2003	Change
Wind Telecomunicazioni SpA	12.7	10.7	2.0
Enel Distribuzione SpA	3.2	6.2	- 3.0
Enelpower SpA	3.4	8.8	- 5.4
Enel Facility Management SpA	5.7	4.3	1.4
Enel.it Srl	2.8	2.1	0.7
Enelpower do Brasil	0.0	1.7	- 1.7
Ape Gruppo Enel Srl	0.7	0.7	0.0
Enel Produzione SpA	0.4	0.3	0.1
Sfera Srl	0.3	0.3	0.0
Others	0.1	0.2	- 0.1
<b>Total</b>	<b>29.3</b>	<b>35.3</b>	<b>- 6.0</b>

The payables *vis-à-vis* Wind Telecomunicazioni SpA regard costs for transmission and telephony services provided to the Group Parent. The euro 2.0 million rise compared with 2003 (10.7 million) is chiefly due to the value of the services rendered by said company for upgrading the electricity supply systems of the network infrastructures.

Payables due to Enel Distribuzione SpA relate to payment of electricity supply discounts to current and retired employees and to sundry technical services. The decrease (euro - 3.0 million) compared

with 2003 is due to the payment of invoices relating to investment activity, completed in the last quarter of the previous year, and to the adjustment in Terna's favor, of the transfer price of the plant acquired by Enel Distribuzione SpA on December 29, 2004.

The euro 3.4 million payable due to Enelpower SpA relates to amounts accrued on the EPC contract stipulated with the subsidiaries. The decrease compared with 2003 (euro - 5.4 million) reflects the redemption of the debt relating to the adjustment of the acquisition price of Novatrans SA.

**Payables to the  
Parent Company**  
*Euro 1.7 million*

The payables to Enel SpA consist of the following:

Millions of euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
<b>Trade payables</b>	<b>1.1</b>	<b>1.0</b>	<b>0.1</b>
<b>Financial payables:</b>	<b>0.0</b>	<b>493.7</b>	<b>-493.7</b>
> Assumed liability for Enel pension fund	0.0	37.5	-37.5
> Assumption of loans and financing	0.0	456.2	-456.2
<b>Sundry payables</b>	<b>0.6</b>	<b>0.7</b>	<b>-0.1</b>
<b>TOTAL</b>	<b>1.7</b>	<b>495.4</b>	<b>-493.7</b>

The "trade payables" are mainly made up of fees for management, communication and e-procurement services.

**Tax payables**  
*Euro 25.1 million*

The "tax payables" chiefly relate to the Group Parent (16.1 million) and show the tax liability for 2004 in respect of euro 85.1 million for Corporate Income Tax (IRES) and 19.4 million in local tax (IRAP), net of the advances totaling euro 92.3 million paid in June and November 2004. It also includes a payable of around euro 3.9 million in tax withheld by the company. The amounts recorded by the Brazilian subsidiaries (approximately 9 million) chiefly relate to sundry local taxes and to tax withheld by the companies.

**Social security payables**  
*Euro 8.1 million*

The item refers to payables due from the Group Parent to INPS for the month of December 2004. The item also includes contributions paid on staff incentives to be distributed in the following financial year.

**Other payables**  
*Euro 12.9 million*

“Sundry payables” are entirely imputable to the Group Parent and reflect the payables to employees for staff termination indemnities, to be paid out by December 31, 2004 in addition to the staff incentives that will be distributed in 2005. The sharp decrease recorded, equal to 20.6 million, chiefly relates to the payment of the staff termination indemnities representing the exposure at December 31, 2003.

**Accrued liabilities and deferred income**  
*Euro 180.8 million*

Accrued liabilities and deferred income consist of the following:

Millions of euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Interest payable on loans	18.4	5.4	13.0
Other accrued liabilities	0.6	1.3	-0.7
Capital contributions	161.2	147.4	13.8
Other deferred income	0.6	0.6	0.0
<b>Total</b>	<b>180.8</b>	<b>154.7</b>	<b>26.1</b>

This item records values that are entirely imputable to the Group Parent and shows a sharp increase on the previous year (euro 26.1 million), partly attributable to interest payable on loans (euro +13.0 million), which reflect the expenses related to the bond issues as well as the transactions in underlying derivative instruments, as detailed in the section “Bond Issues”. The further euro 13.1 million increase is chiefly due to the recording of deferred income concerning the surplus capital contributions following the tax clean up effected on the Financial Statements.



The following table provides a breakdown of payables and accrued liabilities by maturity.

Millions of euro	Within 1 year	From 2 to 5 years	Over 5 years	Total
<b>FINANCIAL PAYABLES TO THIRD PARTIES</b>				
Payables to third parties for bonds			1,400.0	1,400.0
Medium- and long-term bank loans	47.0	235.2	414.9	697.1
<b>Total financial payables</b>	<b>47.0</b>	<b>235.2</b>	<b>1,814.9</b>	<b>2,097.1</b>
<b>OTHER PAYABLES</b>				
Advances	20.4	15.8		36.2
Trade payables	149.6	3.0		152.6
Payables to Parent Company	1.7			1.7
<b>Total payables to Parent Company</b>	<b>1.7</b>			<b>1.7</b>
Payables to other Enel Group companies	29.3			29.3
Tax payables	25.1			25.1
Social security payables	8.1			8.1
Other payables	12.9			12.9
<b>Total other payables</b>	<b>247.1</b>	<b>18.8</b>		<b>265.9</b>
<b>Accrued liabilities</b>	<b>19.0</b>			<b>19.0</b>
<b>TOTAL</b>	<b>313.1</b>	<b>254.0</b>	<b>1,814.9</b>	<b>2,382.0</b>

The table below provides a breakdown of payables by geographical area.

Euro	Bonds	Bank loans	Third party advances	Trade payables	Payables to Parent Com.	Other payables	Total
Italy	444.0		36.2	170.1	1.7	46.1	698.1
EU	798.0	318.2		3.8			1,120.0
Non-EU	70.0			2.4			72.4
North America	46.0						46.0
Central/South America		378.9		5.6			384.5
Asia	6.0						6.0
Others	36.0						36.0
<b>Total</b>	<b>1,400.0</b>	<b>697.1</b>	<b>36.2</b>	<b>181.9</b>	<b>1.7</b>	<b>46.1</b>	<b>2,363.0</b>

## Commitments

Commitments include amounts relating to guarantees, risks and other commitments, as detailed below:

Millions of euro	at Dec. 31, 2004	at Dec. 31, 2003	Change
Guarantees granted:			
> Guarantees given to third parties	13.9	7.4	6.5
> Equity participations pledged to third parties	300.0	0.0	300.0
<b>Total</b>	<b>313.9</b>	<b>7.4</b>	<b>306.5</b>
Other commitments:			
> Hedging derivatives	2,135.7	0.0	2,135.7
> Commitments with suppliers for purchase of:			
- sundry supplies	219.1	193.4	25.7
- contract work	164.5	162.7	1.8
<b>Total</b>	<b>383.6</b>	<b>356.1</b>	<b>27.5</b>
<b>TOTAL</b>	<b>2,833.2</b>	<b>363.5</b>	<b>2,469.7</b>

The guarantees given refer to shares of the subsidiaries TSN and Novatrans, owned by Terna, pledged to the banks (BNDES-IDB) providing loans for the investments in Brazil and to the guarantees granted to third parties in respect of contracts for works and services rendered by the Group Parent.

The notional value of the financial interest rate derivatives is recorded in commitments and risks and emerges as positive by euro 11.3 million at December 31, 2004. Specifically, hedging on the EIB loans feature a negative value of euro 19.7 million, while hedging on the bond issues record a current positive value of euro 31 million.

The commitments to suppliers refer to the total of orders/contract work commissioned, net of supplies and services already invoiced.

## Off-Balance Sheet items

### Environmental litigation

Environmental litigation relates to the installation and operation of electrical plant, and, especially, the effects of electrical and magnetic fields. Terna is a defendant in a number of civil and administrative proceedings requesting the relocation of power lines or changes in operational conditions. The claims are based on the alleged health hazards posed by the power lines, even though they have been installed in full compliance with regulatory requirements. Only a very limited number of suits have been filed against the Company seeking damages for personal injury caused by electromagnetic fields.

On July 8, 2003, a Prime Minister's Decree was enacted to complete the implementation of framework Law 36 of February 22, 2001. It establishes values for three parameters (exposure limits, thresholds of concern and quality targets) that electrical plant must meet. The decree had a favorable impact on pending disputes, because the scope of the framework law was limited to laying down general principles only.

Only a few adverse rulings have been issued against the Company in this area and these have all been appealed (the cases are still pending). No claim for damages for personal injury has ever been upheld.

Finally, it should be noted that, in addition to Terna, the ISO has increasingly been called as a defendant in these proceedings, because the ISO is legally responsible for all matters relating to energy flows transiting on the network owned by Terna.

#### Legislation concerning electrical and magnetic fields

The relevant framework law, enacted on February 22, 2001, entrusts the State with the task of defining, through specific orders, the reference parameters (exposure limits, thresholds of concern and quality targets) with which electrical plant must comply.

Attention is drawn in this regard to the framework law on reclamation which establishes a mechanism for recovery of related expenses according to criteria defined by the Authority for Electricity and Gas, pursuant to Law no. 481/95, given that costs are incurred for common benefit. On August 29, 2003 the Prime Minister's Decree of July 8, 2003 for the "Definition of exposure limits, thresholds of concern and quality targets for the protection of the population from exposure to electrical and magnetic fields at network frequency (50 Hz) generated by power lines" which established the values for the three parameters provided by the framework law, was published in the Official Gazette of the Italian Republic.

According to Company assessments, an estimated cost of over euro 400 million shall be incurred in implementing appropriate investments. The relevant interventions are expected to commence in 2007 and continue until at least 2014.

On regional legislation level, some regional governments have formulated bills governing the matter, which establish more restrictive limits compared to those prescribed by Prime Minister's Decree 1992, and by the more recent Prime Minister's Decree of July, 8 2003.

However it must be noted that on October 7, 2003 judgment no. 307 of the Constitutional Court was published and this declared some regional laws on the matter of electromagnetic fields to be constitutionally unlawful (amongst which the law of the Campania regional government no. 13 of November 24, 2001). It also established the principle that derogation from the state law is not permitted, even where this may involve higher standards being implemented by regional laws, as public health must be uniformly guaranteed throughout Italian territory.

**Other pending  
litigation**

A number of legal disputes are pending in relation to urban planning and environmental issues associated with the construction and operation of a number of transmission lines. Adverse rulings could have repercussions, but since the impact cannot be quantified at present they have not been included under the “provisions for litigations”. An assessment of the suits, which included taking advice from external legal counsel, suggests that unfavorable rulings are remote, though for a limited number of cases this cannot be ruled out completely. The effects of an adverse ruling could include not only the payment of damages but also the costs involved in modifying power lines and the temporary unavailability of the lines.

In any case, an adverse outcome would not jeopardize the operation of the power lines.

## Income Statement

For the purposes of correct comparison of figures it is specified that the Consolidated Income Statement at December 31, 2004 is the first ensuing from the full consolidation of the Terna Group. As the Parent Company acquired the equity investments in TSN and Novatrans on December 31, 2003, the Income Statement figures for the previous year only reflect the economic situation of Terna and the relative tax clean up adjustments performed in drawing up the 2003 Consolidated Financial Statements.

### Value of production

The item comprises the following:

Revenues from sales and services  
*Euro 990.5 million*

They include the following:

Millions of euro	2004	2003	Change
NTN usage fees	929.1	782.3	146.8
Other sales and services	61.4	61.6	-0.2
<b>Total</b>	<b>990.5</b>	<b>843.9</b>	<b>146.6</b>

“Revenues from sales and services” largely consist (euro 810.8 million) of fees to the Parent Company for use of the national transmission network.

The revenues relating to the Brazilian companies, equal to 118.3 million, refer to the fixed local fees established in the licence for the operation of power lines issued by the local energy Authority (ANEEL).

“Revenues from other sales and services” amount to euro 61.4 million and chiefly relate to services and supplies provided to the Enel Group companies, among which the revenues generated from the contract for the maintenance of high-voltage lines owned by Enel Distribuzione SpA (euro 27.1 million) and those invoiced to Enel.Net Srl (euro 11.7 million) for the laying of fiber optic lines and the maintenance and development of the same. The item also includes the delivery of specialized engineering services relating to high-voltage plant in favor of third-party customers (approximately 15.3 million) entirely invoiced by the Group Parent.

<b>Change in contract work in progress</b> <i>Euro 3.3 million</i>	The change in contract work in progress is the result of the work for work orders to third parties of the Group Parent that is still pending at December 31, 2004 (euro 6.8 million) and work completed and tested in the year (euro - 3.5 million).
<b>Increase in capitalized expenses for internal projects</b> <i>Euro 22.5 million</i>	Capitalized costs refer to labor costs (euro 12.6 million) and the consumption of materials and machinery (euro 9.9 million) for plant currently under construction and related exclusively to the Group Parent.
<b>Other income and revenues</b> <i>Euro 29.0 million</i>	“Other income and revenues” chiefly regard (euro 15.3 million) the accrued portion for the year of operating grants posted under “Deferred income”. Other revenues relate to insurance indemnities for third-party damage to plant, rents collected and sales of material, in addition to ordinary contingent items referred to the Group Parent. Specifically, the latter reflect the recording in the Income Statement of the provision for disposal of surplus plant compared to the real usage implemented during the year (euro 3.7 million) and the positive adjustment to the network fees for the year 2000 paid out by ISO (euro 1.2. million).

## Operating costs

<b>Raw materials</b> <i>Euro 21.8 million</i>	This item consists of the costs incurred for the purchase of various materials and equipment used for the operation and maintenance of facilities and chiefly attributable to the Group Parent (euro 21.7 million).
<b>Services</b> <i>Euro 114.7 million</i>	This item primarily consists of costs for maintenance and repair work relating to contracts, services and the routine upholding of plant efficiency. The Group Parent records these expenses for a total of euro 102.9 million.
<b>Leases and rentals</b> <i>Euro 12.7 million</i>	This item primarily consists of property rent payable to Enel Group companies and third parties, leasing costs and miscellaneous fees.

**Personnel****Euro 165.0 million**

This item consists of the costs for wages and salaries, social security contributions and other personnel costs of which euro 163.2 million relate to the Group Parent and euro 1.8 million to the Brazilian companies. The aforesaid costs break down as follows:

Millions of euro	2004	2003	Change
Wages and salaries	116.9	114.5	2.4
Social security contributions	31.9	31.3	0.6
Employee termination indemnity	9.0	9.7	-0.7
Other costs	7.2	8.3	-1.1
<b>Total</b>	<b>165.0</b>	<b>163.8</b>	<b>1.2</b>

Both the average number of employees by category of employment and their number at December 31, 2004 are shown in the table below:

	Average number 2004	Number at Dec. 31, 2004
Senior management	35	34
Middle management	210	224
Office staff	1,516	1,522
Workers	1,173	1,149
<b>Total</b>	<b>2,934</b>	<b>2,929</b>

**Amortization,  
depreciation****and write-downs****Euro 161.6 million****Amortization of intangible assets**

This item comes to euro 4.3 million and regards amortization for the year of the "goodwill arising on consolidation", recorded further to the acquisition of the equity investments in TSN and Novatrans, valorized on the basis of the residual life of the concession for operation of the power lines in Brazil.

**Depreciation of tangible assets**

This item comes to euro 156.7 million and includes accruals for the year calculated on the basis of the depreciation rates representing the remaining useful life of the Company's plant. Depreciation relating to the Group Parent amounts to euro 143.5 million.

#### Write-downs of fixed assets

These amount to euro 0.7 million and refer to the release of work in progress, on the part of the Group Parent, due to abandoned projects.

#### Change in inventories

*Euro -1.7 million*

This shows the net positive change in inventories during the year and refers entirely to the Group Parent.

#### Provision for risks and charges

*Euro 9.7 million*

These include accruals made at December 31, 2004, as described in the section on the provision for risks and charges, pertaining to the Group Parent.

#### Other operating costs

*Euro 49.9 million*

This item records ordinary contingent items relating to adjustments calculated and charged to the Parent Group by ISO for network fees for the years 2002/2003 (euro 14.8 million). It also includes, once again in respect of the Group Parent, expenses for losses due to retirement of power lines (euro 2.5 million), discounts on electricity supplied to retired personnel (euro 1.9 million) and sundry local indirect taxes (euro 3.4 million).

The amounts recorded by the Brazilian subsidiaries chiefly relate to local taxes and duties (euro 18.8 million) and to fees and expenses relating to the disbursement of loans (NVT, euro 2.1 million). Hence, of the total figure, euro 21.2 million are attributable to the subsidiaries and euro 28.7 million to the Group Parent.

### Financial income and expense

*Euro -79.5 million*

#### Other financial income

A breakdown of "other financial income" is provided below:

Millions of euro	2004	2003	Change
Interest on current account with Parent Company (Terna)	4.4	15.8	-11.4
Other financial income (Terna)	0.2	0.3	-0.1
Other financial income (TSN-NVT)	6.8	0	6.8
<b>Total</b>	<b>11.4</b>	<b>16.1</b>	<b>-4.7</b>



### Interest and other financial expense

Millions of euro	2004	2003	Change
Interest due to Enel SpA (Terna)	25.7	37.0	-11.3
Interest on loans and sundries:			
> Terna	21.5	14.2	7.3
> TSN	21.4	0.0	21.4
> NVT	7.4	0.0	7.4
Net loss on foreign exchange trading (Subsidiaries)	14.9	0.0	14.9
<b>Total</b>	<b>90.9</b>	<b>51.2</b>	<b>39.7</b>

### Extraordinary items Euro -22.7 million

This item consists of amounts that refer exclusively to the Group Parent. The “extraordinary income” items amount to euro 0.9 million and derive from excess income taxes recorded in the previous year in relation to the liability recognized in the Company’s accounts (euro 0.8 million) as well as from legal expenses recovered thanks to court rulings in the Company’s favor (euro 0.1 million). “Extraordinary expenses” totaled euro 23.7 million and regard the tax amnesty for the year 2002 (euro 2.2 million), early retirement agreements with employees (euro 10.5 million) and specifically, the tax clean up expenses concerning the surplus operating grants (euro 11.0 million) recorded under Shareholders’ Equity in the Consolidated Financial Statements 2003.

### Income taxes Euro 173.4 million

Income taxes, which amount to 42.35% of pre-tax income, are composed of current taxes and net temporary differences for the year. The table below shows how taxes expenses are distributed between the Parent Company and the Brazilian subsidiaries:

Millions of euro	2004	2003	Change
Current taxes:			
> IRES	85.1	75.2	9.9
> IRAP	19.4	19.0	0.4
> Brazilian companies	8.2	0.0	8.2
Prepaid taxes	7.4	-8.4	15.8
Deferred taxes	53.3	57.3	-4.0
<b>Total</b>	<b>173.4</b>	<b>143.1</b>	<b>30.3</b>

The reconciliation between expected and effective income taxes pertaining to the Group Parent is given below:

Millions of euro	2004
Statutory income	839.5
> Tax clean up	-421.3
> Additional depreciation	-153.9
> Changes in provisions	-19.2
> Other increases/decreases	12.9
<b>Taxable income</b>	<b>258.0</b>
<b>Tax expense (33%) for the year</b>	<b>85.1</b>

The breakdown of prepaid taxes is represented by provisions for:

> tax recovered amounting to euro 13.7 million, due to the use of provisions taxed in previous years to cover adjustment to previous years' network fees, retirement of plant and the coverage of exceptional events on plant;

> tax prepayments relating to temporary differences of euro 6.3 million that emerged in the year for accruals to the risk provision for litigation and the provisions for future risks and charges.

Deferred taxes relate to the portion of depreciation in excess of the ordinary depreciation rate, calculated net of grants, accrued for tax purposes. The total (euro 63.5 million) adjusted to reflect the realignment of the deferred tax provision to the prevailing tax rate (euro - 4.5 million) and the utilizations arising from the taxation of depreciation in excess of the deductible limit (euro 5.7 million), is quantified on the basis of the current tax rate in the financial year in which reversal will take place.

#### Transactions with related parties

Transactions involving related parties concern the exchange of goods and services with companies of the Enel Group, all of which are governed by specific contracts stipulated between the parties in accordance with the market conditions that would have been applied between two independent parties.

Contracts with the Parent Company Enel SpA that generate expenses relate primarily to:

> provision of institutional or on-request assistance and consulting services;

> communication services;

> two short-term loans opened during the first year-half and used to redeem the pre-existing financial loan and to refund the share capital reduction of equal amount approved by Shareholders' Meeting. During the third quarter, the two bond issues raised sufficient financial resources to allow the integral repayment of the aforesaid loans.

As for other Group companies, contracts producing expenses related primarily to:

- > providing meals in the company restaurants (canteens)-(Enel Facility Management SpA);
- > building maintenance services (Enel Facility Management SpA);
- > providing meals other than in canteens (tickets)-(Ape Gruppo Enel Srl);
- > human resource management services (Ape Gruppo Enel Srl);
- > EPC services (Engineering Procurement & Construction) with EPower/EPower do Brasil;
- > supply and management of IT services (Enel.it Srl);
- > supply of telephony and telecommunication services (Wind Telecomunicazioni SpA);
- > staff training services (Sfera Srl);
- > rental of buildings (NewReal SpA), deconsolidated from July 2004;
- > repayment of discounts on electricity to current and retired employees (Enel Distribuzione SpA);
- > transfer of lines, stations and disconnecting plant.

Contracts generating revenues related to:

- > operation and maintenance of high-voltage network (Enel Distribuzione SpA);
- > development, laying and maintenance of fiber optics (Enel.Net Srl);
- > transfer of power lines and stations.

The following table shows expenses and revenues for the year, in millions of euro.

Company	Expenses	Revenues
Ape Gruppo Enel Srl	4.6	0.0
Enel Distribuzione SpA	4.2	30.2
Enel Green Power SpA	0.1	1.1
Enel Produzione SpA	0.4	1.6
Enel Facility Management SpA	5.7	0.1
Enel.it Srl	7.8	0.1
Enel.Net Srl	0.4	11.7
Enelpower SpA	0.0	0.5
Sfera Srl	0.8	0.0
Enel SpA	39.7	5.1
Enelpower do Brasil	0.9	0.2
Newreal SpA	2.0	0.0
Wind Telecomunicazioni SpA	24.3	1.7
Dalmazia Trieste Srl	0.3	0.1
Deval Spa	0.0	0.1
Enel.si Srl	0.0	0.1
<b>Total</b>	<b>91.2</b>	<b>52.6</b>

**Companies and important equity investments of the Terna Group at December 31, 2004**

In accordance with the provisions of Articles 38 and 39 of Legislative Decree 127/91 and of Article 26 of CONSOB Resolution no. 11971 of May 14, 1999, the table below provides a list of the companies that are subsidiaries and associates of Enel SpA at December 31, 2004, in compliance with Article 2359 of the Italian Civil Code, and of any other important equity investments. All equity investments are held by ownership.

The following details are provided for each company: name, registered office, activity, share capital, currency, percentage owned by the Group.

List of the companies consolidated with the line-by-line method at December 31, 2004:

Name	Registered office	Activity	Share capital	Currency	% Group ownership at Dec. 31, 2004	Held by	%
<b>Parent company:</b> <a href="#">Terna SpA</a>	Rome	Construction, operation and maintenance of the national electricity transmission network	440,000,000	euro	-	-	
<b>Parent Company:</b> <a href="#">Transmissora Sudeste Nordeste SA</a>	Rio de Janeiro	Construction, operation and maintenance of electricity transmission networks	250,000,000	real	100	Terna SpA	100
<a href="#">Novatrans Energia SA</a>	Rio de Janeiro	Construction, operation and maintenance of electricity transmission networks	373,135,465	real	100	Terna SpA	100

List of other important equity investments as at December 31, 2004:

Name	Registered office	Activity	Share capital	Currency	% Group ownership at Dec. 31, 2004	Held by	%
<a href="#">CESI-Centro Elettrotecnico Sperimentale Italiano Giacinto Motta SpA</a>	Milan	Research, trial and testing services	8,550,000	euro	15	Terna SpA	15

## Other information

The table below outlines, pursuant to Article 2497 *bis* of the Italian Civil Code, the key figures from the latest Financial Statements approved by the Parent Company Enel SpA (in millions of euro). Enel SpA is responsible for directing and co-ordinating and at year it holds an ownership percentage in Terna equal to 50% of the share capital:

BALANCE SHEET 2003	Millions of euro
<b>Assets</b>	
Share capital not paid-in	0
Long-term assets	23,420
Current assets	5,965
Accruals and deferrals	136
<b>TOTAL ASSETS</b>	<b>29,521</b>
<b>Liabilities</b>	
Shareholders' Equity	
Share capital	6,063
Reserves	5,327
Net income for the year	607
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>11,997</b>
Provision for risks and charges	446
Provision for employee termination indemnities	11
Payables	16,904
Accruals and deferrals	163
<b>TOTAL LIABILITIES</b>	<b>29,521</b>
<b>Commitments and other risks</b>	<b>22,655</b>
<b>INCOME STATEMENT 2003</b>	
Production value	1,143
Operating costs	916
Financial income and expense	1,505
Value adjustments to investments	(1,290)
Extraordinary items	433
Income tax for the year	268
<b>NET INCOME FOR THE YEAR</b>	<b>607</b>

**Pension fund expense**

The charge taken in respect of the extraordinary contribution due upon the suppression of the Electricity Sector Employee Pension Fund with Law 488 of December 23, 1999 (the Finance Act for 2000), which was originally recognized as an intangible asset, has been nil since 2002 because the Company opted to amortize it in income over three years (2000, 2001 and 2002), in accordance with the provisions of the same law. If the company had opted to amortize the charge over 20 years, which was also an option under the law and in line with that of the Group Parent, intangible assets would have shown an additional liability of around euro 75 million at December 31, 2004 (about euro 80 million at December 31, 2003).



## Reports



## Report of the Board of Statutory Auditors on the Consolidated Financial Statements at December 31, 2004 of Terna SpA

To the Shareholders' Meeting of Terna SpA.

The Consolidated Financial Statements of the Terna Group at December 31, 2004 have been drawn up by the Group Parent in compliance with the provisions of Legislative Decree no. 127 of April 9, 1991 and consist of the Balance Sheet, the Income Statement and the Notes to the Financial Statements supplemented by the Report on operations, specifying that further information on significant events in 2004, Corporate Governance and other information is provided in the Report on operations supplementing the Statutory Financial Statements.

The Notes to the Financial Statements contain the information required by Article 2427 of the Civil Code and Article 38 of Legislative Decree 127/1991, specifying that:

- > the scope of consolidation includes the controlling interests, pursuant to Article 2359 of the Civil Code, in the Brazilian companies Transmissora Sudeste Nordeste SA and Novatrans Energia SA. Given that the acquisition of the aforesaid equity investments took place on December 31, 2003, in the previous year consolidation referred exclusively to Balance Sheet figures, and thus the 2004 operating results are not comparable with those posted in 2003;
- > the accounting policies adopted are those used by the Group Parent in drawing up its own Financial Statements, and are consistent with the policies used for drawing up the Consolidated Financial Statements of 2003 and the provisions of the Italian Civil Code as amended further to the corporate law reform. Where necessary, adjustments have been implemented for purposes of uniformity;
- > consolidation has been carried out on a full, line-item basis, under which:
  - consolidated equity investments have been eliminated against the recognition of the assets and liabilities of the consolidated companies and the booking of minority interests in Shareholders' Equity and income;
  - positive differences arising on consolidation are posted under "Goodwill arising on consolidation", while negative differences are taken to the "Consolidation reserve";
  - significant receivables and payables and costs and revenues, as well as unrealized gains and losses, generated in transactions between consolidated companies are eliminated.

The Report on operations was drawn up in accordance with the provisions of Article 2428 of the Civil Code and Article 40 of Legislative Decree 127/1991. Our checks were completed with the examination of the report of the Independent Auditors, which certified that the Consolidated Financial Statements for 2004 were clear and provided a true and fair view of the economic and financial situation of the Group.

In conclusion, no significant facts emerged that would require discussion in this report.

Rome, March 11 2005

The Board of Statutory Auditors

Giovanni Ferreri

Bruno Franceschetti

Giancarlo Russo Corvace



**KPMG S.p.A.**  
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(Translation from the Italian original which remains the definitive version)

## **Report of the auditors in accordance with article 156 of legislative decree no. 58 of 24 February 1998**

To the shareholders of  
Terna S.p.A.

- 1 We have audited the consolidated financial statements of Terna S.p.A. and its subsidiaries (Terna Group) as at and for the year ended 31 December 2004. These financial statements are the responsibility of the parent company's management. Our responsibility is to express an opinion on these financial statements based on our audit.
- 2 We conducted our audit in accordance with the auditing standards recommended by Consob, the Italian Commission for Listed Companies and the Stock Exchange. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and are, as a whole, reliable. 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 audit provides a reasonable basis for our opinion.

Reference should be made to the report dated 27 February 2004 for our opinion on the prior year consolidated figures which are presented for comparative purposes as required by law.

- 3 In our opinion, the consolidated financial statements of Terna Group as at and for the year ended 31 December 2004 comply with the Italian regulations governing their preparation; therefore they are clearly stated and give a true and fair view of the financial position and results of the group.
- 4 We draw your attention to the following disclosures that the directors have provided in the notes to the consolidated financial statements:
  - 4.1 The parent company has a number of legal disputes and further uncertain situations, mainly in relation to urban planning and environmental issues. Adverse rulings could lead to significant charges for the parent company, which cannot however be presently measured objectively.

- 4.2 The notes to the consolidated financial statements show the effects on the consolidated financial statements of the application, by the parent company, of Law no. 488/1999, governing the recognition of the extraordinary expense that arose as a result of the suppression of the Electricity Sector Employee Pension Fund.
- 4.3 As required by the law, the parent company disclosed the key figures from the latest financial statements of the company that manages and coordinates it in the notes to its own consolidated financial statements. Our opinion on the consolidated financial statements of Terna Group does not extend to such data.

Rome, 11 March 2005

KPMG S.p.A.

(Signed on the original)

Bruno Mastrangelo  
*Director of Audit*

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