

## **Corporate Governance**

Introduction

Shareholding Set Up

Organization of the Company

Board of Directors

Committees

- Remuneration Committee
- Internal Auditing Committee

Board of Statutory Auditors

Internal Auditing System

Transactions with Related Parties

Handling of Confidential Information

Dealings with Institutional Investors and the Body of Shareholders

General Meetings

Ethical Code

Organizational and Management Model

## **CORPORATE GOVERNANCE**

### **Section I: governance structure**

#### **Introduction**

The corporate governance system in existence within the Company 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, no body - with the exception of Cassa Depositi e Prestiti SpA (joint-stock company owned by the Ministry of the Economy and Finance of the Italian Republic) holder of 29.9% of the share capital, Enel SpA holder of 6.142% of the share capital and the Assicurazioni Generali Group, holder of 5.042% of the share capital - 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 as well as perform all the duties attributable to the Board by law;
- The shareholders' meeting, responsible for resolving amongst other things - in ordinary and extraordinary

session - with regards 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 Articles of Association, (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 Ethical Code 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**

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. 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:

- 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 Articles of Association or reserved for the Board of Directors on the basis of the resolutions of the latter body described hereunder;

- 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 regards to (i) the characteristics of said transactions, (ii) the parties involved and their possible correlation with the Company or its subsidiaries;
- 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;
- Defines and assesses the adequacy of the general organizational and administrative set-up of the Company and its subsidiaries;
- 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;
- 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: (i) the approval of the grid development plan proposal, (ii) the purchase and sale of equity investments in other companies, (iii) the stipulation of agreements (with Ministries, Local Bodies, etc.) of particular strategic relevance for the Company or for amounts greater than € 10 million, (iv) the approval of investments and the stipulation of contracts of a significant size (by this we mean in general those with a value greater than € 20 million, with the exception of contracts concerning the dispatch activities and all the related services, while this threshold is reduced to € 2 million for infraGroup contracts, with the exception of contracts concerning the dispatch activities and all the related services), (v) the participation in bids for tenders which involve a commitment greater than € 5 million, (vi) the issue of bonds, (vii) the issue of fidejussory and secured guarantees for amounts greater than € 5,000,000 per individual transaction, not envisaged by the budget and by the approved financial plans, (viii) purchases, exchanges, disposals of property assets and leases over nine years for amounts greater than € 1,000,000, not envisaged by the budget and by the approved financial plans, (ix) the stipulation of management consultancy contracts for a unit amount of more than € 500,000, not envisaged by the budget and by the approved financial plans, (vi) the undertaking of specific decisions on transactions with a unitary level of more than € 1 million;

- Makes arrangements with regards 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 Articles of Association, 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 privatisations; so far, this power to appoint has not been exercised by the State. The Company's Directors must possess the requisites of respectability and professionalism in common with those applicable to the statutory auditors of listed companies; at least a third of the Directors in office must 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 as laid down in Article 15.5 of the Articles of Association, are applicable to the executive directors, taking into account the specific activities performed by the Company. The Articles of Association also anticipate - by way of implementation of the matters laid down by privatisation legislation, the matters required by the Prime Minister's Decree dated May 11, 2004 and in compliance with the matters envisaged by Italian legislation with regards to listed companies - 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 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 regards to the personal and professional characteristics of the candidates, accompanied by indication of the possible suitability of the same to qualify as independent, 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.

In conclusion, the Articles of Association also envisage - by way of implementation of the matters requested by the Prime Minister's Decree dated May 11, 2004 - a limit equal to 5% of the share capital for operators of 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 November 2, 2005, 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 2007 financial statements. In relation to the appointments made during said meetings, the Board currently comprises the following members, whose brief professional resume is presented below, together with indication of the lists they came from:

- *Luigi Roth, 65 years old - Chairman (indicated on the list presented by Cassa Depositi e Prestiti SpA)*

A Business Studies graduate from Bocconi University in Milan. Since 2001, he has been the Chairman of the Fiera Milano Foundation and, since 2004, Deputy Chairman of Cassa Depositi Prestiti SpA. Currently, he is a Board member of TELECOM Italia SpA. He started his managerial career within the Pirelli Group, carrying out activities both in Italy and abroad. Subsequently, he worked within Metropolitana Milanese as Planning Director. Since 1980 he has run medium-sized companies both in the manufacturing and real estate property sector in the position of General Manager and Chief Executive Officer. From 1986 until 1993, he was Chief Executive Officer of Ernesto Breda SpA; from 1993 until 2001 he was Chairman and Chief Executive Officer of Breda Costruzioni Ferroviarie SpA; from April 1996 until January 1998 he was Chairman of Società Ferrovie Nord Milano SpA; from December 1996 until January 1998, he was Chairman of Società Ferrovie Nord Milano Esercizio SpA; from May 1998 until December 2000 he was Chief Executive Officer of Ansaldo Trasporti SpA as well as Top Manager of the transport section of Finmeccanica SpA.

- *Flavio Cattaneo, 42 years old - Chief Executive Officer (indicated on the list presented by Cassa Depositi e Prestiti SpA)*

An Architecture graduate from the Polytechnic of Milan, he has covered important positions of

responsibility and administration in various Italian companies in the radio-television, services, new technologies, construction, public services and facilities sectors. As from 1999 at the helm of the former Ente Autonomo Fiera Internazionale in Milan as Extraordinary board member, he then saw to its stockmarket listing as Fiera di Milano SpA, becoming Chairman and Chief Executive Officer until 2003. He has been a board member of numerous companies in the energy sector (from 1999 until 2001), including: AEM SpA in Milan (in the office of Deputy Chairman), Serenissima Gas, Triveneta Gas SpA, Seneca S.r.l. and Malpensa Energia. As from April 2003, he was appointed to the senior management of the public television company R.A.I. SpA as General Manager until August 2005.

- *Luigi De Paoli, 56 years old - Director (indicated on the list presented by Cassa Depositi e Prestiti SpA)*

A Nuclear Engineering graduate from the Polytechnic of Milan, Professor of Business economics and management at Bocconi University in Milan and Director of the Masters' course in Environmental economics and management. Director of the IEFE - Institute of Energy and Environmental Economics and Politics and Director of the publication "Economia delle fonti di energia e dell'ambiente (Economics of energy sources and the environment)", as well as member of the scientific committee of Gaz de France and director of AIEE-Italian Association of Energy Economists. He has covered various university lecturing posts both in Italy and abroad. Between June 1999 and May 2002 he was a board member of ENI SpA. A member of various ministerial committees concerned with the development of the national energy sector, restructuring of the electricity sector, public utility services and tariff regulation; since July 2005, he has been a member of the "Commission for natural gas and fuel prices" established at the Ministry of Production Activities. He is the author of many publications in the field of economics and energy.

- *Mario Garraffo, 68 years old - Director (indicated in the list presented by Cassa Depositi e Prestiti SpA)*

A Business Studies graduate from Bocconi University in Milan, he has covered positions of growing responsibility and administration in various Italian companies: Controller and Development Director of La Centrale Finanziaria Generale from 1960 until 1970; Investments Director with the IFI Group between 1970 and 1980; Chief Executive Officer of IFIL-Finanziaria di Partecipazioni between 1980 and 1985; Chairman of IFINT (now EXOR) from 1985 until 1993; Chief Executive Officer of Lazard Italia from 1993 until 1998 and of UNIM-Unione immobiliare between 1998 and 2000; from 2000 until 2004 he was Chairman of General Electric Italia. He is currently Senior Advisor of General Electric Europe and covers the office of Independent Director, member of the Executive Committee and the Remuneration Committee of Recordati SpA as well as Independent Director of Pirelli &C SpA. He is a Trustee of the Johns Hopkins

University in Baltimore and the Johns Hopkins School for Advanced International Studies (SAIS) in Bologna. Chairman of the Bocconi University Alumni Association and member of the Board of Directors of the Donna Gavotte Bocconi Foundation (founding body of Bocconi University).

- *Salvatore Machi, 68 years old - Director (indicated in the list presented by institutional investors)*

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 thermo-electrical production and director of purchasing and contract work. Chief Executive Officer (from July 1999 until April 2000) and, therefore, Chairman (until July 2003) of Gestore della Rete di Trasmissione Nazionale SpA (GRTN), also during this period he was a 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 and, since September 2004, he is also a Board Member of Terna SpA.

- *Carmin Macri, 56 years old - Director (indicated on the list presented by Cassa Depositi e Prestiti SpA)*

A law graduate from the Rome “La Sapienza” University, he carries out his professional activities as cassation lawyer. Since 1996, he has been Professor of Banking Law and Legislation at the Business Studies faculty of Rome’s second university “Tor Vergata”, after having covered various academic posts until 1986. Between 1997 and 2003, he was a board member of Italgas SpA. For approximately 8 years, he performed consulting activities for the Associazione tra le Casse di Risparmio Italiane (ACRI). Since Autumn 2004, he has been a board member of SUDGEST S.C.a R.L., a company in which the Ministry of Public Functions holds an investment via “Formez”.

- *Piero Giuseppe Maranesi, 64 years old - Director (indicated on the list presented by Cassa Depositi e Prestiti SpA)*

A Physics graduate from Milan University. Since 1990, he had been Professor of Electronics at Milan University and director of a research laboratory after having covered, until 1968, other academic postings also in other Italian universities and frequented research laboratories abroad. He is active within the international scientific community, has undertaken operative roles on behalf of the Institute of Electrical and Electronic Engineers (IEEE), including, between 1990 and 1996, the role of Board Director of IEEE-Power Electronics Society. Chairman of Transparency International Italia in 1995. Between 1997 and

2001, he was Councillor of the Province of Como. He collaborates with industrial companies which operate in the space electronics sector and is the author of numerous scientific publications.

- *Massimo Ponzellini, 55 years old - Director (indicated on the list presented by the Assicurazioni Generali Group)*

Chief Executive Officer of the Istituto Poligrafico e Zecca dello Stato SpA since February 2006 and Deputy Chairman and Chief Executive Officer of Patrimonio dello Stato SpA since November 2002. He is also a Board Director of NA and Banca Nazionale del Lavoro and honorary Deputy Chairman of EIB (European Investment Bank), of which between 1994 and 2003 he was Deputy Chairman and Chief Administrative Officer for loans and finance. During his career he has been a board director of various important industrial groups such as Alitalia (1986-1994) and Finmeccanica (1986-1990). From 1986 until 1990 he was Chief Executive Officer of SOFIN SpA. Between 1990 and 1994 he was a member of the Transitional Team for the formation of the BERS-European Bank for reconstruction and development and following that Director of operations of the Bank. Between 1981-1982 he was General manager of NOMISMA SpA. At IRI, in 1983, he took over the position of senior executive and executive secretary of the Committee for Restructuring and Privatisation and from 1984 until 1986 he was the head of the Strategy and Studies Division.

- *Massimo Romano, 46 years old - Director (indicated in the list presented by Enel SpA)*

From 1990 until 1994 he was head of Institutional Relations at ILVA Sp.A (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, he also covers the role of senior advisor to the task force for the internationalisation of the Italian manufacturing system set up by the Foreign Office. Member of the Confindustria Council and Management Committee of Assoelettrica, since March 2004 he had also been Board Director of Terna SpA.

- *Franco Smurro, 48 years old - Director (indicated in the list presented by Cassa Depositi e Prestiti SpA)*

A Pedagogy graduate from Rome's "La Sapienza" University. After academic collaboration with the IInd Chair of Special Pedagogy at Rome's "La Sapienza" University between 1986/1987, he started his managerial career within Telecom Italia SpA in the External Affairs Division from 1987 until 1997. From 1997 and until 2001 he carried out consulting activities with the Authority for the Guarantee of

Communications and, until 2002, at Nortel Networks SpA and, at Bull SpA, until 2004. Since May 2005, he had been a Board Director of Asteimmobiliari SpA.

All the Directors dedicate 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

During 2005, the Board of Directors held 9 meetings with an average duration of 2 hours and 20 minutes each, which involved the due participation of the Directors and the presence of the Board of Statutory Auditors.

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 regards 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 November 2, 2005 - for the task of (i) taking care of the dealings of the Company in Italy and abroad with the institutions, public and administrative, national and international bodies and authorities, both central and peripheral, financial, banking, insurance and welfare institutions, private bodies and corporate bodies and individuals, seeing to the relative international relations, in co-ordination with the Chief Executive Officer, as well as (ii) overseeing the internal 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 with their specific skills to board discussions, so as to encourage an examination of the business being discussed 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 (Luigi Roth, Luigi De Paoli, Mario Garraffo, Salvatore Machì, Carmine Macrì, Piero Giuseppe Maranesi, Massimo Ponzellini, Massimo Romano, Franco Smurro) 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 Articles of Association, of guarantor of the application of correct corporate governance within the Board of Directors, as with the representative responsibilities assigned to him by the Board itself, and the supervisory responsibilities on the internal 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 November 2, 2006 certified the existence of the independence requisite as belonging to the following 8 non-executive directors: Flavio Cattaneo, Luigi De Paoli, Mario Garraffo, Salvatore Machì, Carmine Macrì, Piero Giuseppe Maranesi, Massimo Ponzellini, Franco Smurro. Subsequently, during the same meeting, the Director Flavio Cattaneo was appointed Chief Executive Officer of the Company and was granted the necessary operating power of attorney. Consequently, the remaining 7 non-executive Directors are independent.

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 afore-mentioned 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

In 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 renewal of the Board of Directors, during the meeting held on November 16, 2005, steps were taken to re-establish the Committee and appoint the members. The Remuneration Committee currently comprises Massimo Ponzellini (acting as co-ordinator), Mario Garraffo, Massimo Romano, Luigi Roth and Franco Smurro, all non-executive directors, and most also being independent.

During the 2005 accounting period, this Committee held 6 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, during 2005, took steps 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 achievement of specific targets.

During the meetings held in 2005, the Remuneration Committee analysed, putting forward the related proposals to the Board of Directors, an incentive system based on a stock option plan addressing the Terna Group's senior management, and the related implementing regulations as well as an incentive plan, intended for the Company's management not involved in the stock option plan, which anticipates the payment of a bonus if, over the medium term, specific income objectives are achieved and a value threshold of the Terna stock is passed.

### Internal Auditing Committee

Again in 2004, an Internal Auditing Committee was also formed as part of the Board of Directors, with advisory and proposal-related tasks.

Following the renewal of the Board of Directors, during the meeting held on November 16, 2005, steps were taken to re-establish the Internal Auditing Committee defining, in particular, 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.

Following the afore-mentioned renewal of the Board of Directors, steps were taken on November 16, 2005 to appoint the members of the Internal Auditing Committee, which currently comprises Mario Garraffo (acting as co-ordinator), Luigi De Paoli, Salvatore Machi, Carmine Macrì and Piero Giuseppe Maranesi, all non-executive and independent directors. During the 2005 accounting period, this Committee held 7 meetings, which involved the regular participation of the members and an average duration of one hour and 35 minutes 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 2005 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 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 Articles of Association, 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 Articles of Association; furthermore, on the basis of said Articles of Association, 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 Articles of Association 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 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 regards 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 April 1, 2005, 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, together with indication of the lists they come from:

- *Giovanni Ferreri, 71 years old (indicated on the list presented by Enel SpA)*

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 A.S Roma SpA.

- *Giancarlo Russo Corvace, 53 years old (indicated on the list presented by Enel SpA)*

Graduate in business studies from Rome’s LUISS University, he also gained a Masters 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.

- *Roberto Tasca, 44 years old (indicated on the list presented by institutional investors)*

Graduate in Business Economics from the “Luigi Bocconi” commercial university. Since 2001 he has been an Extraordinary Professor of the Economics of Financial Brokers at the Faculty of Economics at Bologna University. Between 1992 and 2000 he covered various university lecturing positions at Bologna University and the Luigi Bocconi University in Milan. He is the author of numerous essays and monographs on various subjects dealing with the economics of financial brokerage, as well as a lecturer at SDA Bocconi and the University of Bologna for various Masters’ courses.

During the 2005 accounting period, the Board of Statutory Auditors held meetings lasting around two hours each on average; said meetings saw the regular participation of the acting auditors.

## Internal auditing system

With regards 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 on 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 of the internal auditing system defined by the Board of Directors on the basis of the indications of the specific Committee 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 and, 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;
- 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 regards 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

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 afore-mentioned 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 forty "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 afore-mentioned 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 € 50,000 to € 25,000) or without delay after the related performance (from € 250,000 to € 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.

The regulations for the handling and management of confidential information and the code of conduct concerning internal dealing indicated, are currently being reviewed in view of the enforcement of the recent norms concerning market abuse and the implementing regulations.

### **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 under the staff of the Chief Executive Officer and (ii) an area tasked with conversing with the body of shareholders within the “Corporate Secretariat and Legal Division”.

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)), 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, Articles of Association and general shareholders' meeting regulations, information and documents on corporate governance, ethical code, 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 valorising 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 Articles of Association, 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, 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 Articles of Association, are approved by the ordinary shareholders' meeting by virtue of a specific responsibility assigned to said body by the Articles of Association. 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.

## Ethical Code

Back in May 2002, Terna's Board of Directors voted for the adoption of the Ethical Code (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 towards all the stakeholders. In particular, the ethical code 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, valorisation 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 towards 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 ethical code and its on-going improvement.

As a result of the Enel Group having left the Company shareholding structure and the integration of the GRTN business segment, the Ethical Code adopted by Terna is currently being updated.

### **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 regards 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 regards 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.

The approved Model is, at present, under review due to the subsequent legislative measures which widened the sphere of the offences envisaged by Italian Legislative Decree No. 231/2001 as well as consequent to the acquisition of the GRTN business segment.

Terna’s Board of Directors Meeting held on December 21, 2005, partly in view of the review underway of the “Organizational and management model pursuant to Italian Legislative Decree No. 231 dated June 8, 2001” adopted by the Company and having considered the dimensions of the Company, approved the variation of the composition of Terna’s Supervisory Body set up in accordance with the same Legislative Decree No. 231/01 as envisaged by the afore-mentioned model, from monocratic to collective.

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						
Office	Members	Executive	Non executive	Independents	(5)	Number of other offices (6)
Chairman	Luigi Roth <sup>(1)</sup>		●		100%	3
Chief Executive Officer	Flavio Cattaneo <sup>(1)</sup>	●			100%	-
Director	Luigi De Paoli <sup>(1)</sup>		●	●	66.6%	-
Director	Mario Garraffo <sup>(1)</sup>		●	●	100%	4
Director	Carmine Macri <sup>(1)</sup>		●	●	66.6%	-
Director	Piero Giuseppe Maranesi <sup>(1)</sup>		●	●	100%	-
Director	Massimo Ponzellini <sup>(1) (2)</sup>		●	●	100%	4
Director	Franco Smurro <sup>(1)</sup>		●	●	100%	-
Director	Salvatore Machì <sup>(2)</sup>		●	●	100%	2
Director	Massimo Romano <sup>(2)</sup>		●		100%	-
Chairman	Fulvio Conti <sup>(3)</sup>		●		100%	15
Chief Executive Officer	Sergio Mobili <sup>(3)</sup>	●			100%	1
Director	Luca Arnaboldi <sup>(3)</sup>		●	●	66.6%	1
Director	Paolo Cantarella <sup>(3)</sup>		●	●	83.3%	-
Director	Davide Croff <sup>(3)</sup>		●	●	66.6%	1
Director	Claudio Machetti <sup>(3)</sup>		●		83.3%	14
Director	Paolo Ruzzini <sup>(3)</sup>		●		83.3%	2
Director	Salvatore Sardo <sup>(4)</sup>		●		0%	-

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 2005:

**BoD: 9 Internal Auditing Committee: 7 Remuneration Committee: 6**

INTERNAL AUDITING COMMITTEE		REMUNERATION COMMITTEE		POSSIBLE APPOINTMENT COMMITTEE		POSSIBLE EXECUTIVE COMMITTEE	
(7)	(5)	(7)	(5)	(7)	(5)	(7)	(5)
		●	50%	Non existent		Non existent	
●	100%						
●	100%	●	100%				
●	0%						
●	100%						
		●	100%				
		●	50%				
●	100%						
		● <sup>(8)</sup>	100%				
●	66.6%						
		●	100%				
●	100%						
		●	50%				
		●	100%				

<sup>(1)</sup> In office as from November 2, 2005

<sup>(2)</sup> The director was appointed by means of lists presented by the minority shareholders. (You are hereby informed that, for the first time, steps were taken to apply the "list voting" mechanism during the general shareholders' meeting held on November 2, 2005)

<sup>(3)</sup> In office until November 2, 2005

<sup>(4)</sup> In office until June 30, 2005

<sup>(5)</sup> 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

<sup>(6)</sup> 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

<sup>(7)</sup> This column indicates by means of an "●" if any of the Directors belong to Committees

<sup>(8)</sup> Member of the Committee as from November 16, 2005

## STRUCTURE OF TERNA'S BOARD OF STATUTORY AUDITORS

	Members	Percentage of participation at meetings of the Board of Statutory Auditors (2)	Number of other offices (3)
Chairman	Giovanni Ferreri	100%	1
Acting Auditor	Giancarlo Russo Corvace	100%	-
Acting Auditor	Roberto Tasca <sup>(1)</sup> <sup>(4)</sup>	100%	-
Alternate Auditor	Bruno Franceschetti <sup>(4)</sup>	N.A.	-
Alternate Auditor	Vito Di Battista <sup>(1)</sup> <sup>(4)</sup>	N.A.	-
Acting Auditor	Bruno Franceschetti <sup>(5)</sup>	100%	-
Alternate Auditor	Daniela Gallucci <sup>(5)</sup>	N.A.	-
Alternate Auditor	Fabrizio Orazi <sup>(5)</sup>	N.A.	-

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

Number of meetings held during 2005: **7**

<sup>(1)</sup> The Auditor was appointed by means of lists presented by the minority shareholders

<sup>(2)</sup> All cases of absence have been adequately justified

<sup>(3)</sup> 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

<sup>(4)</sup> In office as from April 1, 2005

<sup>(5)</sup> In office until April 1, 2005

## OTHER PROVISIONS OF THE CODE OF SELF-GOVERNANCE

	YES	NO
<b>SYSTEM OF THE POWERS OF ATTORNEY AND TRANSACTIONS WITH RELATED PARTIES</b>		
Has the BoD assigned powers of attorney defining:		
- <i>limits</i>	●	
- <i>operating formalities</i>	●	
- <i>frequency of the disclosure?</i>	●	
Does the BoD propose to examine and approve the transactions with a particular economic, equity and financial significance (including transactions with related parties)?	●	
Has the BoD defined guidelines and criteria for the identification of the “significant” transactions”?	●	
Are the guidelines and criteria indicated above described in the report?	●	
Has the BoD defined specific procedures for the examination and approval of the transactions with related parties?	●	
Are the procedures for the approval of the transactions with related parties described in the report?	●	
<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?	●	
Were the candidatures for the office of director accompanied by in-depth disclosure?	●	
Were the candidatures for the office of director accompanied by indication of the suitability of the candidates to qualify as independents?	●	
Did the registration of the candidatures for the office of auditor take place at least ten days in advance?	●	
Were the candidatures for the office of auditor accompanied by in-depth disclosure?	●	
<b>GENERAL MEETINGS</b>		
Has the Company approved General Meeting regulations?	●	
Are the regulations attached to the report (or has it been indicated where they can be obtained/downloaded from)?	●	
<b>INTERNAL AUDITING</b>		
Has the Company appointed a head of Internal Auditing?	●	
Is this individual hierarchically independent from the heads of the operating areas?	●	
Organizational grade of the head of internal auditing <sup>(1)</sup>		
<b>INVESTOR RELATIONS</b>		
Has the Company appointed a head of Investor Relations?	●	
Organizational unit and references of the head of Investor Relations <sup>(2)</sup>		

<sup>(1)</sup> Head of the Internal Auditing division

<sup>(2)</sup> *Investor Relations* is the unit entrusted with dealings with the institutional investors.

*Investor Relations*: Via Arno 64 00198 Rome - Tel. 06.8313 8145 - Fax 06.8313 8389 - E-mail: [www.investor.relations@terna.it](mailto:www.investor.relations@terna.it)

The Corporate Secretariat and Legal Division is entrusted with dealing with individual shareholders .

*Corporate Secretariat*: Via Arno 64 00198 Rome - Tel. 06.83138136 - 06 8313 8376 - Fax 06.8313 8317

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