

OFFERING CIRCULAR



T.E.R.N.A. – Trasmissione Elettricità Rete Nazionale S.p.A.

(incorporated with limited liability in the Republic of Italy)

€800,000,000 4.90 per cent. Notes due 2024

Issue Price: 99.624 per cent.

and

€600,000,000 4.25 per cent. Notes due 2014

Issue Price: 99.968 per cent.

The €800,000,000 4.90 per cent. Notes due 2024 (the **A Notes**) and the €600,000,000 4.25 per cent. Notes due 2014 (the **B Notes** and, together with the A Notes, the **Notes**) are issued by T.E.R.N.A. – Trasmissione Elettricità Rete Nazionale S.p.A. (the **Issuer**). Unless previously redeemed or purchased and cancelled, the Issuer will redeem the A Notes at their principal amount on 28th October, 2024 and will redeem the B Notes at their principal amount on 28th October, 2014, in each case as described under “*Conditions of the A Notes - Redemption and Purchase*” and “*Conditions of the B Notes - Redemption and Purchase*”, respectively. In particular, the Issuer may, at its option, redeem all, but not some only, of the Notes at any time at par plus accrued interest, in the event of certain tax changes as described under “*Conditions of the A Notes - Redemption and Purchase*” and “*Conditions of the B Notes - Redemption and Purchase*”.

The A Notes bear interest from, and including, 28th October, 2004 (the **Closing Date**) at the rate of 4.90 per cent. per annum, payable annually on 28th October in each year. The B Notes bear interest from, and including the Closing Date at the rate of 4.25 per cent. per annum, payable annually on 28th October in each year.

The Issuer will not be liable to pay any additional amounts to holders of the Notes or the interest coupons appertaining to the Notes (the **Coupons**) with respect to any withholding or deduction required pursuant to Italian Legislative Decree No. 239 of 1st April, 1996 and any related implementing regulations, as more fully set out in “*Conditions of the A Notes - Taxation*” and “*Conditions of the B Notes - Taxation*” and as described under “*Taxation - Italian Taxation*”. In addition, certain other customary exceptions to the Issuer’s obligation to pay additional amounts to holders of the Notes or the Coupons with respect to the imposition of withholding or deduction in respect of payments relating to the Notes or the Coupons apply, also as more fully set out in “*Conditions of the A Notes - Taxation*” and “*Conditions of the B Notes - Taxation*”.

Application has been made for the listing of the Notes on the Luxembourg Stock Exchange.

The A Notes and the B Notes will initially each be represented by a temporary global note (the **Temporary Global A Note** and the **Temporary Global B Note**, respectively, and together, the **Temporary Global Notes**), without Coupons, which will be deposited on or about the Closing Date with a common depository for Euroclear Bank S.A./N.V., as operator of the Euroclear System, (**Euroclear**) and Clearstream Banking, société anonyme (**Clearstream, Luxembourg**). Interests in the Temporary Global A Note and the Temporary Global B Note will be exchangeable for interests in a permanent global note representing the A Notes (the **Permanent Global A Note**) and a permanent global note representing the B Notes (the **Permanent Global B Note** and, together with the Permanent Global A Note, the **Permanent Global Notes** and, together with the Temporary Global Notes, the **Global Notes**) respectively, each without Coupons, on or after 7th December, 2004 (the **Exchange Date**), upon certification as to non-U.S. beneficial ownership. Interests in the Permanent Global Notes will be exchangeable for definitive Notes only in certain limited circumstances - see “*Summary of Provisions relating to the Notes while represented by the Global Notes*”.

The Notes are in the denominations of €50,000 and integral multiples of €1,000 above €50,000. For so long as the Notes are represented by a Global Note and the relevant clearing system(s) so permit, the Notes shall be tradable in such denominations, subject always to the minimum denomination and trading amount of €50,000. There is no assurance, however, that the relevant clearing system(s) will enforce the minimum trading amount.

Joint-Lead Managers

Credit Suisse First Boston

JPMorgan

UBS Investment Bank

Co-Lead Managers

**Dresdner Kleinwort Wasserstein
Lehman Brothers**

**HSBC
SG CIB**

Co-Lead Managers

**ABN AMRO
Banco Bilbao Vizcaya
Argentaria, S.A.
Daiwa Securities SMBC Europe
DZ BANK AG
Mitsubishi Securities International plc
RASFIN SIM S.p.A.**

**Banca Akros S.p.A. - Gruppo Banca Popolare di Milano
Banc of America Securities Limited**

**Deutsche Bank
HVB Corporates and Markets
MPS Finance
Santander Central Hispano**

**Banca Nazionale del Lavoro
Bear, Stearns International
Limited
Dexia Capital Markets
ING Financial Markets
Nomura International
The Royal Bank of Scotland**

The date of this Offering Circular is 26th October, 2004

The Issuer accepts responsibility for the information contained in this Offering Circular. To the best of the knowledge and belief of the Issuer (having taken all reasonable care to ensure that such is the case) the information contained in this Offering Circular is in accordance with the facts and does not omit anything likely to affect the import of such information. The Issuer, having made all reasonable enquiries, confirms that this Offering Circular contains or incorporates by reference all information which is material in the context of the Notes, that the information contained or incorporated by reference in this Offering Circular is in all material respects true and accurate and not misleading, that the opinions and intentions expressed in this Offering Circular are honestly held and that there are no other facts the omission of which would make this Offering Circular or any of such information or the expression of any such opinions or intentions misleading. The Issuer accepts responsibility accordingly.

No person has been authorised to give any information or to make any representation other than those contained in this document in connection with the offering of the Notes and, if given or made, such information or representations must not be relied upon as having been authorised by the Issuer or the Managers (as defined under “*Subscription and Sale*” below). Neither the delivery of this document nor any sale made hereunder shall, under any circumstances, constitute a representation or create any implication that there has been no change in the affairs of the Issuer or the Group since the date hereof. This document does not constitute an offer of, or an invitation by, or on behalf of, the Issuer or the Managers to subscribe for, or purchase, any of the Notes. This document does not constitute an offer, and may not be used for the purpose of an offer to, or a solicitation by, anyone in any jurisdiction or in any circumstances in which such an offer or solicitation is not authorised or is unlawful.

Neither the Managers nor J. P. Morgan Corporate Trustee Services Limited (the **Trustee**) have separately verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability is accepted by the Managers, the Trustee or any of them as to the accuracy or completeness of the information contained in this Offering Circular or any other information provided by the Issuer in connection with the Notes or their distribution.

This Offering Circular is not intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by the Issuer, the Managers or the Trustee that any recipient of this Offering Circular should purchase any of the Notes. Each investor contemplating purchasing Notes should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended, (the **Securities Act**) and are subject to U.S. tax law requirements. Subject to certain exceptions, the Notes may not be offered, sold or delivered within the United States or to U.S. persons. For a further description of certain restrictions on the offering and sale of the Notes and on distribution of this document, see “*Subscription and Sale*” below.

All references in this document to **euro** and **€** refer to the currency introduced at the start of the third stage of European economic and monetary union pursuant to the Treaty establishing the European Community, as amended.

IN CONNECTION WITH THE ISSUE OF THE NOTES, UBS LIMITED OR ANY PERSON ACTING FOR HIM MAY OVER-ALLOT OR EFFECT TRANSACTIONS WITH A VIEW TO SUPPORTING THE MARKET PRICE OF THE NOTES AT A LEVEL HIGHER THAN THAT WHICH MIGHT OTHERWISE PREVAIL FOR A LIMITED PERIOD AFTER THE CLOSING DATE. HOWEVER THERE MAY BE NO OBLIGATION ON UBS LIMITED OR ANY AGENT OF UBS LIMITED TO DO THIS. SUCH STABILISING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME AND MUST BE BROUGHT TO AN END AFTER A LIMITED PERIOD.

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DOCUMENTS INCORPORATED BY REFERENCE

The Annual Reports of the Issuer for the years ended 31st December, 2002 and 2003 and the unaudited interim non-consolidated financial statements of the Issuer as at, and for the six month period ended, 30th June, 2004 are incorporated by reference and form part of this Offering Circular.

Copies of these financial statements and Annual Reports are available, free of charge, at the specified office of the Paying Agent in Luxembourg as described in “*General Information*” below, for as long as any of the Notes remain outstanding.

Any statement contained herein or in a document which is deemed to be incorporated by reference herein shall be deemed to be modified or superseded for the purpose of this Offering Circular to the extent that a statement contained in any such subsequent document which is deemed to be incorporated by reference herein modifies or supersedes such earlier statement (whether expressly, by implication or otherwise). Any statement so modified or superseded shall not be deemed, except as so modified or superseded, to constitute a part of this Offering Circular.

CONDITIONS OF THE A NOTES

The following is the text of the Conditions of the A Notes which will be endorsed on each Note in definitive form (if issued):

The €800,000,000 4.90 per cent. Notes due 2024 (the **Notes**, which expression shall in these Conditions, unless the context otherwise requires, include any further notes issued pursuant to Condition 15 and forming a single series with the Notes) of T.E.R.NA. – Trasmissione Elettricità Rete Nazionale S.p.A. (the **Issuer**) are constituted by a Trust Deed dated 28th October, 2004 (the **Trust Deed**) made between the Issuer and J. P. Morgan Corporate Trustee Services Limited (the **Trustee**, which expression shall include its successor(s)) as trustee for the holders of the Notes (the **Noteholders**) and the holders of the interest coupons appertaining to the Notes (the **Couponholders** and the **Coupons** respectively).

The statements in these Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Trust Deed. Copies of the Trust Deed and the Agency Agreement dated 28th October, 2004 (the **Agency Agreement**) made between the Issuer, the initial paying agents named therein (together with any successor or additional paying agent, the **Paying Agents**) and the Trustee are available for inspection during normal business hours at the registered office for the time being of the Trustee, being at the date of issue of the Notes at Trinity Tower, 9 Thomas More Street, London E1W 1YT and at the specified office of each of the Paying Agents. The Noteholders and the Couponholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and the Agency Agreement applicable to them.

1. FORM, DENOMINATION AND TITLE

1.1 Form and Denomination

The Notes are in bearer form, serially numbered, in the denomination of €50,000 and integral multiples of €1,000 above €50,000, each with Coupons attached on issue. In the event that definitive Notes are issued and the Notes are listed on the Luxembourg Stock Exchange, the Issuer will advise the Luxembourg Stock Exchange of the denominations in which they are issued.

1.2 Title

Title to the Notes and to the Coupons will pass by delivery.

1.3 Holder Absolute Owner

The Issuer, any Paying Agent and the Trustee may (to the fullest extent permitted by applicable laws) deem and treat the bearer of any Note or Coupon as the absolute owner for all purposes (whether or not the Note or Coupon shall be overdue and notwithstanding any notice of ownership or writing on the Note or Coupon or any notice of previous loss or theft of the Note or Coupon or of any trust or interest therein) and shall not be required to obtain any proof thereof or as to the identity of such bearer.

2. STATUS

The Notes and the Coupons are direct, unconditional and (subject to the provisions of Condition 3) unsecured obligations of the Issuer and (subject as provided above) rank and will rank *pari passu*, without any preference among themselves, with all other outstanding unsecured and unsubordinated obligations of the Issuer, present and future (save for such obligations as may be preferred by mandatory provisions of law) but, in the event of insolvency, only to the extent permitted by applicable laws relating to creditors' rights.

3. NEGATIVE PLEDGE

So long as any of the Notes remains outstanding (as defined in the Trust Deed), the Issuer will not, and will ensure that none of its Material Subsidiaries will, create or permit to subsist any Security upon the whole or any part of its assets or revenues, present or future, to secure any Indebtedness, except for Permitted Encumbrances, unless:

- (a) the same Security shall forthwith be extended equally and rateably to the Notes and the Coupons to the satisfaction of the Trustee; or
- (b) such other Security or guarantee (or other arrangement) as (i) the Trustee in its absolute discretion deems not materially less beneficial to the interests of the Noteholders or (ii) shall be approved by an Extraordinary Resolution of the Noteholders, shall previously have been or shall forthwith be extended equally and rateably to the Notes and the Coupons.

As used herein:

Group means the Issuer and its Subsidiaries;

Indebtedness means any present or future indebtedness for borrowed money which is in the form of, or represented by, bonds, notes, debentures or other securities and which is or are intended to be quoted, listed or ordinarily dealt in on any stock exchange, over-the-counter or regulated securities market;

Material Subsidiary means any consolidated Subsidiary of the Issuer:

- (a) whose total assets (consolidated in the case of a Subsidiary which itself has Subsidiaries) represent not less than 10 per cent. of the consolidated total assets of the Issuer and its Subsidiaries taken as a whole, as calculated respectively by reference to the then latest audited accounts (consolidated or, as the case may be, unconsolidated) of the Subsidiary and the then latest audited consolidated accounts of the Issuer and its Subsidiaries, or
- (b) to which is transferred the whole or substantially the whole of the undertaking and assets of a Subsidiary of the Issuer which immediately before the transfer is a Material Subsidiary of the Issuer.

A report by two Directors of the Issuer whether or not addressed to the Trustee that in their opinion a Subsidiary of the Issuer is or is not or was or was not at any particular time or throughout any specified period a Material Subsidiary may be relied upon by the Trustee without further enquiry or evidence and, if relied upon by the Trustee, shall, in the absence of manifest or (to the satisfaction of the Trustee) proven error, be conclusive and binding on all parties;

Permitted Encumbrances means:

- (a) any Security arising pursuant to any mandatory provision of law other than as a result of any action taken by the Issuer; or
- (b) any Security in existence as at the date of issuance of the Notes; or
- (c) in the case of any entity which becomes a Subsidiary of any member of the Group after the date of issuance of the Notes, any Security existing over such entity's assets at the time it becomes such a Subsidiary, provided that the Security was not created in contemplation of, or in connection with, it becoming a Subsidiary and the amounts secured have not been increased in contemplation of, or in connection with, such acquisitions; or
- (d) any Security securing Project Finance Indebtedness; or
- (e) any Security which is created in connection with, or pursuant to, a limited-recourse financing, securitisation or other like arrangement where the payment obligations in respect of the indebtedness secured by the relevant Security are to be discharged solely from the revenues

generated by the assets over which such Security is created (including, without limitation, receivables) provided that the aggregate book value of the assets over which such Security is created shall not exceed €400,000,000 or, if greater, 10 per cent. of the consolidated net worth of the Group; or

- (f) any Security created after the date of issue of the Notes on any asset acquired by the person creating the Security and securing only Indebtedness incurred for the sole purpose of financing or re-financing that acquisition provided that the principal amount of such Indebtedness so secured does not exceed the overall cost of that acquisition.

Person means any individual, company, corporation, firm, partnership, joint venture, association, organisation, state or agency of a state or other entity, whether or not having separate legal personality;

Project Finance Indebtedness means any present or future Indebtedness incurred in financing the ownership, acquisition, construction, development, leasing, maintenance and/or operation of an asset or assets, whether or not an asset of a member of the Group:

- (a) which is incurred by a Project Finance Subsidiary; or
- (b) in respect of which the Person or Persons to whom any such Indebtedness is or may be owed by the relevant borrower (whether or not a member of the Group) has or have no recourse whatsoever to any member of the Group (other than a Project Finance Subsidiary) for the repayment thereof other than:
 - (i) recourse for amounts limited to the cash flow or the net cash flow (other than historic cash flow or historic net cash flow) from such asset or assets or the income or other proceeds deriving therefrom; and/or
 - (ii) recourse for the purpose only of enabling amounts to be claimed in respect of such Indebtedness in an enforcement of any Security given by such borrower over such asset or assets or the income, cash flow or other proceeds, deriving therefrom (or given by any shareholder or the like in the borrower over its shares or the like in the capital of the borrower) to secure such Indebtedness,

provided that (a) the extent of such recourse is limited solely to the amount of any recoveries made on any such enforcement, and (b) such Person or Persons is/are not entitled, by virtue of any right or claim arising out of or in connection with such Indebtedness, to commence any proceedings of whatever nature against any member of the Group (other than a Project Finance Subsidiary).

Project Finance Subsidiary means any Subsidiary of the Issuer either:

- (a)
 - (i) which is a single purpose company whose principal assets and business are constituted by the ownership, acquisition, construction, development, leasing, maintenance and/or operation of an asset or assets; and
 - (ii) none of whose Indebtedness in respect of the financing of such ownership, acquisition, construction, development, leasing, maintenance and/or operation of an asset or assets is subject to any recourse whatsoever to any member of the Group (other than such Subsidiary or another Project Finance Subsidiary) in respect of the repayment thereof, except as expressly referred to in sub-paragraph (ii) of the definition of Project Finance Indebtedness; or
- (b) at least 70 per cent. in principal amount of whose Indebtedness is Project Finance Indebtedness.

Security means any mortgage, lien, pledge, charge or other security interest;

Subsidiary means, in respect of any Person (the **first Person**) at any particular time, any other Person (the **second Person**):

- (i) whose majority of votes in ordinary shareholders' meetings of the second Person is held by the first Person; or
- (ii) in which the first Person holds a sufficient number of votes giving the first Person a dominant influence in ordinary shareholders' meetings of the second Person; or
- (iii) whose accounts are required to be consolidated with those of the First Person pursuant to article 26 of Law 127 of 1991;

(in the case of (i) and (ii) pursuant to the provisions of Article 2359, first paragraph, no. 1 and no. 2, of the Italian Civil Code).

4. INTEREST

4.1 Interest Rate and Interest Payment Dates

The Notes bear interest from and including 28th October, 2004 at the rate of 4.90 per cent. per annum, payable annually in arrear on 28th October (each an **Interest Payment Date**). The first payment (representing a full year's interest) and amounting to €49 per €1,000 principal amount of Notes) shall be made on 28th October, 2005.

4.2 Interest Accrual

Each Note will cease to bear interest from and including its due date for redemption unless, upon due presentation, payment of the principal in respect of the Note is improperly withheld or refused or unless default is otherwise made in respect of payment, in which event interest shall continue to accrue as provided in the Trust Deed.

4.3 Calculation of Broken Interest

When interest is required to be calculated in respect of a period of less than a full year, it shall be calculated on the basis of (a) the actual number of days in the period from and including the date from which interest begins to accrue (the **Accrual Date**) to but excluding the date on which it falls due divided by (b) the actual number of days from and including the Accrual Date to but excluding the next following Interest Payment Date.

5. PAYMENTS

5.1 Payments in respect of Notes

Payments of principal and interest in respect of each Note will be made against presentation and surrender (or, in the case of part payment only, endorsement) of the Note, except that payments of interest due on an Interest Payment Date will be made against presentation and surrender (or, in the case of part payment only, endorsement) of the relevant Coupon, in each case at the specified office outside the United States of any of the Paying Agents.

5.2 Method of Payment

Payments will be made by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by euro cheque.

5.3 Missing Unmatured Coupons

Each Note should be presented for payment together with all relative unmatured Coupons, failing which the full amount of any relative missing unmatured Coupon (or, in the case of payment not being made in full, that proportion of the full amount of the missing unmatured Coupon which the amount so paid bears to the total amount due) will be deducted from the amount due for payment. Each amount so deducted will be paid in the manner mentioned above against presentation and surrender

(or, in the case of part payment only, endorsement) of the relative missing Coupon at any time before the expiry of 10 years after the Relevant Date (as defined in Condition 7) in respect of the relevant Note (whether or not the Coupon would otherwise have become void pursuant to Condition 8) but not thereafter.

5.4 Payments subject to Applicable Laws

Payments in respect of principal and interest on the Notes are subject in all cases to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to the provisions of Condition 7.

5.5 Payment only on a Presentation Date

A holder shall be entitled to present a Note or Coupon for payment only on a Presentation Date and shall not, except as provided in Condition 4, be entitled to any further interest or other payment if a Presentation Date is after the due date.

Presentation Date means a day which (subject to Condition 8):

- (a) is or falls after the relevant due date;
- (b) is a Business Day in the place of the specified office of the Paying Agent at which the Note or Coupon is presented for payment; and
- (c) in the case of payment by credit or transfer to a euro account as referred to above, is a TARGET Settlement Day.

In this Condition, **Business Day** means, in relation to any place, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in that place and **TARGET Settlement Day** means any day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) system is open.

5.6 Initial Paying Agents

The names of the initial Paying Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right, subject to the prior written approval of the Trustee, at any time to vary or terminate the appointment of any Paying Agent and to appoint additional or other Paying Agents provided that:

- (a) there will at all times be a Principal Paying Agent;
- (b) there will at all times be at least one Paying Agent (which may be the Principal Paying Agent) having its specified office in a European city outside the Republic of Italy (**Italy**) which so long as the Notes are listed on the Luxembourg Stock Exchange shall be Luxembourg; and
- (c) the Issuer undertakes that it will ensure that it maintains a Paying Agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26th-27th November, 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive.

Notice of any termination or appointment and of any changes in specified offices will be given to the Noteholders promptly by the Issuer in accordance with Condition 11.

6. REDEMPTION AND PURCHASE

6.1 Redemption at Maturity

Unless previously redeemed or purchased and cancelled as provided below, the Issuer will redeem the Notes at their principal amount on 28th October, 2024.

6.2 Redemption for Taxation Reasons

If the Issuer satisfies the Trustee immediately before the giving of the notice referred to below that:

- (a) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction (as defined in Condition 7), or any change in the application or official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after 26th October, 2004, on the next Interest Payment Date the Issuer would be required to pay additional amounts as provided or referred to in Condition 7; and
- (b) the requirement cannot be avoided by the Issuer taking reasonable measures available to it,

the Issuer may at its option, having given not less than 30 nor more than 60 days' notice to the Noteholders in accordance with Condition 12 (which notice shall be irrevocable), redeem all the Notes, but not some only, at any time at their principal amount together with interest accrued to but excluding the date of redemption, provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be required to pay such additional amounts, were a payment in respect of the Notes then due. Prior to the publication of any notice of redemption pursuant to this paragraph, the Issuer shall deliver to the Trustee a certificate signed by two Authorised Officers (as defined in the Trust Deed) of the Issuer stating that the requirement referred to in (a) above will apply on the next Interest Payment Date and cannot be avoided by the Issuer taking reasonable measures available to it and an opinion of independent legal advisers of recognised standing to the effect that the Issuer has or will become required to pay such additional amounts as a result of the change or amendment and the Trustee shall be entitled to accept such certificate and opinion as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event they shall be conclusive and binding on the Noteholders and the Couponholders.

6.3 Purchases

The Issuer or any of its Subsidiaries (as defined above) may at any time purchase Notes (provided that all unmatured Coupons appertaining to the Notes are purchased with the Notes) in any manner and at any price. If purchases are made by tender, tenders must be available to all Noteholders alike.

6.4 Cancellations

All Notes which are (a) redeemed or (b) purchased by or on behalf of the Issuer or any of its Subsidiaries will forthwith be cancelled, together with all relative unmatured Coupons attached to the Notes or surrendered with the Notes, and accordingly may not be held, reissued or resold.

6.5 Notices Final

Upon the expiry of any notice as is referred to in paragraph 6.2 above the Issuer shall be bound to redeem the Notes to which the notice refers in accordance with the terms of such paragraph.

7. TAXATION

7.1 Payment without Withholding

All payments in respect of the Notes by or on behalf of the Issuer shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental

charges of whatever nature (**Taxes**) imposed or levied by or on behalf of the Relevant Jurisdiction, unless the withholding or deduction of the Taxes is required by law. In that event, the Issuer will pay such additional amounts as may be necessary in order that the net amounts received by the Noteholders and Couponholders after the withholding or deduction shall equal the respective amounts which would have been receivable in respect of the Notes or, as the case may be, Coupons in the absence of the withholding or deduction; except that no additional amounts shall be payable in relation to any payment in respect of any Note or Coupon:

- (a) presented for payment by, or on behalf of, a holder who is liable for such Taxes in respect of the Note or Coupon by reason of his having some connection with the Relevant Jurisdiction other than the mere holding of the Note or Coupon; or
- (b) presented for payment by, or on behalf of, a holder who would be able to avoid such withholding or deduction by making a declaration or any other statement, including but not limited to a declaration of residence or non-residence, but fails to do so; or
- (c) presented for payment by, or on behalf of, a holder who would be able to avoid such withholding or deduction by presenting the relevant Note and/or Coupon to another Paying Agent in a Member State of the European Union, but fails to do so; or
- (d) presented for payment more than 30 days after the Relevant Date (as defined below) except to the extent that a holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day assuming that day to have been a Presentation Date (as defined in Condition 5); or
- (e) where such withholding or deduction is imposed on a payment to an individual resident outside Italy and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26th-27th November, 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (f) on account of *imposta sostitutiva* pursuant to Italian Legislative Decree No. 239 of 1st April, 1996 (**Legislative Decree No. 239**) and any related implementing regulations as in force on the date of the issue of the Notes in all circumstances in which the procedures set forth in Legislative Decree No. 239 have not been met or complied with, except where such procedures have not been met or complied with due to the actions or omissions of the Issuer or its agents; or
- (g) in the event of payment to a non-Italian resident legal entity or a non-Italian resident individual, to the extent that interest or other amounts are paid to a non-Italian resident legal entity or a non-Italian resident individual which is resident in a country which does not allow for a satisfactory exchange of information with Italy.

7.2 Interpretation

In these Conditions:

- (a) **Relevant Date** means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by the Principal Paying Agent or the Trustee on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect has been duly given to the Noteholders by the Issuer in accordance with Condition 12; and
- (b) **Relevant Jurisdiction** means Italy or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal and interest on the Notes and Coupons.

7.3 Additional Amounts

Any reference in these Conditions to any amounts in respect of the Notes shall be deemed also to refer to any additional amounts which may be payable under this Condition or under any undertakings given in addition to, or in substitution for, this Condition pursuant to the Trust Deed.

8. PRESCRIPTION

Claims for payment in respect of a Note or Coupon will become void unless presentation for payment is made within a period of 10 years (in the case of principal) and five years (in the case of interest) from the Relevant Date in respect of the Notes or, as the case may be, the Coupon, subject to the provisions of Condition 5.

9. EVENTS OF DEFAULT

The Trustee at its discretion may, and if so requested in writing by the holders of at least one-fifth in principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the Noteholders shall (subject in each case to being indemnified and/or secured to its satisfaction), (but, in the case of the happening of any of the events described in subparagraphs (c) and (e) to (h) inclusive, only if the Trustee shall have certified in writing to the Issuer that such event is, in its opinion, materially prejudicial to the interests of the Noteholders) give notice to the Issuer that the Notes are, and they shall accordingly forthwith become, immediately due and repayable at their principal amount, together with accrued interest as provided in the Trust Deed, in any of the following events (**Events of Default**):

- (a) if default is made for a period of 10 days or more in the payment of principal of or any interest in respect of the Notes or any of them after the due date thereof; or
- (b) if the Issuer shall be adjudicated or becomes insolvent or shall stop payment or announce that it shall stop payment or shall be found unable to pay all or substantially all of its debts, or any order shall be made by any competent court or other competent body for, or any resolution shall be passed by the Issuer for judicial composition proceedings with its creditors or for the appointment of a receiver, administrative receiver or trustee or other similar official in insolvency proceedings in relation to the Issuer; or
- (c) if the Issuer fails to pay a final judgment (*sentenza passata in giudicato*, in the case of a judgment issued by an Italian court) of a court of competent jurisdiction within 60 days from the receipt of a notice that a final judgment in excess of an amount equal to the value of a substantial part of the assets or property of the Issuer has been entered against it or an execution is levied, enforced upon or sued out against any substantial part of the assets or property of the Issuer pursuant to any such judgment; or
- (d) if the Issuer shall be wound up or dissolved (otherwise than for the purpose of a solvent amalgamation, merger, de-merger or reconstruction (a **Solvent Reorganisation**) (i) to be adopted or implemented pursuant to any mandatory provisions of law or (ii) on terms approved in writing by the Trustee or by an Extraordinary Resolution of the Noteholders, and (in the case of (i) and (ii)) under which the assets and liabilities of the Issuer are assumed by the entity resulting from such Solvent Reorganisation and such entity assumes all the obligations of the Issuer in respect of the Notes, the Coupons and the Trust Deed and an opinion of an independent legal adviser of recognised standing in Italy has been delivered to the Trustee confirming the same prior to the effective date of such Solvent Reorganisation); or
- (e) if the Issuer shall cease or announce that it shall cease to carry on all or substantially all of its business or shall dispose of all or substantially all of its assets (in each case otherwise than for the purpose of a Solvent Reorganisation (i) to be adopted or implemented pursuant to any mandatory provisions of law or (ii) on terms approved in writing by the Trustee or by an Extraordinary Resolution of the Noteholders, and (in the case of (i) and (ii)) under which the

assets and liabilities of the Issuer are assumed by the entity resulting from such Solvent Reorganisation and such entity assumes all the obligations of the Issuer in respect of the Notes, the Coupons and the Trust Deed and an opinion of an independent legal adviser of recognised standing in Italy has been delivered to the Trustee confirming the same prior to the effective date of such Solvent Reorganisation); or

- (f) if any Indebtedness for Borrowed Money of the Issuer becomes due and repayable prematurely by reason of an event of default (however described), or the Issuer fails to make any payment in respect of any Indebtedness for Borrowed Money on the due date for payment (as extended by any originally applicable grace period) or default is made by the Issuer in making any payment due under any guarantee and/or indemnity given by it in relation to any Indebtedness for Borrowed Money of any other person (as extended by any originally applicable grace period), provided that no such event shall constitute an Event of Default so long as and to the extent that the Issuer is contesting, in good faith, in a competent court in a recognised jurisdiction or before a competent arbitration panel that the relevant Indebtedness for Borrowed Money or any such guarantee and/or indemnity shall be due or enforceable, as appropriate, and provided further that no such event shall constitute an Event of Default unless the aggregate Indebtedness for Borrowed Money relating to all such events which shall have occurred and be continuing shall exceed €20,000,000 (or its equivalent in any other currency); or
- (g) any Security (other than any Security securing Project Finance Indebtedness), present or future, created or assumed on or against all or a material part of the property, assets or revenues of the Issuer, becomes enforceable and any step is taken to enforce it (including the taking of possession or the appointment of a receiver, manager or other similar person), which is not discharged within 30 days of such enforcement; or
- (h) if the Issuer fails to perform or observe any of its other obligations under these Conditions or the Trust Deed and (except in any case where the Trustee considers the failure to be incapable of remedy, when no continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 30 days (or such longer period as the Trustee may permit) following the service by the Trustee on the Issuer of notice requiring the same to be remedied.

For the purposes of this Condition:

Indebtedness for Borrowed Money means any present or future indebtedness (whether being principal, premium, interest or other amounts) for or in respect of (i) money borrowed, (ii) liabilities under or in respect of any acceptance or acceptance credit or (iii) any notes, bonds, debentures, debenture stock, loan stock or other securities offered, issued or distributed whether by way of public offer, private placing, acquisition consideration or otherwise and whether issued for cash or in whole or in part for a consideration other than cash.

10. ENFORCEMENT

10.1 Enforcement by the Trustee

The Trustee may at any time, at its discretion and without notice, take such proceedings against the Issuer as it may think fit to enforce the provisions of the Trust Deed, the Notes and the Coupons, but it shall not be bound to take any such proceedings or any other action in relation to the Trust Deed, the Notes or the Coupons unless (a) it has been so directed by an Extraordinary Resolution of the Noteholders or so requested in writing by the holders of at least one-fifth in principal amount of the Notes then outstanding and (b) it has been indemnified and/or secured to its satisfaction.

10.2 Enforcement by the Noteholders

No Noteholder or Couponholder shall be entitled to proceed directly against the Issuer unless the Trustee, having become bound so to proceed, fails so to do within a reasonable period and the failure shall be continuing.

11. REPLACEMENT OF NOTES AND COUPONS

Should any Note or Coupon be lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the Principal Paying Agent or the Paying Agent in Luxembourg upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Notes or Coupons must be surrendered before replacements will be issued.

12. NOTICES

All notices to the Noteholders will be valid if published in a leading English language daily newspaper published in London or such other English language daily newspaper with general circulation in Europe as the Trustee may approve and, so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of that exchange so require, in one leading newspaper of general circulation in Luxembourg. It is expected that publication will normally be made in the *Financial Times* and the *Luxemburger Wort* or the *Tageblatt*. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules and regulations of any stock exchange or other relevant authority on which the Notes are for the time being listed. Any such notice will be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers. If publication as provided above is not practicable, notice will be given in such other manner, and shall be deemed to have been given on such date, as the Trustee may approve. Couponholders will be deemed for all purposes to have notice of the contents of any notice given to the Noteholders in accordance with this paragraph.

13. MEETINGS OF NOTEHOLDERS, MODIFICATION, WAIVER, AUTHORISATION AND DETERMINATION

13.1 Meetings of Noteholders

The Trust Deed contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the modification or abrogation by Extraordinary Resolution of any of these Conditions or any of the provisions of the Trust Deed. The directors of the Issuer and/or the Noteholders' Representative (as defined below) at their discretion may, and if so requested in writing by the holders of at least 5 per cent. in principal amount of the Notes for the time being outstanding shall, convene a meeting. To be validly held, each such meeting must be quorate which shall mean (i) in the case of a first meeting, there are one or more persons present being or representing Noteholders holding at least one half in aggregate principal amount of the Notes for the time being outstanding, (ii) in the case of an adjourned meeting, there are one or more persons present being or representing Noteholders holding more than one third in aggregate principal amount of the Notes for the time being outstanding and (iii) in the case of a further adjourned meeting, there are one or more persons present being or representing Noteholders holding at least one fifth in aggregate principal amount of the Notes for the time being outstanding. The majority required to pass an Extraordinary Resolution at any meeting (including any adjourned meeting) will be one or more persons holding or representing at least two thirds in aggregate principal amount of the Notes represented at the meeting; provided, however, that certain proposals, as set out in Article 2415 of the Italian Civil Code (including any proposal to modify the maturity of the Notes or the dates on which interest is payable on them; to reduce or cancel the principal amount of, or interest on, the Notes; or to change the currency of payment of the Notes) may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders (including any adjourned meeting) by one or more persons holding or representing not less than one half in aggregate principal amount of the Notes for the time being outstanding. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present or not and on all Couponholders.

13.2 Noteholders' Representative

A representative of the Noteholders (*rappresentante comune*) (the **Noteholders' Representative**) (who might, subject to the mandatory provisions of Italian law, also be the same legal entity as the Trustee) may be appointed pursuant to Article 2417 of the Italian Civil Code in order to represent the Noteholders' interests under these Conditions and to give effect to resolutions passed at a meeting of the Noteholders. If the Noteholders' Representative is not appointed by a meeting of such Noteholders, the Noteholders' Representative shall be appointed by a decree of the President of the Court where the Issuer has its registered office at the request of one or more Noteholders or at the request of the directors of the Issuer. The Noteholders' Representative shall remain appointed for a maximum period of three years but may be re-appointed again thereafter.

13.3 Modification, Waiver, Authorisation and Determination

The Trustee may agree, without the consent of the Noteholders or Couponholders, to any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of these Conditions or any of the provisions of the Trust Deed, or determine, without any such consent as aforesaid, that any Event of Default or Potential Event of Default (as defined in the Trust Deed) shall not be treated as such (provided that, in any such case, it is not, in the opinion of the Trustee, materially prejudicial to the interests of the Noteholders or may agree, without any such consent as aforesaid, to any modification which is of a formal, minor or technical nature or to correct a manifest or (to the satisfaction of the Trustee) proven error.

13.4 Trustee to have Regard to Interests of Noteholders as a Class

In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation or determination), the Trustee shall have regard to the general interests of the Noteholders as a class but shall not have regard to any interests arising from circumstances particular to individual Noteholders or Couponholders (whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Noteholders or Couponholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof and the Trustee shall not be entitled to require, nor shall any Noteholder or Couponholder be entitled to claim, from the Issuer, the Trustee or any other person any indemnification or payment in respect of any tax consequence of any such exercise upon individual Noteholders or Couponholders except to the extent already provided for in Condition 7 and/or any undertaking given in addition to, or in substitution for, Condition 7 pursuant to the Trust Deed.

13.5 Notification to the Noteholders

Any modification, abrogation, waiver, authorisation or determination shall be binding on the Noteholders and the Couponholders and, unless the Trustee agrees otherwise, any modification or substitution shall be notified by the Issuer to the Noteholders as soon as practicable thereafter in accordance with Condition 12.

14. INDEMNIFICATION OF THE TRUSTEE AND ITS CONTRACTING WITH THE ISSUER

14.1 Indemnification of the Trustee

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility, including provisions relieving it from taking action unless indemnified and/or secured to its satisfaction.

14.2 Trustee Contracting with the Issuer

The Trust Deed also contains provisions pursuant to which the Trustee is entitled, *inter alia*, (a) to enter into business transactions with the Issuer and/or any of the Issuer's Subsidiaries and to act as trustee for the holders of any other securities issued or guaranteed by, or relating to, the Issuer and/or any of the Issuer's Subsidiaries, (b) to exercise and enforce its rights, comply with its obligations and perform its duties under or in relation to any such transactions or, as the case may be, any such trusteeship without regard to the interests of, or consequences for, the Noteholders or Couponholders, and (c) to retain and not be liable to account for any profit made or any other amount or benefit received thereby or in connection therewith.

15. FURTHER ISSUES

The Issuer shall be at liberty from time to time (but subject always to the provisions of these Conditions and the Trust Deed) without the consent of the Noteholders or Couponholders to create and issue further notes ranking *pari passu* in all respects (or in all respects save for the issue price and the first payment of interest thereon), and so that the same shall be consolidated and form a single series, with the Notes.

16. GOVERNING LAW AND SUBMISSION TO JURISDICTION

16.1 Governing Law

The Trust Deed, the Notes and the Coupons are governed by, and will be construed in accordance with English law.

16.2 Jurisdiction of English Courts

The Issuer has, in the Trust Deed, irrevocably agreed for the benefit of the Trustee, the Noteholders and the Couponholders that the courts of England are to have exclusive jurisdiction to settle any disputes which may arise out of or in connection with the Trust Deed, the Notes or the Coupons and accordingly has submitted to the exclusive jurisdiction of the English courts. The Issuer has, in the Trust Deed, waived any objection to the courts of England on the grounds that they are an inconvenient or inappropriate forum.

The Trustee, the Noteholders and the Couponholders may take any suit, action or proceeding arising out of or in connection with the Trust Deed, the Notes or the Coupons respectively (together referred to as **Proceedings**) against the Issuer in any other court of competent jurisdiction and concurrent Proceedings in any number of jurisdictions.

16.3 Appointment of Process Agent

The Issuer has, in the Trust Deed, irrevocably and unconditionally appointed Fleetside Legal Representative Services Limited of 9 Cheapside, London EC2V 6AD as its agent for service of process in England in respect of any Proceedings and has undertaken that in the event of such agent ceasing so to act it will appoint such other person as the Trustee may approve as its agent for that purpose.

17. RIGHTS OF THIRD PARTIES

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Note, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

CONDITIONS OF THE B NOTES

The following is the text of the Conditions of the B Notes which will be endorsed on each Note in definitive form (if issued):

The €600,000,000 4.25 per cent. Notes due 2014 (the **Notes**, which expression shall in these Conditions, unless the context otherwise requires, include any further notes issued pursuant to Condition 15 and forming a single series with the Notes) of T.E.R.NA. – Trasmissione Elettricità Rete Nazionale S.p.A. (the **Issuer**) are constituted by a Trust Deed dated 28th October, 2004 (the **Trust Deed**) made between the Issuer and J. P. Morgan Corporate Trustee Services Limited (the **Trustee**, which expression shall include its successor(s)) as trustee for the holders of the Notes (the **Noteholders**) and the holders of the interest coupons appertaining to the Notes (the **Couponholders** and the **Coupons** respectively).

The statements in these Conditions include summaries of, and are subject to, the detailed provisions of and definitions in the Trust Deed. Copies of the Trust Deed and the Agency Agreement dated 28th October, 2004 (the **Agency Agreement**) made between the Issuer, the initial paying agents named therein (together with any successor or additional paying agent, the **Paying Agents**) and the Trustee are available for inspection during normal business hours at the registered office for the time being of the Trustee, being at the date of issue of the Notes at Trinity Tower, 9 Thomas More Street, London E1W 1YT and at the specified office of each of the Paying Agents. The Noteholders and the Couponholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and the Agency Agreement applicable to them.

1. FORM, DENOMINATION AND TITLE

1.1 Form and Denomination

The Notes are in bearer form, serially numbered, in the denomination of €50,000 and integral multiples of €1,000 above €50,000, each with Coupons attached on issue. In the event that definitive Notes are issued and the Notes are listed on the Luxembourg Stock Exchange, the Issuer will advise the Luxembourg Stock Exchange of the denominations in which they are issued.

1.2 Title

Title to the Notes and to the Coupons will pass by delivery.

1.3 Holder Absolute Owner

The Issuer, any Paying Agent and the Trustee may (to the fullest extent permitted by applicable laws) deem and treat the bearer of any Note or Coupon as the absolute owner for all purposes (whether or not the Note or Coupon shall be overdue and notwithstanding any notice of ownership or writing on the Note or Coupon or any notice of previous loss or theft of the Note or Coupon or of any trust or interest therein) and shall not be required to obtain any proof thereof or as to the identity of such bearer.

2. STATUS

The Notes and the Coupons are direct, unconditional and (subject to the provisions of Condition 3) unsecured obligations of the Issuer and (subject as provided above) rank and will rank *pari passu*, without any preference among themselves, with all other outstanding unsecured and unsubordinated obligations of the Issuer, present and future (save for such obligations as may be preferred by mandatory provisions of law) but, in the event of insolvency, only to the extent permitted by applicable laws relating to creditors' rights.

3. NEGATIVE PLEDGE

So long as any of the Notes remains outstanding (as defined in the Trust Deed), the Issuer will not, and will ensure that none of its Material Subsidiaries will, create or permit to subsist any Security upon the whole or any part of its assets or revenues, present or future, to secure any Indebtedness, except for Permitted Encumbrances, unless:

- (a) the same Security shall forthwith be extended equally and rateably to the Notes and the Coupons to the satisfaction of the Trustee; or
- (b) such other Security or guarantee (or other arrangement) as (i) the Trustee in its absolute discretion deems not materially less beneficial to the interests of the Noteholders or (ii) shall be approved by an Extraordinary Resolution of the Noteholders, shall previously have been or shall forthwith be extended equally and rateably to the Notes and the Coupons.

As used herein:

Group means the Issuer and its Subsidiaries;

Indebtedness means any present or future indebtedness for borrowed money which is in the form of, or represented by, bonds, notes, debentures or other securities and which is or are intended to be quoted, listed or ordinarily dealt in on any stock exchange, over-the-counter or regulated securities market;

Material Subsidiary means any consolidated Subsidiary of the Issuer:

- (a) whose total assets (consolidated in the case of a Subsidiary which itself has Subsidiaries) represent not less than 10 per cent. of the consolidated total assets of the Issuer and its Subsidiaries taken as a whole, as calculated respectively by reference to the then latest audited accounts (consolidated or, as the case may be, unconsolidated) of the Subsidiary and the then latest audited consolidated accounts of the Issuer and its Subsidiaries, or
- (b) to which is transferred the whole or substantially the whole of the undertaking and assets of a Subsidiary of the Issuer which immediately before the transfer is a Material Subsidiary of the Issuer.

A report by two Directors of the Issuer whether or not addressed to the Trustee that in their opinion a Subsidiary of the Issuer is or is not or was or was not at any particular time or throughout any specified period a Material Subsidiary may be relied upon by the Trustee without further enquiry or evidence and, if relied upon by the Trustee, shall, in the absence of manifest or (to the satisfaction of the Trustee) proven error, be conclusive and binding on all parties;

Permitted Encumbrances means:

- (a) any Security arising pursuant to any mandatory provision of law other than as a result of any action taken by the Issuer; or
- (b) any Security in existence as at the date of issuance of the Notes; or
- (c) in the case of any entity which becomes a Subsidiary of any member of the Group after the date of issuance of the Notes, any Security existing over such entity's assets at the time it becomes such a Subsidiary, provided that the Security was not created in contemplation of, or in connection with, it becoming a Subsidiary and the amounts secured have not been increased in contemplation of, or in connection with, such acquisitions; or
- (d) any Security securing Project Finance Indebtedness; or
- (e) any Security which is created in connection with, or pursuant to, a limited-recourse financing, securitisation or other like arrangement where the payment obligations in respect of the indebtedness secured by the relevant Security are to be discharged solely from the revenues

generated by the assets over which such Security is created (including, without limitation, receivables) provided that the aggregate book value of the assets over which such Security is created shall not exceed €400,000,000 or, if greater, 10 per cent. of the consolidated net worth of the Group; or

- (f) any Security created after the date of issue of the Notes on any asset acquired by the person creating the Security and securing only Indebtedness incurred for the sole purpose of financing or re-financing that acquisition provided that the principal amount of such Indebtedness so secured does not exceed the overall cost of that acquisition.

Person means any individual, company, corporation, firm, partnership, joint venture, association, organisation, state or agency of a state or other entity, whether or not having separate legal personality;

Project Finance Indebtedness means any present or future Indebtedness incurred in financing the ownership, acquisition, construction, development, leasing, maintenance and/or operation of an asset or assets, whether or not an asset of a member of the Group:

- (a) which is incurred by a Project Finance Subsidiary; or
- (b) in respect of which the Person or Persons to whom any such Indebtedness is or may be owed by the relevant borrower (whether or not a member of the Group) has or have no recourse whatsoever to any member of the Group (other than a Project Finance Subsidiary) for the repayment thereof other than:
 - (i) recourse for amounts limited to the cash flow or the net cash flow (other than historic cash flow or historic net cash flow) from such asset or assets or the income or other proceeds deriving therefrom; and/or
 - (ii) recourse for the purpose only of enabling amounts to be claimed in respect of such Indebtedness in an enforcement of any Security given by such borrower over such asset or assets or the income, cash flow or other proceeds, deriving therefrom (or given by any shareholder or the like in the borrower over its shares or the like in the capital of the borrower) to secure such Indebtedness,

provided that (a) the extent of such recourse is limited solely to the amount of any recoveries made on any such enforcement, and (b) such Person or Persons is/are not entitled, by virtue of any right or claim arising out of or in connection with such Indebtedness, to commence any proceedings of whatever nature against any member of the Group (other than a Project Finance Subsidiary).

Project Finance Subsidiary means any Subsidiary of the Issuer either:

- (a)
 - (i) which is a single purpose company whose principal assets and business are constituted by the ownership, acquisition, construction, development, leasing, maintenance and/or operation of an asset or assets; and
 - (ii) none of whose Indebtedness in respect of the financing of such ownership, acquisition, construction, development, leasing, maintenance and/or operation of an asset or assets is subject to any recourse whatsoever to any member of the Group (other than such Subsidiary or another Project Finance Subsidiary) in respect of the repayment thereof, except as expressly referred to in sub-paragraph (ii) of the definition of Project Finance Indebtedness; or
- (b) at least 70 per cent. in principal amount of whose Indebtedness is Project Finance Indebtedness.

Security means any mortgage, lien, pledge, charge or other security interest;

Subsidiary means, in respect of any Person (the **first Person**) at any particular time, any other Person (the **second Person**):

- (i) whose majority of votes in ordinary shareholders' meetings of the second Person is held by the first Person; or
- (ii) in which the first Person holds a sufficient number of votes giving the first Person a dominant influence in ordinary shareholders' meetings of the second Person; or
- (iii) whose accounts are required to be consolidated with those of the First Person pursuant to article 26 of Law 127 of 1991;

(in the case of (i) and (ii) pursuant to the provisions of Article 2359, first paragraph, no. 1 and no. 2, of the Italian Civil Code).

4. INTEREST

4.1 Interest Rate and Interest Payment Dates

The Notes bear interest from and including 28th October, 2004 at the rate of 4.25 per cent. per annum, payable annually in arrear on 28th October (each an **Interest Payment Date**). The first payment (representing a full year's interest) and amounting to €42.50 per €1,000 principal amount of Notes) shall be made on 28th October, 2005.

4.2 Interest Accrual

Each Note will cease to bear interest from and including its due date for redemption unless, upon due presentation, payment of the principal in respect of the Note is improperly withheld or refused or unless default is otherwise made in respect of payment, in which event interest shall continue to accrue as provided in the Trust Deed.

4.3 Calculation of Broken Interest

When interest is required to be calculated in respect of a period of less than a full year, it shall be calculated on the basis of (a) the actual number of days in the period from and including the date from which interest begins to accrue (the **Accrual Date**) to but excluding the date on which it falls due divided by (b) the actual number of days from and including the Accrual Date to but excluding the next following Interest Payment Date.

5. PAYMENTS

5.1 Payments in respect of Notes

Payments of principal and interest in respect of each Note will be made against presentation and surrender (or, in the case of part payment only, endorsement) of the Note, except that payments of interest due on an Interest Payment Date will be made against presentation and surrender (or, in the case of part payment only, endorsement) of the relevant Coupon, in each case at the specified office outside the United States of any of the Paying Agents.

5.2 Method of Payment

Payments will be made by credit or transfer to a euro account (or any other account to which euro may be credited or transferred) specified by the payee or, at the option of the payee, by euro cheque.

5.3 Missing Unmatured Coupons

Each Note should be presented for payment together with all relative unmatured Coupons, failing which the full amount of any relative missing unmatured Coupon (or, in the case of payment not being made in full, that proportion of the full amount of the missing unmatured Coupon which the amount so paid bears to the total amount due) will be deducted from the amount due for payment. Each amount so deducted will be paid in the manner mentioned above against presentation and surrender

(or, in the case of part payment only, endorsement) of the relative missing Coupon at any time before the expiry of 10 years after the Relevant Date (as defined in Condition 7) in respect of the relevant Note (whether or not the Coupon would otherwise have become void pursuant to Condition 8) but not thereafter.

5.4 Payments subject to Applicable Laws

Payments in respect of principal and interest on the Notes are subject in all cases to any fiscal or other laws and regulations applicable in the place of payment, but without prejudice to the provisions of Condition 7.

5.5 Payment only on a Presentation Date

A holder shall be entitled to present a Note or Coupon for payment only on a Presentation Date and shall not, except as provided in Condition 4, be entitled to any further interest or other payment if a Presentation Date is after the due date.

Presentation Date means a day which (subject to Condition 8):

- (a) is or falls after the relevant due date;
- (b) is a Business Day in the place of the specified office of the Paying Agent at which the Note or Coupon is presented for payment; and
- (c) in the case of payment by credit or transfer to a euro account as referred to above, is a TARGET Settlement Day.

In this Condition, **Business Day** means, in relation to any place, a day on which commercial banks and foreign exchange markets settle payments and are open for general business (including dealing in foreign exchange and foreign currency deposits) in that place and **TARGET Settlement Day** means any day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) system is open.

5.6 Initial Paying Agents

The names of the initial Paying Agents and their initial specified offices are set out at the end of these Conditions. The Issuer reserves the right, subject to the prior written approval of the Trustee, at any time to vary or terminate the appointment of any Paying Agent and to appoint additional or other Paying Agents provided that:

- (a) there will at all times be a Principal Paying Agent;
- (b) there will at all times be at least one Paying Agent (which may be the Principal Paying Agent) having its specified office in a European city outside the Republic of Italy (**Italy**) which so long as the Notes are listed on the Luxembourg Stock Exchange shall be Luxembourg; and
- (c) the Issuer undertakes that it will ensure that it maintains a Paying Agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26th-27th November, 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive.

Notice of any termination or appointment and of any changes in specified offices will be given to the Noteholders promptly by the Issuer in accordance with Condition 11.

6. REDEMPTION AND PURCHASE

6.1 Redemption at Maturity

Unless previously redeemed or purchased and cancelled as provided below, the Issuer will redeem the Notes at their principal amount on 28th October, 2014.

6.2 Redemption for Taxation Reasons

If the Issuer satisfies the Trustee immediately before the giving of the notice referred to below that:

- (a) as a result of any change in, or amendment to, the laws or regulations of a Relevant Jurisdiction (as defined in Condition 7), or any change in the application or official interpretation of the laws or regulations of a Relevant Jurisdiction, which change or amendment becomes effective after 26th October, 2004, on the next Interest Payment Date the Issuer would be required to pay additional amounts as provided or referred to in Condition 7; and
- (b) the requirement cannot be avoided by the Issuer taking reasonable measures available to it,

the Issuer may at its option, having given not less than 30 nor more than 60 days' notice to the Noteholders in accordance with Condition 12 (which notice shall be irrevocable), redeem all the Notes, but not some only, at any time at their principal amount together with interest accrued to but excluding the date of redemption, provided that no such notice of redemption shall be given earlier than 90 days prior to the earliest date on which the Issuer would be required to pay such additional amounts, were a payment in respect of the Notes then due. Prior to the publication of any notice of redemption pursuant to this paragraph, the Issuer shall deliver to the Trustee a certificate signed by two Authorised Officers (as defined in the Trust Deed) of the Issuer stating that the requirement referred to in (a) above will apply on the next Interest Payment Date and cannot be avoided by the Issuer taking reasonable measures available to it and an opinion of independent legal advisers of recognised standing to the effect that the Issuer has or will become required to pay such additional amounts as a result of the change or amendment and the Trustee shall be entitled to accept such certificate and opinion as sufficient evidence of the satisfaction of the conditions precedent set out above, in which event they shall be conclusive and binding on the Noteholders and the Couponholders.

6.3 Purchases

The Issuer or any of its Subsidiaries (as defined above) may at any time purchase Notes (provided that all unmatured Coupons appertaining to the Notes are purchased with the Notes) in any manner and at any price. If purchases are made by tender, tenders must be available to all Noteholders alike.

6.4 Cancellations

All Notes which are (a) redeemed or (b) purchased by or on behalf of the Issuer or any of its Subsidiaries will forthwith be cancelled, together with all relative unmatured Coupons attached to the Notes or surrendered with the Notes, and accordingly may not be held, reissued or resold.

6.5 Notices Final

Upon the expiry of any notice as is referred to in paragraph 6.2 above the Issuer shall be bound to redeem the Notes to which the notice refers in accordance with the terms of such paragraph.

7. TAXATION

7.1 Payment without Withholding

All payments in respect of the Notes by or on behalf of the Issuer shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental

charges of whatever nature (**Taxes**) imposed or levied by or on behalf of the Relevant Jurisdiction, unless the withholding or deduction of the Taxes is required by law. In that event, the Issuer will pay such additional amounts as may be necessary in order that the net amounts received by the Noteholders and Couponholders after the withholding or deduction shall equal the respective amounts which would have been receivable in respect of the Notes or, as the case may be, Coupons in the absence of the withholding or deduction; except that no additional amounts shall be payable in relation to any payment in respect of any Note or Coupon:

- (a) presented for payment by, or on behalf of, a holder who is liable for such Taxes in respect of the Note or Coupon by reason of his having some connection with the Relevant Jurisdiction other than the mere holding of the Note or Coupon; or
- (b) presented for payment by, or on behalf of, a holder who would be able to avoid such withholding or deduction by making a declaration or any other statement, including but not limited to a declaration of residence or non-residence, but fails to do so; or
- (c) presented for payment by, or on behalf of, a holder who would be able to avoid such withholding or deduction by presenting the relevant Note and/or Coupon to another Paying Agent in a Member State of the European Union, but fails to do so; or
- (d) presented for payment more than 30 days after the Relevant Date (as defined below) except to the extent that a holder thereof would have been entitled to an additional amount on presenting the same for payment on such thirtieth day assuming that day to have been a Presentation Date (as defined in Condition 5); or
- (e) where such withholding or deduction is imposed on a payment to an individual resident outside Italy and is required to be made pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the ECOFIN Council meeting of 26th-27th November, 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, such Directive; or
- (f) on account of *imposta sostitutiva* pursuant to Italian Legislative Decree No. 239 of 1st April, 1996 (**Legislative Decree No. 239**) and any related implementing regulations as in force on the date of the issue of the Notes in all circumstances in which the procedures set forth in Legislative Decree No. 239 have not been met or complied with, except where such procedures have not been met or complied with due to the actions or omissions of the Issuer or its agents; or
- (g) in the event of payment to a non-Italian resident legal entity or a non-Italian resident individual, to the extent that interest or other amounts are paid to a non-Italian resident legal entity or a non-Italian resident individual which is resident in a country which does not allow for a satisfactory exchange of information with Italy.

7.2 Interpretation

In these Conditions:

- (a) **Relevant Date** means the date on which the payment first becomes due but, if the full amount of the money payable has not been received by the Principal Paying Agent or the Trustee on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect has been duly given to the Noteholders by the Issuer in accordance with Condition 12; and
- (b) **Relevant Jurisdiction** means Italy or any political subdivision or any authority thereof or therein having power to tax or any other jurisdiction or any political subdivision or any authority thereof or therein having power to tax to which the Issuer becomes subject in respect of payments made by it of principal and interest on the Notes and Coupons.

7.3 Additional Amounts

Any reference in these Conditions to any amounts in respect of the Notes shall be deemed also to refer to any additional amounts which may be payable under this Condition or under any undertakings given in addition to, or in substitution for, this Condition pursuant to the Trust Deed.

8. PRESCRIPTION

Claims for payment in respect of a Note or Coupon will become void unless presentation for payment is made within a period of 10 years (in the case of principal) and five years (in the case of interest) from the Relevant Date in respect of the Notes or, as the case may be, the Coupon, subject to the provisions of Condition 5.

9. EVENTS OF DEFAULT

The Trustee at its discretion may, and if so requested in writing by the holders of at least one-fifth in principal amount of the Notes then outstanding or if so directed by an Extraordinary Resolution of the Noteholders shall (subject in each case to being indemnified and/or secured to its satisfaction), (but, in the case of the happening of any of the events described in subparagraphs (c) and (e) to (h) inclusive, only if the Trustee shall have certified in writing to the Issuer that such event is, in its opinion, materially prejudicial to the interests of the Noteholders) give notice to the Issuer that the Notes are, and they shall accordingly forthwith become, immediately due and repayable at their principal amount, together with accrued interest as provided in the Trust Deed, in any of the following events (**Events of Default**):

- (a) if default is made for a period of 10 days or more in the payment of principal of or any interest in respect of the Notes or any of them after the due date thereof; or
- (b) if the Issuer shall be adjudicated or becomes insolvent or shall stop payment or announce that it shall stop payment or shall be found unable to pay all or substantially all of its debts, or any order shall be made by any competent court or other competent body for, or any resolution shall be passed by the Issuer for judicial composition proceedings with its creditors or for the appointment of a receiver, administrative receiver or trustee or other similar official in insolvency proceedings in relation to the Issuer; or
- (c) if the Issuer fails to pay a final judgment (*sentenza passata in giudicato*, in the case of a judgment issued by an Italian court) of a court of competent jurisdiction within 60 days from the receipt of a notice that a final judgment in excess of an amount equal to the value of a substantial part of the assets or property of the Issuer has been entered against it or an execution is levied, enforced upon or sued out against any substantial part of the assets or property of the Issuer pursuant to any such judgment; or
- (d) if the Issuer shall be wound up or dissolved (otherwise than for the purpose of a solvent amalgamation, merger, de-merger or reconstruction (a **Solvent Reorganisation**) (i) to be adopted or implemented pursuant to any mandatory provisions of law or (ii) on terms approved in writing by the Trustee or by an Extraordinary Resolution of the Noteholders, and (in the case of (i) and (ii)) under which the assets and liabilities of the Issuer are assumed by the entity resulting from such Solvent Reorganisation and such entity assumes all the obligations of the Issuer in respect of the Notes, the Coupons and the Trust Deed and an opinion of an independent legal adviser of recognised standing in Italy has been delivered to the Trustee confirming the same prior to the effective date of such Solvent Reorganisation); or
- (e) if the Issuer shall cease or announce that it shall cease to carry on all or substantially all of its business or shall dispose of all or substantially all of its assets (in each case otherwise than for the purpose of a Solvent Reorganisation (i) to be adopted or implemented pursuant to any mandatory provisions of law or (ii) on terms approved in writing by the Trustee or by an Extraordinary Resolution of the Noteholders, and (in the case of (i) and (ii)) under which the

assets and liabilities of the Issuer are assumed by the entity resulting from such Solvent Reorganisation and such entity assumes all the obligations of the Issuer in respect of the Notes, the Coupons and the Trust Deed and an opinion of an independent legal adviser of recognised standing in Italy has been delivered to the Trustee confirming the same prior to the effective date of such Solvent Reorganisation); or

- (f) if any Indebtedness for Borrowed Money of the Issuer becomes due and repayable prematurely by reason of an event of default (however described), or the Issuer fails to make any payment in respect of any Indebtedness for Borrowed Money on the due date for payment (as extended by any originally applicable grace period) or default is made by the Issuer in making any payment due under any guarantee and/or indemnity given by it in relation to any Indebtedness for Borrowed Money of any other person (as extended by any originally applicable grace period), provided that no such event shall constitute an Event of Default so long as and to the extent that the Issuer is contesting, in good faith, in a competent court in a recognised jurisdiction or before a competent arbitration panel that the relevant Indebtedness for Borrowed Money or any such guarantee and/or indemnity shall be due or enforceable, as appropriate, and provided further that no such event shall constitute an Event of Default unless the aggregate Indebtedness for Borrowed Money relating to all such events which shall have occurred and be continuing shall exceed €20,000,000 (or its equivalent in any other currency); or
- (g) any Security (other than any Security securing Project Finance Indebtedness), present or future, created or assumed on or against all or a material part of the property, assets or revenues of the Issuer, becomes enforceable and any step is taken to enforce it (including the taking of possession or the appointment of a receiver, manager or other similar person), which is not discharged within 30 days of such enforcement; or
- (h) if the Issuer fails to perform or observe any of its other obligations under these Conditions or the Trust Deed and (except in any case where the Trustee considers the failure to be incapable of remedy, when no continuation or notice as is hereinafter mentioned will be required) the failure continues for the period of 30 days (or such longer period as the Trustee may permit) following the service by the Trustee on the Issuer of notice requiring the same to be remedied.

For the purposes of this Condition:

Indebtedness for Borrowed Money means any present or future indebtedness (whether being principal, premium, interest or other amounts) for or in respect of (i) money borrowed, (ii) liabilities under or in respect of any acceptance or acceptance credit or (iii) any notes, bonds, debentures, debenture stock, loan stock or other securities offered, issued or distributed whether by way of public offer, private placing, acquisition consideration or otherwise and whether issued for cash or in whole or in part for a consideration other than cash.

10. ENFORCEMENT

10.1 Enforcement by the Trustee

The Trustee may at any time, at its discretion and without notice, take such proceedings against the Issuer as it may think fit to enforce the provisions of the Trust Deed, the Notes and the Coupons, but it shall not be bound to take any such proceedings or any other action in relation to the Trust Deed, the Notes or the Coupons unless (a) it has been so directed by an Extraordinary Resolution of the Noteholders or so requested in writing by the holders of at least one-fifth in principal amount of the Notes then outstanding and (b) it has been indemnified and/or secured to its satisfaction.

10.2 Enforcement by the Noteholders

No Noteholder or Couponholder shall be entitled to proceed directly against the Issuer unless the Trustee, having become bound so to proceed, fails so to do within a reasonable period and the failure shall be continuing.

11. REPLACEMENT OF NOTES AND COUPONS

Should any Note or Coupon be lost, stolen, mutilated, defaced or destroyed it may be replaced at the specified office of the Principal Paying Agent or the Paying Agent in Luxembourg upon payment by the claimant of the expenses incurred in connection with the replacement and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Notes or Coupons must be surrendered before replacements will be issued.

12. NOTICES

All notices to the Noteholders will be valid if published in a leading English language daily newspaper published in London or such other English language daily newspaper with general circulation in Europe as the Trustee may approve and, so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of that exchange so require, in one leading newspaper of general circulation in Luxembourg. It is expected that publication will normally be made in the *Financial Times* and the *Luxemburger Wort* or the *Tageblatt*. The Issuer shall also ensure that notices are duly published in a manner which complies with the rules and regulations of any stock exchange or other relevant authority on which the Notes are for the time being listed. Any such notice will be deemed to have been given on the date of the first publication or, where required to be published in more than one newspaper, on the date of the first publication in all required newspapers. If publication as provided above is not practicable, notice will be given in such other manner, and shall be deemed to have been given on such date, as the Trustee may approve. Couponholders will be deemed for all purposes to have notice of the contents of any notice given to the Noteholders in accordance with this paragraph.

13. MEETINGS OF NOTEHOLDERS, MODIFICATION, WAIVER, AUTHORISATION AND DETERMINATION

13.1 Meetings of Noteholders

The Trust Deed contains provisions for convening meetings of the Noteholders to consider any matter affecting their interests, including the modification or abrogation by Extraordinary Resolution of any of these Conditions or any of the provisions of the Trust Deed. The directors of the Issuer and/or the Noteholders' Representative (as defined below) at their discretion may, and if so requested in writing by the holders of at least 5 per cent. in principal amount of the Notes for the time being outstanding shall, convene a meeting. To be validly held, each such meeting must be quorate which shall mean (i) in the case of a first meeting, there are one or more persons present being or representing Noteholders holding at least one half in aggregate principal amount of the Notes for the time being outstanding, (ii) in the case of an adjourned meeting, there are one or more persons present being or representing Noteholders holding more than one third in aggregate principal amount of the Notes for the time being outstanding and (iii) in the case of a further adjourned meeting, there are one or more persons present being or representing Noteholders holding at least one fifth in aggregate principal amount of the Notes for the time being outstanding. The majority required to pass an Extraordinary Resolution at any meeting (including any adjourned meeting) will be one or more persons holding or representing at least two thirds in aggregate principal amount of the Notes represented at the meeting; provided, however, that certain proposals, as set out in Article 2415 of the Italian Civil Code (including any proposal to modify the maturity of the Notes or the dates on which interest is payable on them; to reduce or cancel the principal amount of, or interest on, the Notes; or to change the currency of payment of the Notes) may only be sanctioned by an Extraordinary Resolution passed at a meeting of Noteholders (including any adjourned meeting) by one or more persons holding or representing not less than one half in aggregate principal amount of the Notes for the time being outstanding. Any Extraordinary Resolution duly passed at any such meeting shall be binding on all the Noteholders, whether present or not and on all Couponholders.

13.2 Noteholders' Representative

A representative of the Noteholders (*rappresentante comune*) (the **Noteholders' Representative**) (who might, subject to the mandatory provisions of Italian law, also be the same legal entity as the Trustee) may be appointed pursuant to Article 2417 of the Italian Civil Code in order to represent the Noteholders' interests under these Conditions and to give effect to resolutions passed at a meeting of the Noteholders. If the Noteholders' Representative is not appointed by a meeting of such Noteholders, the Noteholders' Representative shall be appointed by a decree of the President of the Court where the Issuer has its registered office at the request of one or more Noteholders or at the request of the directors of the Issuer. The Noteholders' Representative shall remain appointed for a maximum period of three years but may be re-appointed again thereafter.

13.3 Modification, Waiver, Authorisation and Determination

The Trustee may agree, without the consent of the Noteholders or Couponholders, to any modification of, or to the waiver or authorisation of any breach or proposed breach of, any of these Conditions or any of the provisions of the Trust Deed, or determine, without any such consent as aforesaid, that any Event of Default or Potential Event of Default (as defined in the Trust Deed) shall not be treated as such (provided that, in any such case, it is not, in the opinion of the Trustee, materially prejudicial to the interests of the Noteholders or may agree, without any such consent as aforesaid, to any modification which is of a formal, minor or technical nature or to correct a manifest or (to the satisfaction of the Trustee) proven error.

13.4 Trustee to have Regard to Interests of Noteholders as a Class

In connection with the exercise by it of any of its trusts, powers, authorities and discretions (including, without limitation, any modification, waiver, authorisation or determination), the Trustee shall have regard to the general interests of the Noteholders as a class but shall not have regard to any interests arising from circumstances particular to individual Noteholders or Couponholders (whatever their number) and, in particular but without limitation, shall not have regard to the consequences of any such exercise for individual Noteholders or Couponholders (whatever their number) resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory or any political sub-division thereof and the Trustee shall not be entitled to require, nor shall any Noteholder or Couponholder be entitled to claim, from the Issuer, the Trustee or any other person any indemnification or payment in respect of any tax consequence of any such exercise upon individual Noteholders or Couponholders except to the extent already provided for in Condition 7 and/or any undertaking given in addition to, or in substitution for, Condition 7 pursuant to the Trust Deed.

13.5 Notification to the Noteholders

Any modification, abrogation, waiver, authorisation or determination shall be binding on the Noteholders and the Couponholders and, unless the Trustee agrees otherwise, any modification or substitution shall be notified by the Issuer to the Noteholders as soon as practicable thereafter in accordance with Condition 12.

14. INDEMNIFICATION OF THE TRUSTEE AND ITS CONTRACTING WITH THE ISSUER

14.1 Indemnification of the Trustee

The Trust Deed contains provisions for the indemnification of the Trustee and for its relief from responsibility, including provisions relieving it from taking action unless indemnified and/or secured to its satisfaction.

14.2 Trustee Contracting with the Issuer

The Trust Deed also contains provisions pursuant to which the Trustee is entitled, *inter alia*, (a) to enter into business transactions with the Issuer and/or any of the Issuer's Subsidiaries and to act as trustee for the holders of any other securities issued or guaranteed by, or relating to, the Issuer and/or any of the Issuer's Subsidiaries, (b) to exercise and enforce its rights, comply with its obligations and perform its duties under or in relation to any such transactions or, as the case may be, any such trusteeship without regard to the interests of, or consequences for, the Noteholders or Couponholders, and (c) to retain and not be liable to account for any profit made or any other amount or benefit received thereby or in connection therewith.

15. FURTHER ISSUES

The Issuer shall be at liberty from time to time (but subject always to the provisions of these Conditions and the Trust Deed) without the consent of the Noteholders or Couponholders to create and issue further notes ranking *pari passu* in all respects (or in all respects save for the issue price and the first payment of interest thereon), and so that the same shall be consolidated and form a single series, with the Notes.

16. GOVERNING LAW AND SUBMISSION TO JURISDICTION

16.1 Governing Law

The Trust Deed, the Notes and the Coupons are governed by, and will be construed in accordance with English law.

16.2 Jurisdiction of English Courts

The Issuer has, in the Trust Deed, irrevocably agreed for the benefit of the Trustee, the Noteholders and the Couponholders that the courts of England are to have exclusive jurisdiction to settle any disputes which may arise out of or in connection with the Trust Deed, the Notes or the Coupons and accordingly has submitted to the exclusive jurisdiction of the English courts. The Issuer has, in the Trust Deed, waived any objection to the courts of England on the grounds that they are an inconvenient or inappropriate forum.

The Trustee, the Noteholders and the Couponholders may take any suit, action or proceeding arising out of or in connection with the Trust Deed, the Notes or the Coupons respectively (together referred to as **Proceedings**) against the Issuer in any other court of competent jurisdiction and concurrent Proceedings in any number of jurisdictions.

16.3 Appointment of Process Agent

The Issuer has, in the Trust Deed, irrevocably and unconditionally appointed Fleetside Legal Representative Services Limited of 9 Cheapside, London EC2V 6AD as its agent for service of process in England in respect of any Proceedings and has undertaken that in the event of such agent ceasing so to act it will appoint such other person as the Trustee may approve as its agent for that purpose.

17. RIGHTS OF THIRD PARTIES

No rights are conferred on any person under the Contracts (Rights of Third Parties) Act 1999 to enforce any term of this Note, but this does not affect any right or remedy of any person which exists or is available apart from that Act.

SUMMARY OF PROVISIONS RELATING TO THE NOTES WHILE REPRESENTED BY THE GLOBAL NOTES

The following is a summary of the provisions to be contained in the Trust Deed relating to the A Notes (the **A Notes Trust Deed**) constituting the A Notes and in the Trust Deed relating to the B Notes (the **B Notes Trust Deed** and, together with the A Notes Trust Deed, the **Trust Deeds**) constituting the B Notes and in the Temporary Global Notes and the Permanent Global Notes (together, the **Global Notes**) which will apply to, and in some cases modify, the Terms and Conditions of the A Notes and the Terms and Conditions of the B Notes while the Notes are represented by the Global Notes.

1. Exchange

Each Permanent Global Note will be exchangeable in whole but not in part (free of charge to the holder) for definitive Notes only:

- (a) upon the happening of any of the events defined in the Trust Deeds as **Events of Default**; or
- (b) if either Euroclear or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or announces an intention permanently to cease business or does in fact do so and no alternative clearing system satisfactory to the Trustee is available; or
- (c) if the Issuer would suffer a disadvantage as a result of a change in laws or regulations (taxation or otherwise) or as a result of a change in the practice of Euroclear and/or Clearstream, Luxembourg which would not be suffered were the Notes in definitive form and a certificate to such effect signed by two Authorised Officers (as defined in the Trust Deed) of the Issuer is given to the Trustee.

Thereupon (in the case of (a) or (b) above), the holder of a Permanent Global Note (acting on the instructions of one or more of the Accountholders (as defined below)) or the Trustee may give notice to the Issuer and (in the case of (c) above) the Issuer may give notice to the Trustee and the Noteholders, of its intention to exchange the Permanent Global Note for definitive Notes on or after the Exchange Date (as defined below).

On or after the Exchange Date the holder of a Permanent Global Note may or, in the case of (c) above, shall surrender the Permanent Global Note to or to the order of the Principal Paying Agent. In exchange for the Permanent Global Note the Issuer will deliver, or procure the delivery of, an equal aggregate principal amount of definitive Notes (having attached to them all Coupons in respect of interest which has not already been paid on the Permanent Global Note), security printed in accordance with any applicable legal and stock exchange requirements and in or substantially in the form set out in the Trust Deeds. On exchange of the Permanent Global Note, the Issuer will procure that it is cancelled and, if the holder so requests, returned to the holder together with any relevant definitive Notes.

For these purposes, **Exchange Date** means a day specified in the notice requiring exchange falling not less than 60 days after that on which such notice is given, being a day on which banks are open for general business in the place in which the specified office of the Principal Paying Agent is located and, except in the case of exchange pursuant to (b) above, in the place in which the relevant clearing system is located.

2. Payments

On and after 7th December, 2004, no payment will be made on either Temporary Global Note unless exchange for an interest in the relevant Permanent Global Note is improperly withheld or refused. Payments of principal and interest in respect of Notes represented by a Global Note will, subject as set out below, be made against presentation for endorsement and, if no further payment falls to be made in respect of the Notes, surrender of such Global Note to the order of the Principal Paying Agent or such other Paying Agent as shall have been notified to the Noteholders for such purposes. A record of each payment made will be endorsed on the appropriate part of the schedule to the relevant Global Note by or on behalf of the Principal Paying Agent, which endorsement shall be *prima facie* evidence that such payment has been made in respect of the Notes. Payments of interest on a Temporary Global Note (if permitted by the first sentence of this

paragraph) will be made only upon certification as to non-U.S. beneficial ownership unless such certification has already been made.

3. Notices

For so long as all of the Notes are represented by a Global Note and such Global Notes are held on behalf of Euroclear and/Clearstream, Luxembourg, notices to Noteholders may be given by delivery of the relevant notice to Euroclear and/or Clearstream, Luxembourg (as the case may be) for communication to the relative Accountholders rather than by publication as required by Condition 11, provided that, so long as the Notes are listed on the Luxembourg Stock Exchange, notice will also be given by publication in a daily newspaper published in Luxembourg if and to the extent that the rules of the Luxembourg Stock Exchange so require. Any such notice shall be deemed to have been given to the Noteholders on the second day after the day on which such notice is delivered to Euroclear and/or Clearstream, Luxembourg (as the case may be) as aforesaid.

Whilst any of the Notes held by a Noteholder are represented by a Global Note, notices to be given by such Noteholder may be given by such Noteholder (where applicable) through Euroclear and/or Clearstream, Luxembourg and otherwise in such manner as the Principal Paying Agent and Euroclear and Clearstream, Luxembourg may approve for this purpose.

4. Accountholders

For so long as all of the Notes are represented by a Global Note and such Global Notes are held on behalf of Euroclear and/or Clearstream, Luxembourg, each person (other than Euroclear or Clearstream, Luxembourg) who is for the time being shown in the records of Euroclear or Clearstream, Luxembourg as the holder of a particular principal amount of Notes (each an **Accountholder**) (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the principal amount of such Notes standing to the account of any person shall be conclusive and binding for all purposes) shall be treated as the holder of that principal amount for all purposes (including but not limited to, for the purposes of any quorum requirements of, or the right to demand a poll at, meetings of the Noteholders and giving notices to the Issuer pursuant to Condition 9) other than with respect to the payment of principal and interest on the principal amount of such Notes, the right to which shall be vested, as against the Issuer and the Trustee, solely in the bearer of the relevant Global Note in accordance with and subject to its terms and the terms of the Trust Deeds. Each Accountholder must look solely to Euroclear or Clearstream, Luxembourg, as the case may be, for its share of each payment made to the bearer of the relevant Global Note.

5. Cancellation

Cancellation of any Note represented by a Global Note and required by the Terms and Conditions of the relevant Notes to be cancelled following its redemption or purchase will be effected by endorsement by or on behalf of the Principal Paying Agent of the reduction in the principal amount of the relevant Global Note on the relevant part of the schedule thereto.

6. Euroclear and Clearstream, Luxembourg

Notes represented by a Global Note are transferable in accordance with the rules and procedures for the time being of Euroclear and Clearstream, Luxembourg, as appropriate. References in the Global Notes and this summary to Euroclear and/or Clearstream, Luxembourg shall be deemed to include references to any other clearing system approved by the Trustee.

7. Denominations and Minimum Trading Amount

The Notes are in the denominations of €50,000 and integral multiples of €1,000 above €50,000. For so long as the Notes are represented by a Global Note and the relevant clearing system(s) so permit, the Notes shall be tradable in such denominations, subject always to the minimum denomination and trading amount of €50,000. There is no assurance, however, that the relevant clearing system(s) will enforce the minimum

trading amount. Definitive Notes (if issued) will be printed in denominations of €50,000 and integral multiples of €1,000 thereafter.

USE OF PROCEEDS

The net proceeds of the issue of the Notes, amounting to approximately €1,392,850,000, after deduction of the combined management and underwriting commission and selling concession, will be applied by the Issuer for general corporate purposes, including the repayment of existing indebtedness with Enel S.p.A.

CAPITALISATION OF THE ISSUER

The following table sets forth the Issuer's total consolidated capitalisation at 31st December, 2003 and 30th June, 2004.

	As of 30th June, 2004 Actual (unaudited)	As of 31st December 2003 Actual (audited)
(millions of euro)		
Cash and cash equivalents, including intercompany pooled funds held by Enel S.p.A. and restricted amounts ⁽¹⁾	31.2	340.0
Short-term debt (including current portion of long-term debt)	1,414.8	8.5
Long-term debt (excluding current portion)	478.7	936.9
Shareholders' equity ⁽²⁾ :		
Ordinary shares	440.0	2,036.1
Reserves	1,329.0	930.3
Total shareholders' equity ⁽³⁾	1,768.8	2,966.4
Total capitalisation	3,662.3	3,911.8

(1) The restricted amounts consist of €6.7 million held in a deposit account in favour of Banco Nacional de Desenvolvimento Economico e Social (**BNDES**) as part of the collateral for the loan from BNDES (and which will be reduced over time as corresponding repayments of principal are made under the BNDES loan).

(2) The authorised share capital of the Issuer is €440,000,000. The issued and outstanding share capital of the Issuer is €440,000,000, fully paid up, divided into 2,000,000,000 ordinary shares of par value €0.22 each. At 31st December, 2003, the share capital of the Issuer was €2,036,100,000 divided into 2,036,100,000 ordinary shares of par value €1.00 each.

(3) Excluding minority interest of €0.2 million.

There has been no material change in the capitalisation of the Issuer since 30th June, 2004.

DESCRIPTION OF THE ISSUER

Overview

T.E.R.N.A. – Trasmissione Elettricità Rete Nazionale S.p.A. (hereinafter, **Terna** or the **Company**) is the principal electricity transmission company in Italy, and is currently 50 per cent. owned by Enel S.p.A. (hereinafter **Enel**). Terna owns a substantial portion of Italy's electricity transmission grid which, according to the Italian Energy Authority's latest estimate of 11th January, 2001, accounts for 94.136 per cent. of Italy's transmission capacity (hereinafter, the **Terna Grid**). As of 30th June, 2004, the Terna Grid consisted of 38,585km of electricity lines, which included five 380kV connections (one of which consists of double-circuit transmission lines), nine 220kV connections, one 200kV DC connection, one 400kV DC connection and 295 substations. Through each of TSN – Transmissora Sudeste Nordeste S.A. (hereinafter **TSN**) and Novatrans Energia S.A. (hereinafter **Novatrans**), both of which the Company acquired from Enelpower S.p.A. (hereinafter **Enelpower**) on 31st December, 2003, the Terna Group holds two 30-year concessions from the Brazilian Energy Authority (both of which expire on 20th December, 2030) for the construction, development and operation and maintenance of 2,328km of 500kV connections and four substations in Brazil (hereinafter, the **Brazilian Subsidiaries Grid**).

Terna's principal business is the operation, maintenance and development of the Terna Grid, based on guidelines and directives of the Italian System Operator, the *Gestore della Rete di Trasmissione Nazionale S.p.A.* (hereinafter the **Italian ISO**) (an entity wholly-owned and controlled by the Ministry of Economy and Finance), which Terna reports in its financial statements as revenues from regulated activities in Italy. The Company also offers certain other (unregulated) services in Italy including: (a) engineering, construction and operation and maintenance services to Enel Group companies and third parties which own or use high and very-high voltage power systems, (b) remote network management and control services and (c) support structure and equipment housing services for the fiberoptic infrastructure of Enel Group companies and third parties in the telecommunications sector. Since 31st December, 2003, the Company has been responsible for the construction, development and operation and maintenance of the Brazilian Subsidiaries Grid, the final portions of which began operations in April and May 2004, respectively.

Terna total consolidated revenues in 2003 were €871.8 million and Terna total pro forma consolidated revenues in 2003 were €918.6 million. In 2003, the annual fees that the Company received for the operation, maintenance and development of the Terna Grid (which is reported as revenue from regulated activities in Italy), accounted for 89.7 per cent. of the total consolidated revenues and 85.2 per cent. of the total pro forma consolidated revenues. In the same year, Terna's other activities in Italy accounted for 7.5 per cent. of the total consolidated revenues and 7.1 per cent. of the total pro forma consolidated revenues. In 2003, 5.1 per cent. of Terna total pro forma consolidated revenues were represented by the *receita anual permitida*, the annual fees Terna receives for the construction, development and operation and maintenance of the Brazilian Subsidiaries Grid.

For the six-month period ended 30th June, 2004, Terna total consolidated revenues were €518,9 million. Terna regulated activities in Italy, other activities in Italy and regulated activities in Brazil accounted for 82.6 per cent., 7.4 per cent. and 10.0 per cent. of this amount, respectively.

History and organisation

The Terna Group operates its Italian businesses through Terna.

In 1999, Enel established Terna as a wholly-owned subsidiary and, later in the same year, Enel transferred to Terna all of its electricity transmission systems and assets that formed the Terna Grid (as it then existed) while the management and operation of the national electricity transmission grid were entrusted to the Italian ISO pursuant to Legislative Decree n. 79 dated 16th March, 1999 (hereinafter the **Bersani Decree**). The Bersani Decree required the separation of the ownership and management of the national transmission grid.

This structure will change significantly in the near future as a result of the recent Law 290/03, as amended by Law 239/04, and the implementing measures of the Decree of the President of the Council of Ministers published on 18th May, 2004 (hereinafter the **DPCM**). Law 290/03 and the DPCM require the integration

of the ownership and management of the Italian grid and place certain restrictions on the ownership of the entity resulting from the integration as well as certain voting rights of the shareholders of the resulting entity. See “Regulatory Matters—Changes to present regulation and future impact—DPCM”.

On 31st December, 2003, Terna acquired from Enelpower 99.74 per cent. of the issued and outstanding shares of TSN and all of the issued and outstanding shares of Novatrans.

TSN and Novatrans, which were established in Brazil on 11th October, 2000 and 18th October, 2000, respectively, have registered offices in Rio de Janeiro, Brazil, and are responsible for the construction, development, operation and maintenance of the part of the Brazilian Subsidiaries Grid for which each has been granted a 30-year concession by the Brazilian Energy Authority.

In order to achieve a more efficient management of Terna’s financial structure, on 29th April, 2004, Terna’s share capital was reduced, pursuant to Article 2445 of the Italian Civil Code, from €2,036.1 million to €440.0 million by means of (i) a return of capital in the amount of €1,200.0 million, (ii) the allocation of €396.1 million to “Other reserves” and (iii) the reduction of the par value of each ordinary share from €1.00 to €0.22.

As a result of the 23rd June, 2004 initial public offering of Terna ordinary shares to retail investors in Italy and a private placement with certain institutional investors in accordance with Rule 144A and Regulation S under the United States Securities Act of 1933, as amended, Enel holds 50 per cent. of the outstanding shares of the Company while the remaining 50 per cent. of Terna is publicly held. Enel, which is controlled by the Ministry of Economy and Finance, is in a position to control Terna and to appoint the majority of its Board of Directors, to influence its dividend policies and management and generally to determine the outcome of any matter put to a vote of its shareholders. Terna is subject to the direction and coordination activity of Enel pursuant to Article 2497 and subsequent provisions of the Italian Civil Code.

As a consequence of Italian laws and regulations providing for the integration of the ownership and management of the Italian transmission grid and imposing certain restrictions on the entity that will own and manage it, Enel is required to reduce its stake in Terna from 50 per cent. to not more than 20 per cent. by 1st July, 2007. Nevertheless Enel formally announced its intention to reduce its interest in Terna from 50 per cent. to as little as 5 per cent. by the end of 2005, market conditions permitting.

On 8th September, 2004, Cassa Depositi e Prestiti indicated that it is interested in acquiring a controlling stake in Terna from Enel.

BUSINESS

Electricity transmission networks and systems in Italy

Terna operates the electricity transmission business in Italy and is the principal owner of the high voltage and very-high voltage electricity transmission networks and systems of the Italian grid. Based on the Italian Energy Authority's most recent estimate of 11th January, 2001, Terna owns approximately 94.136 per cent. of the Italian grid.

Terna's principal activities consist of the operation, maintenance and development of the Terna Grid pursuant to the terms of the operating agreement entered into by Terna and the Italian ISO on 22nd December, 2000 (the **Terna Operating Agreement**), which allocates responsibilities as follows:

Italian ISO

- Manages the flow of electricity over the Terna Grid
- Decides on activities related to the maintenance of the Terna Grid
- Decides on development projects

Terna

- Owns the Terna Grid and operates the Terna Grid in accordance with the guidelines and directives issued by the Italian ISO
- Makes proposals to, and implements the directives of, the Italian ISO regarding the maintenance of the Terna Grid
- Implements the Italian ISO's directives for development project

Pursuant to the Terna Operating Agreement, the Company may engage in all the activities outside the electricity sector which do not conflict with the conduct of the Terna Group's principal business.

For its operation, maintenance and development activities, the Company earns revenues through an annual fee paid to Terna by the Italian ISO. The revenues are derived from tariffs received by the Italian ISO from producers and distributors. The tariffs received by the Italian ISO are calculated as an amount per kWh of electricity that is (i) injected in the Terna Grid by the plants where it is generated or, in the case of imported energy, by the points of acquisition from foreign electricity transmissions grids, and (ii) drawn from the Terna Grid by distributors in Italy. The Italian ISO deducts an amount for its own costs from the payments it receives and distributes the balance of the proceeds from the tariffs payments to Terna and other Italian grid owners in the form of annual fees.

THE TERNA GRID

As of 30th June, 2004, the Terna Grid consisted of:

- approximately 10,900km of 380kV or 400kV (very-high voltage) connections, including those connecting Italy and Greece;
- approximately 10,112km of 200kV or 220kV (very-high voltage) connections, including those connecting Sardinia, Corsica and the Italian mainland;
- approximately 18,383km of connections of 150kV, 132kV or less (high voltage);
- 298 substations; and
- certain other fixed assets.

The electricity transmission networks and systems which comprise the Terna Grid as of 31st December, 2002 and 2003, and as of 30th June, 2004, were as follows:

Type of facility	31st December 2002	31st December 2003	30th June 2004
Primary transformer/switching substations	257	277	280
Other substations ⁽¹⁾	18	18	18
Total substations	275	295	298
Transformers	554	565	566
Transforming capacity (in MVA)	101,493	107,485	108,382
Bays	3,678	3,864	3,873
380kV (or greater) transmission lines ⁽²⁾	10,062	10,073	10,090
220kV transmission lines ⁽³⁾	10,115	10,155	10,112
150kV (or less) transmission lines	17,406	18,349	18,383
Total transmission lines (in km)	37,583	38,577	38,585

(1) Facilities owned by Terna which are not included in the Italian grid but connect the Terna Grid with high voltage customers or connect long-distance overhead lines to underground or underwater cables. Although the Company believes that these substations are necessary for the optimal performance of the Italian grid, the Company cannot be certain that all of these substations meet the requirements for their inclusion in the Italian grid. Currently the Company do not receive an annual fee for these facilities. Includes the 400kV Italy-Greece direct current ("DC") connection.

(2) Includes the 200kV Sardinia-Corsica-Italian mainland DC connection.

(3) As of 31st December, 2001, the Italian grid consisted of a total of 42,650km of transmission lines. (Source: Italian ISO's Report on its business, April 2002—March 2003).

The general increase in the size of the Terna Grid between 31st December, 2002 and 31st December, 2003 is due mainly to the increase in the approved scope of the entire Italian Grid pursuant to the Ministry of Industry's decree of 23rd December, 2002.

The Terna Grid's 38,585 km of transmission lines consists of, among other things, five 380kV connections (one of which consists of double-circuit transmission lines), nine 220kV connections, one 200kV DC connection and one 400kV DC connection. The 200kV DC line connects Sardinia, Corsica and the Italian mainland, while the 400kV DC line connects the Italian Grid to Greece via the Otranto Channel in the Mediterranean. Terna constructed the Italy-Greece connection, which is part of the Italian Grid, jointly with the Athens Public Power Corporation (the Greek national power company). This connection began operations on 27th June, 2002 and consists of 207km of electricity transmission lines (including 163km of underwater cable). Terna owns the 400kV DC connection in Italy, underwater cables in Italian territorial waters, part of the underwater cables in Greek territorial waters and the Arachthos switching station in Greece. In 2002, Terna established a representative branch office in Greece to administer financial, legal and tax matters related to this part of the Terna Grid in Greece.

The bonus/penalty mechanism

Pursuant to the Terna Operating Agreement, the quality of Terna service will be subject to a bonus/penalty mechanism evaluated by the Italian ISO through an index representing the level of availability of the Terna Grid components. Specifically, the index represents the number of hours per year during which a particular component is made available to the Italian ISO for the performance of transmission and dispatch activities compared to the total number of hours per year. The level of availability of the plants owned by Terna was: for 2002, 99.5 per cent.; for 2003, excluding the blackout in September, 99.1 per cent.; and for the six-month period ended 30th June, 2004, 99.5 per cent. (source: internal management estimate). However, the bonus/penalty mechanism has not yet been applied to the Terna Grid (or any other portions of the Italian grid) pending the definition of some parameters necessary for the application.

Operation, maintenance and development of the Terna Grid

Operation

Terna operates the Terna Grid in accordance with the procedures and guidelines determined by the Italian ISO in the following manner:

(a) Plant management and control

The Italian ISO determines the configurations and sequences for the switches, known as “breaker switches”, that connect the various components of the Italian Grid. Terna is required to take all necessary actions to implement and maintain the configurations and sequences determined by the Italian ISO, as applicable to the Terna Grid. Terna does this by managing and controlling the transmission network and systems of the Terna Grid by the following means:

- The plant management and control personnel are located in three management centres: Bari, Dolo (Venice) and Rondissone (Turin). The plant management and control personnel are able to configure and control the sequences for the breaker switches at remote locations on the Terna Grid through a telecommunications network known as SCTI-Net (owned and built by Wind Telecomunicazioni S.p.A. in collaboration with Terna using a fibroptic technology platform known as E-Net), which is supplemented by radio links and, to a limited extent, by connections provided by Telecom Italia S.p.A.
- SCTI-Net is also used to receive and transmit signals, measurements and data regarding the status of the Terna Grid. This system of continuous monitoring is designed to promptly alert the plant management and control personnel of any actual or potential malfunctions or failures of any part on the Terna Grid.
- Each of the three management centres is specifically responsible for designated parts of the Terna Grid as follows:
 - Bari: south-central region (Lazio, Umbria, Abruzzo, Campania, Basilicata, Molise, Puglia and Calabria) and Sicily;
 - Dolo (Venice): north-central region (Tuscany, Emilia-Romagna and Marche) and north-eastern region (Veneto, Friuli Venezia Giulia and Trentino Alto Adige); and
 - Rondissone (Turin): north-western region (Lombardy, Piedmont, Valle d’Aosta and Liguria) and Sardinia.
- If any of the management centres is temporarily out of service, the SCTI-Net system, through its “multisite” software, automatically routes signals, measurements and data from the part of the Terna Grid for which that management centre is responsible to another management centre which is then able to remotely monitor and manage that part of the Terna Grid (in addition to those parts of the Terna Grid for which it is specifically responsible).

(b) Response operations

Terna is required to promptly respond to all hazardous conditions that arise from any failure or malfunction of any part of the Terna Grid and, if possible, rectify such failure or malfunction.

(c) Temporary placement out of service for maintenance

If a part of the Terna Grid is required to be temporarily placed out of service for maintenance or other projects, Terna specialist personnel (i) implement certain procedures to create safe conditions for maintenance or other projects to be conducted, and (ii) implement procedures for resumption of service.

(d) *Plant inspections*

Terna's personnel make plant inspections to monitor the technical conditions of the components of the Terna Grid and to collect current information that is not automatically obtained through SCTI-Net. These inspections also aim to ensure that the components are not subject to interference from vegetation, construction by third parties, activities on or near the sites on which Terna networks and systems exist and other potential hazards or activities that may cause a malfunction of the Terna Grid. Inspections are conducted on a scheduled basis, and also when failures or malfunctions occur on the Terna Grid.

Maintenance

Maintenance includes all the actions performed on the Italian grid and its components in order to preserve or restore their effective and proper operations, without making changes to their technical or functional characteristics (known as "routine maintenance") or to renew or extend the useful life of any component by making changes to its technical (but not functional) characteristics (known as "extraordinary maintenance"). Terna is required to conduct routine maintenance and extraordinary maintenance of the Terna Grid and its components in accordance with the Terna Operating Agreement.

Terna must obtain approval from, and follow the procedures determined by, the Italian ISO for:

- (i) routine maintenance activities which require Terna to temporarily remove from service parts of the Terna Grid, or
- (ii) extraordinary maintenance activities. Before commencing such activities, Terna must present to the Italian ISO the details of the proposed maintenance and an annual plan specifying which components of the Terna Grid need to be removed from service and when this is planned to be done. The Italian ISO decides on the maintenance to be carried out based on such proposals and plans. If Terna fails to correctly perform the maintenance tasks assigned to it by the Italian ISO, the Italian ISO may, at Terna's expense, replace Terna in the performance of such tasks. The Italian ISO can also impose a penalty that is proportional to the seriousness of such failure by Terna. On 16th December, 2003, the Italian ISO approved the maintenance proposals and the related unavailability plan for 2004 which had been submitted to the Italian ISO by Terna on 24th June, 2003. In 2004, Terna budgeted approximately €67 million to cover the costs of extraordinary maintenance activities relating to its own assets.

Terna is not required to obtain prior approval from the Italian ISO for maintenance related to safety issues or routine maintenance that does not require Terna to temporarily remove from service components of the Terna Grid. In general, Terna is required to temporarily remove from service relevant components of the Terna Grid before commencing maintenance activities. As a result, Terna has developed methods and procedures, and is the only company in Italy authorised to implement such methods and procedures, to perform routine maintenance activities (such as the cleaning or the replacement of isolators or ground wires) without placing parts of the Terna Grid out of service. Such procedures are known as the "live works" methods of maintenance.

In the past, Terna conducted all its maintenance activities according to a predetermined schedule regardless of the condition of particular Terna Grid components. Currently, Terna is gradually replacing this system of scheduled maintenance with a new system known as "condition-based" maintenance which reduces the need to temporarily place the Terna Grid or its components out of service by limiting maintenance activities to situations where, among other things, the Terna Grid or its components have actually deteriorated or malfunctioned. However, for this system to be effective in minimising maintenance action by Terna, continuous, real-time updates are required for the status of each component of the Terna Grid. To achieve this, Terna is gradually phasing in additional on-line monitoring systems and tools, which are already in operation in its substations and will become operational on its transmission lines by the end of 2004.

Development

Terna also engages in development activities related to the expansion and upgrade of the Terna Grid and other parts of the Italian grid. These development activities can be categorised as follows:

- *Functional requirements and decommissioning* The Italian ISO decides on the construction and installation of new connections and new transformer or switching substations, upgrades of existing facilities or the decommissioning of existing facilities. If such decisions relate to the Terna Grid, Terna is directed by the Italian ISO to implement them. If they relate to other portions of the Italian grid, contracts for such development projects are put out to tender by the Italian ISO. Up to 30th June, 2004, 13 out of 19 such contracts were awarded to Terna. For this type of development activity, Terna receives an annual fee upon commencement of operations of the facilities which typically last for 20 years, in the case of transformer or switching substations, and 35 years, in the case of high voltage and very-high voltage electricity transmission lines. In the case of the decommissioning of an existing plant, the Italian ISO pays Terna an additional indemnity payment which is added to the annual fees for the existing elements of the Terna Grid. For the 2004–2007 regulatory period, for those development activities that have been approved by the Ministry of Industry, the Italian Energy Authority has increased the rate of remuneration of new invested capital by 2 per cent.. This will ultimately result in an increase of the amount of the remuneration that the Company receives for this category of development activity. Between January 2002 and 30th June, 2004, Terna and the Italian ISO signed 115 contracts for this type of development activity. In 2003, the Annual Fees increased by €33.6 million, due to such development activities that have already been completed.
- *Legal and regulatory compliance.* These are development activities undertaken to comply with legal and regulatory requirements (including environmental laws such as Law No. 36/01 of 22nd February, 2001 (**Law 36/01**)) or decisions by governmental authorities. Pursuant to the Terna Operating Agreement with the Italian ISO, Terna is required to present a plan for the required development activities to the Italian ISO, and such plan must be approved by the Italian ISO before Terna may commence such development activities. Each development project will be governed by a contract between Terna and the Italian ISO, which will specify, among other things, the annual fee for development activities payable to Terna, in addition to the annual fees for existing elements of the Terna Grid. However, these annual fees are paid to Terna in monthly installments as an aggregate payment. See “Regulatory Matters—Regulation under the Bersani Decree— Regulatory structure of the transmission sector—The Terna Operating Agreement”. Prior to the execution of the Terna Operating Agreement, Terna had spent €7.3 million on such development activities. From the execution date of the Terna Operating Agreement to 30th June, 2004, Terna and the Italian ISO had not entered into any contracts for such development activities as a result of laws or regulations that have been issued or adopted since the execution of the Terna Operating Agreement.
- *Operational efficiency.* These are development activities that are proposed by Terna and approved by the Italian ISO. They relate to the upgrading of engineering systems with the objective of improving the operational efficiency of the Terna Grid. The Italian ISO does not pay any fees to Terna for such projects, as Terna should theoretically benefit through lower future costs in the operation of the Terna Grid.
- *Modifications.* These development activities originate from requests by third parties. These are usually requests for Terna to remove or reduce any interference caused by parts of the Terna Grid to local authorities or owners (e.g. on roads, highways or buildings). The projects must be approved by the Italian ISO. The Italian ISO does not pay any fees to Terna for such projects; such projects, however, may be financed through contributions from the relevant local authorities or owners.

Other businesses

In Italy, Terna also offers certain unregulated services to third parties (including other Enel Group companies). The services are provided in the following fields:

- engineering, construction, operation and maintenance of high voltage and very-high voltage networks and systems;
- remote systems for network management and control; and
- telecommunications services sector.

The Company reports the revenues from these services under the line item “Revenues from other activities and other income in Italy”. For the year ended 31st December, 2003, this amounted to €64.8 million on a pro forma basis, or 7.1 per cent. of Terna total pro forma revenues. The Company received 73.7 per cent. of this amount from Enel Group companies. For the six-month period ended 30th June, 2004, Terna revenues from these services amounted to €29.5 million and 5.7 per cent. of Terna total revenues.

Engineering, construction, operation and maintenance

Since the Bersani Decree, the gradual liberalisation of laws and regulations regarding the production and sale of electricity in Italy has led to greater demand from independent power producers for services relating to the engineering, construction, operation and maintenance of high voltage and very-high voltage networks and systems for connection to the Italian grid or for activities designed to increase the connection capacity of the Italian grid with the electricity systems of neighbouring countries, the so-called “merchant lines”. At present, it is not clear whether these projects will proceed as they are still under evaluation by the Italian ISO. If the projects do proceed, Terna will be remunerated by the project sponsor and the owner of the lines on the basis of agreements executed with the latter.

The Company also provides engineering services both to other Enel Group companies and independent power producers. Terna is often retained to provide construction services for engineering designs, including as general contractor on behalf of project sponsors for various new “merchant lines” connecting the Italian grid to foreign transmission networks.

Terna operations and maintenance services are, for the most part, provided to industrial companies or other power companies that own high voltage and very-high voltage transmission networks and systems. Terna’s principal agreement of this type is with Enel Distribuzione S.p.A. (hereinafter **Enel Distribuzione**), for the operation and routine maintenance of the high voltage transmission lines owned or used by Enel Distribuzione. Terna revenues from this agreement were €13.5 million as of 30th June, 2004.

Remote systems for network management and control

The Company plans to offer its know-how and expertise obtained from the remote management and control of the Terna Grid, to assist companies with the operation and remote control of their electricity, water and gas networks. In particular, the Company offers its SCTI-Net system and related services to assist such companies in receiving and transmitting signals, measurements and other data (e.g., voltage or amperage in the case of electricity networks, or pressure levels in the case of water and gas networks) for the continuous control and monitoring of their networks from a remote location.

Telecommunication sector services

(a) Installation, maintenance and development of fibreoptic cable networks

The Company offers to other Enel Group companies and to third parties, services for the installation, maintenance and development of fibreoptic cables and network infrastructure.

As of the date of this Offering Circular, the Company provides these services to Enel Group companies, including Enel.Net for the installation, maintenance and development of the fibreoptic cables and network infrastructure for its E-Net system, as well as the maintenance of fibreoptic cables and network infrastructure for Enel Distribuzione’s high voltage lines. Terna revenues earned from these services for the year ended 31st December, 2003 were €5.7 million. For the six-month period ended 30th June, 2004, Terna revenues from these services amounted to €4.0 million.

(b) *Support structures and equipment housing*

The Company leases out space on the Terna Grid for the installation of support structures (such as towers, masts, poles, and other supports) for antenna systems and for the installation of telecommunications housing equipment. The Company currently offers this type of service mainly to Wind. Revenues earned from these services for the year ended 31st December, 2003 totaled approximately €1.8 million. For the six-month period ended 30th June, 2004, Terna revenues from this service amounted to €1.0 million.

Electricity transmission networks and systems in Brazil

Since 31st December, 2003, the Company has operated in the electricity transmission sector in Brazil through TSN and Novatrans, Terna's Brazilian subsidiaries.

Each of TSN and Novatrans is responsible for the construction, development and operation and maintenance of the portion of the Brazilian Subsidiaries Grid for which it has been granted a 30-year concession by the Brazilian Energy Authority. Each of the concessions expires on 20th December, 2030.

TSN and Novatrans must operate their respective concessions in accordance with their *contrato de prestacao de servicos de transmissao* (contract for transmission services) (CPST) agreements with the Brazilian ISO. TSN and Novatrans earn their revenues based on the respective annual fees determined by the concession contract and increased annually to adjust for inflation pursuant to a resolution of the Brazilian Energy Authority. As of 30th June, 2004, the portion of the Brazilian Subsidiaries Grid for which TSN holds a concession, has an aggregate value of €204.6 million and consists of:

- approximately 1,050km of 500kV (very-high voltage) interconnections connecting the state of Goias (at the Serra da Mesa substation) to the state of Bahia (at the Sapeacu substation); and
- four substations.

Commercial operations for most of the TSN transmission lines began in March 2003 and, for the entire facility, including a static compensator and some minor 230kV interconnections, in June 2003.

The portion of the Brazilian Subsidiaries Grid for which Novatrans holds a concession, as of 30th June, 2004, has an aggregate value of €273.3 million and consists of five 500kV (very-high voltage) interconnections totaling approximately 1,278km, which connect the state of Maranhao (at the Imperatriz substation) to the Federal District (at the Samambaia substation). All these Interconnections are already in commercial operation.

The connections on the Brazilian Subsidiaries Grid play a major role in Brazil's electricity sector, as they connect the southeastern region of Brazil with the northern and north-eastern regions, areas with different hydrological systems.

TSN and Novatrans both can use their own personnel and subcontractors.

TSN began reporting net revenues almost as soon as its portion of the Brazilian Subsidiaries Grid began operations.

For the year ended 31st December, 2003, TSN reported net revenues of R\$138 million. Novatrans began producing revenues when the first segment of its portion of the Brazilian Subsidiaries Grid began operations on 3rd June, 2003. For the year ended 31st December, 2003, Novatrans reported net revenues of R\$22.4 million. For the six-month period ended 30th June, 2004, TSN and Novatrans revenues amounted, respectively to €28.5 million and to €23.2 million.

Research and development

CESI S.p.A. (CESI), one of Terna's affiliates, maintains Terna's research and development programme pursuant to certain research and development agreements. The programme primarily aims to develop

solutions to improve the efficiency of electricity transmission networks and reduce the environmental impact of high voltage and very-high voltage transmission networks and systems.

Terna has invested the following amounts in such research and development activities: €0.7 million in 2002 and €1.0 million in 2003.

Terna's innovative solutions have led to substantial improvements to the Terna business, decision-making processes, technology and work methods.

Electricity market

The electricity market in Italy

According to provisional data published by the Italian ISO, consumption of electricity in Italy increased by 12.0 per cent. from 267.3 TWh in 1999 to 299.5 TWh in 2003, reflecting a 2.9 per cent. average annual increase. In 2001, the Italian electricity market was the fourth largest consumer of electricity in the EU after Germany, France and the United Kingdom. The demand for electricity in Italy in 2003 was 319.7 TWh, an increase of 2.9 per cent. over 2002.

In the period from 2000 to 2003, the growth of demand for electricity in Italy outpaced the real Gross Domestic Product (GDP) growth rate for Italy, as shown in the following table.

	2000	2001	2002	2003
Growth in demand for electricity in Italy ⁽¹⁾	4.4%	2.1%	1.9%	2.9%
Growth in the real GDP of Italy ⁽²⁾	3.0%	1.8%	0.4%	0.3%

(1) Source: management interpretation of the "Italian ISO: statistical data year 1999–2002" and "Revised data fiscal 2003". The Italian State Railroads consumption is excluded.

(2) Source: Istituto Nazionale di Statistica (National Institute of Statistics) ("ISTAT"), "General Report on the Country's Economic Situation—Year 2002–2003".

In the coming years, the Company expects the growth in demand for electricity in Italy to continue to exceed the real GDP growth rate, especially in light of the fact that per capita consumption of electricity in Italy is still below the European average (in 2001, 5,262kWh per capita compared to the EU average of 6,792kWh per capita). In particular, for the period 2003-2006, the Italian ISO estimates a 3.2 per cent. average annual growth in demand for electricity in Italy.

Although there are minimal regulatory barriers to entry for the electricity transmission market in Italy, the cost of major investments in network systems and assets has resulted in a limited number of new market participants. However, as development projects for the Italian grid are increasingly put out to tender, there has been, and will continue to be, a gradual increase in market entrants. Nonetheless, Terna's leadership position in Italy is unlikely to be threatened in the short to medium-term.

The electricity market in Brazil

The Brazilian electricity market is the largest in Latin America in terms of consumption. During the 1997-2002 period (the latest period for which official data is available), the growth rate for electricity consumption was approximately 9 per cent., with an average annual growth rate of 1.8 per cent.. More specifically, electricity consumption in Brazil:

- in 2000, increased by 5.1 per cent. to 331.6 TWh;
- in 2001, decreased by 7.9 per cent. to 309.7 TWh as a result of a prolonged drought which severely depleted the hydroelectric plant basin reserves in Brazil; and
- in 2002, increased by 2.5 per cent. to 321.5 TWh.

From 1997 to 2002, electricity consumption increased from 294.7 TWh to 321.5 TWh. On 31st December, 2002, Brazil depended on hydroelectric generation for approximately 79.2 per cent. of its consumption (source: *Balango Energetico Nacional* 2003 “The Ministry of Mining and Energy”). The Brazilian Subsidiaries Grid is strategically relevant, because of the great distances between production and distribution points and the different hydrological systems of Brazil’s various regions. The Brazilian Subsidiaries Grid plays an important role in meeting Brazil’s electricity needs, as it connects the south-eastern region with the northern and north-eastern regions.

REGULATORY MATTERS

Supervision and regulation of the Italian electricity industry

The Ministry of Industry and the Italian Energy Authority are the entities in charge of the overall supervision and regulation of the Italian electricity industry.

The Ministry of Industry is mainly responsible for the management (including the granting and revocation) of concessions and authorisations as well as for establishing strategic guidelines for the development and safety of the electricity industry. The Italian Energy Authority's primary responsibilities include determining tariff rates and access charges, issuing service quality-control guidelines, and protecting consumers' interests through mediation, arbitration, fines or other sanctions. The Italian Energy Authority is independent from the Italian Government.

Regulation before the Bersani Decree of 1999

Until 1962, the production, transmission and distribution of electricity in Italy were essentially unregulated activities. On 6th December, 1962, the Italian Government granted almost exclusive rights to produce, import and export, transport, transform, distribute and sell electricity in Italy to a nationalised entity.

In 1992, the nationalised entity was converted into a joint stock company (*società per azioni*) wholly-owned by the Ministry of Economy and Finance and renamed "Enel S.p.A." Under the regulatory framework of the Italian electricity industry at that time:

- the Italian Government had the ultimate authority over the generation, transmission and distribution of electricity. The government licensed such activities to Enel and to municipal electricity utilities;
- power generation was restricted to authorised producers who could only produce electricity for their own consumption, for sales to affiliated companies or for sales to Enel; and
- the Italian Energy Authority determined the electricity tariff rates annually on an industry "cost-plus" basis.

Regulation under the Bersani Decree

The enactment of the EU directive of December 1996 (**Electricity Directive**) led to further liberalisation of the electricity industry in Italy. The Bersani Decree and subsequent legislation implemented the principles contained in the Electricity Directive and sought to liberalise the electricity industry through unbundling the integrated electricity industry into four different sectors: production, transmission, distribution and supply. More specifically, the Bersani Decree and subsequent legislation provided for:

- *Production.* An increase of competition in the power generation sector. Italian legislation currently prohibits any single company from producing or importing more than 50 per cent. of the total imported and domestically produced electricity in Italy.
- *Transmission.* A requirement that each network owner transfers its own transmission assets to a special purpose subsidiary. In addition, the Italian Energy Authority continued to be responsible for determining the tariff system pursuant to which each entity owning electricity transmission assets of the Italian grid is compensated. Also, the Italian ISO was established to act as system operator for the electricity dispatching and management operations of the Italian grid.
- *Distribution.* The establishment of a new licensing regime for the distribution of the electricity and the provision of incentives for the consolidation of electricity distribution networks within each municipality.
- *Supply.* The liberalisation of the sale of electricity to consumers that meet certain consumption thresholds (**Eligible Consumers**). The threshold level is currently fixed at 0.1GWh. The Eligible Customers may directly enter into supply agreements with any domestic or foreign producer,

wholesaler or distributor of electricity. The consumers that cannot meet this eligibility threshold (**Captive Customers**), are required to purchase electricity from the distributor serving the area in which they are located. The distinction between Eligible Customers and Captive Customers will be valid until 1st July, 2004 (for business customers) and until July 2007 (for residential customers). From July 2007, all consumers will be able to freely choose their electricity supplier irrespective of their consumption.

In order to co-ordinate the overall functioning of the electricity market mechanisms following the above developments, the Bersani Decree and subsequent legislation provided for the creation of several new entities. In particular, the following entities were created:

- *The Italian ISO*. The Italian ISO was established as a wholly-owned entity of the Ministry of Economy and Finance, with the purpose of acting as a system operator for the electricity dispatching and management operations of the Italian grid. Enel contributed to Terna, on a tax neutral basis, the Terna Grid (as it then existed), to separate the ownership of the Italian grid from the activities of the Italian ISO.
- *La Borsa dell'Energia Elettrica (the Power Exchange)*. The Power Exchange is the institution through which producers, importers, wholesalers, distributors, the Italian ISO, other Eligible Customers and the Single Buyer (as defined below) contribute to the determination of wholesale electricity prices through a competitive bidding process. Since 1st April, 2004, the Power Exchange has been fully operational.
- *Il Gestore del Mercato (the Market Operator)*. The Market Operator is the entity charged with managing the Power Exchange.
- *L'Acquirente Unico (the Single Buyer)*. The Single Buyer was established as a central purchaser of electricity from producers on behalf of all Captive Customers. The Single Buyer and Eligible Customers may freely purchase electricity, either through transactions in the Power Exchange or by entering into bilateral contracts with individual producers or wholesalers. Since 1st April, 2004, the Single Buyer has been fully operational.

Regulatory structure of the transmission sector

The Italian ISO

The Italian ISO is a joint stock company wholly-owned by the Ministry of Economy and Finance. Pursuant to the Bersani Decree and other implementing legislation, the government awarded to the Italian ISO a 30-year concession starting from 1st April, 2000, for the dispatching and transmission of electricity, including the management responsibilities for the Italian grid. More specifically, the Italian ISO has the following powers and responsibilities:

- The Italian ISO dispatches electricity, ensuring the co-ordination between the producers, the Italian grid, the networks connected thereto and of the services auxiliary to the electricity system, in order to provide optimal control and management, and to ensure the efficiency, adequacy and safety of electricity supply in Italy.
- The Italian ISO establishes objective and non-discriminatory technical regulations regarding the distribution of electricity, the engineering and operation of the Italian grid generation plants, distribution networks, connection circuits and other transmission related activities.
- The Italian ISO ensures that all users have free access to the Italian grid under equal conditions, in compliance with the technical rules of the Italian ISO, the requirements of the Italian Energy Authority and the policies of the Ministry of Industry.
- The Italian ISO decides on the Italian grid maintenance and development activities that need to be performed by the grid owners, in order to ensure the safety and continuity of electricity supply and the development of the Italian grid. These decisions are made pursuant to a development plan

prepared by the Italian ISO based on the input of the Italian grid owners and approved by the Ministry of Industry.

- The Italian ISO imports and exports electricity through cross-border interconnections in compliance with the directives of the Ministry of Industry and the Italian Energy Authority. The Italian ISO can sell the imported electricity on the free market.
- The Italian ISO performs other activities such as the following:
 - The Italian ISO purchases, sells and manages the bidding procedures for the assignment to the Eligible Consumers of electricity produced from renewable resources, pursuant to CIP 6/92. The Italian ISO is reimbursed by a compensation fund (which is ultimately funded by the final consumers) for the negative difference between the revenues generated from CIP 6/92 activities and costs incurred in respect of such activities. Therefore, CIP 6/92 activities do not have any net effect on the Italian ISO's financial statements.
 - The Italian ISO ensures that the plants which produce renewable electricity resources comply with the criteria established by the legislation in force, and issues the appropriate licences and certificates.
 - The Italian ISO manages the ownership interest in the authorised share capital of the Single Buyer and the Power Exchange.
 - The Italian ISO provides the Power Exchange with the necessary information for the proper performance of the bidding process.

For the year ended 31st December, 2002 (the latest period for which the Italian ISO has published financial information available on its website, although such website does not form part of this Offering Circular), the Italian ISO's revenues were €6,215 million, which included:

- €2,712.5 million from electricity sales;
- €2,081.9 million from the above-mentioned compensation fund;
- €885.1 million in revenues from tariffs paid by producers and distributors in relation to electricity transmission operations; and
- €535.5 million from other activities.

Of the €885.1 million amount related to tariffs received by the Italian ISO from producers and distributors, after retaining a portion to cover for its operating costs, the Italian ISO paid €776.4 million to the owners of portions of the Italian Grid (including Terna).

For the year ended 31st December, 2002, the Italian ISO's operating income was €41.3 million, its net income was €11.2 million, its total shareholders' equity was €67.8 million and its net invested capital was negative €196.8 million. Based on a report on the activities of the Italian ISO from April 2002 to March 2003, on average, in 2002 the Italian ISO had 698 employees.

The By-laws of the Italian ISO permit it to:

- acquire interests in companies and businesses that operate in industry sectors that are related to, or connected with, its business or which would permit a better use of its own resources and/or structures; and
- enter into transactions or conduct any activities necessary or beneficial to carry out its corporate purposes.

In order to manage the Italian Grid, the Italian ISO is required to enter into operating agreements with the owners of the Italian Grid, in each case, based on the "framework agreement" set forth in Article 3, Paragraph 8 of the Bersani Decree. Pursuant to certain developments described in more detail below, in

addition to having management responsibilities, the Italian ISO may become owner of all or part of the Italian Grid. See “Changes to present regulation and future impact” in this section.

The Terna Operating Agreement

The Terna Operating Agreement governs the operation, maintenance and development activities of the Terna Grid and Terna’s compensation for such activities. Significant provisions of the Terna Operating Agreement include the following:

- *Operation.* The Italian ISO manages electricity flow through the Terna Grid, prepares operational plans and gives Terna the switching orders necessary to operate the Terna Grid. Terna owns the Terna Grid and operates it pursuant to the guidelines and directives of the Italian ISO. Terna may act independently from the Italian ISO in emergency situations.
- *Maintenance.* Terna prepares annual maintenance plans based on the conditions of the Terna Grid (as well as the related system component temporary closure plans) and submits them for approval to the Italian ISO. The Italian ISO issues the annual maintenance plan and Terna updates the Italian ISO on the progress of its implementation.
- *Development.* The Italian ISO makes decisions related to network investments and upgrades, including all those relating to the development of the Terna Grid (i.e., changes in transport capacity and/or geographical coverage, increasing flexibility, decommissioning or temporarily closing parts of the network components and compliance with applicable regulations). Terna carries out the Italian ISO’s instructions and performs development activities on the Terna Grid as required by the Italian ISO. However, Terna must submit a technical and financial proposal for any requested development activity for the approval of the Italian ISO. Development projects which do not relate to the Terna Grid are assigned through public tender by the Italian ISO. See “Description of the Issuer—Business—Electricity transmission networks and systems in Italy—Operation, maintenance and development of the Terna Grid— Development”.
- *Indemnification for the decommissioning and the temporary closure of the plants.* If parts of the Terna Grid are decommissioned or temporarily closed, the Italian ISO pays Terna, as part of the annual fee, indemnities based on the year-end net book value for the last fiscal period prior to 1st April, 1999, less any subsequently recorded depreciation. Such indemnities are increased for Terna’s eventual costs related to the decommissioning of the plants (less the amount of proceeds from the sale of the decommissioned plant, or any component thereof, if applicable).
- *Remuneration.* Terna receives annual fees from the Italian ISO for the operation, maintenance and development of the Terna Grid. The annual fees are paid to Terna in monthly installments.
- *Applicable sanctions.* If Terna fails to perform any of its functions for which it is responsible, the Italian ISO may, at Terna’s expense, carry out such functions. The Italian ISO can also penalise Terna based on the seriousness of such failure. However, the penalty may not exceed 10 per cent. of Terna’s annual fee. Until the adoption of certain regulations under Law No. 481 dated 14th November, 1995, any disputes regarding the interpretation and the implementation of the Terna Operating Agreement may be submitted to an arbitration panel consisting of three members, one to be appointed by each of Terna and the Italian ISO, and the third to be agreed upon between the parties. If the parties fail to agree, the President of the Court of Rome shall appoint the third panel member. Once such regulations under Law No. 481 are adopted, all disputes shall be submitted to the Italian Energy Authority for resolution.

Changes to present regulation and future impact

The current regulatory structure is likely to change substantially in the future as a result of Law 290/03 as amended by Law 239/04 and the DPCM (described below), which:

- provides for the integration of the ownership and management of the Italian grid; and

- effective from 1st July, 2007, prohibits companies (including Enel) that are involved in the production, importation, distribution and sale of electricity or natural gas, and any company controlled, directly or indirectly, by the State, operating in the electricity transmission business, from holding, directly or indirectly, more than 20 per cent. of the share capital of any company that both owns and manages any part of the Italian grid or gas transmission network.

DPCM

On 11th May, 2004, the Italian Government issued the DPCM (subsequently officially published on 18th May, 2004), which specifies the following implementing measures for Law 290/03:

- (i) The Italian ISO must transfer to Terna (either by way of a contribution or a sale and purchase), for consideration, all of its business, assets, active and passive legal relationships (including agreements held by the Italian ISO) (the **ISO Assets**), by no later than 31st October, 2005 (the **Transfer**), except for the following:
 - any business, assets or employees related to (a) management of the electricity generated by facilities subject to special incentives pursuant to CIP6/92, and (b) the activity of verifying the qualifications of the facilities relating to renewable energy sources and issuing so-called “green certificates” pursuant to the Bersani Decree, as well certain other related activities;
 - the ownership interests held in the Market Operator and the Single Buyer; and
 - any liabilities incurred by the Italian ISO prior to the Integration. In any event, the Italian ISO is required to indemnify and hold Terna harmless for such liabilities incurred prior to the effective date of the Transfer, although Terna has an obligation to mitigate such liabilities.

The Italian ISO and Terna shall agree on the ISO Assets and the consideration to be paid for the Transfer. However, if the parties fail to agree by 30th April, 2005 on the ISO Assets and the amount of consideration for the Transfer, and assuming it is to be effected by a sale and purchase (rather than a contribution), the consideration shall be determined by three independent appraisers (having regard to the market value). The Company cannot assure that the consideration paid by Terna or the value attributed to the business, assets and employees that are the subject of the Transfer, will be recognised in the tariff component related to the value of net invested capital (known as Regulatory Asset Base or **RAB**). Also, on the date of the Transfer, Terna shall assume the ownership and the Italian ISO’s obligations for the management of the Italian grid and each of the Italian ISO and Terna shall change their respective corporate names.

- (ii) The Italian ISO is required to prepare by no later than 31st December, 2004, a document entitled “Network transmission, dispatch, development and safety code” (the **Grid Code**), which should contain objective and non-discriminatory rules for the use of, and access to, the Italian grid with respect to dispatching and management operations of the Italian grid. The Grid Code shall also provide for the establishment (prior to the integration) of a technical consulting committee for the users of the Italian grid. This committee will consist of a maximum number of seven members who have the responsibility for (a) updating the rules and specifications contained in the Grid Code, and (b) the resolution of any disputes arising from the application of such rules and specifications. The committee may also express nonbinding opinions on the general criteria for (a) the development of the Italian grid, (b) the development and operation of connections, and (c) security for the Italian grid.

The Grid Code (including the terms for the appointment and operation of the technical consulting committee) is subject to the approval (including by acquiescence) of the Ministry of Industry and the Italian Energy Authority.

- (iii) The Italian Energy Authority will evaluate the mechanisms (including those related to tariffs) required to facilitate the acquisition of the remaining portions of the Italian grid not owned by Terna by 30th April, 2006. The Italian Energy Authority will also evaluate different mechanisms related to the acquisition of Terna’s (or the resulting entity’s) shares by other owners of the Italian grid.

- (iv) The entity resulting from the Integration shall be operated in an objective manner without distinguishing between users or types of users of the Italian grid. To this end, the By-laws will be amended (prior to the earlier of Enel losing control of Terna and the integration) to provide for the following:
- corporate purposes that are consistent with both the ownership and management of the Italian grid;
 - any company that is involved in the production, importation, distribution, sale or transmission of electricity (or which controls, is controlled by or is under common control with, any such company) and that owns more than 5 per cent. of shares of the resulting entity shall be prohibited from voting shares, in the election of the resulting entity's directors, exceeding five per cent of the voting share capital in the resulting entity;
 - within 60 days of the integration, the shareholders of the resulting entity shall elect a new board of directors in accordance with the new By-laws and which consists of members that meet certain standards of integrity and independence, to ensure that the Italian grid will be managed objectively, without discriminating between users or categories of users. Such duly elected board of directors shall remain in office until the date Enel reduces its shareholding in Terna to no more than 20 per cent.; and
 - no person except for the Italian Government or state or local authorities (or entities controlled by any of them) may hold more than five per cent. of Terna's share capital (which provision cannot be amended for at least three years from the integration). In any event, a shareholder who owns, directly or indirectly, shares that in the aggregate constitute more than five per cent. of Terna's share capital may not vote in relation to the excess shares. However, according to Law 474/94, this limitation on holding more than five per cent. of Terna's share capital does not apply in the case of a public tender offer that has the purpose of acquiring the entire outstanding share capital of Terna in accordance with Articles 106 and 107 of the Unified Financial Act.
- (v) Also, prior to the effective date of the Transfer, the Ministry of Industry shall amend the concession for electricity transmission and dispatching activities in Italy (which is currently held by the Italian ISO), in order to better ensure the optimal functionality of such concession in light of the interests and responsibilities acquired by Terna pursuant to the Transfer.
- (vi) Article 4 of the DPCM provides that the privatisation of the entity resulting from the Integration should also aim to ensure the stability and continuity of public utility services through the participation of one or more committed shareholders. To this end, by 1st July, 2007, Enel must reduce its ownership interest in Terna, or the resulting entity from the Integration, to no more than 20 per cent. of the total share capital through (a) a demerger of Terna or the resulting entity, (b) the declaration and payment of a distribution or dividend-in-kind in the form of shares of Terna or the resulting entity or (c) the direct sale of shares of Terna or the resulting entity, in each case without compromising the safety and cost objectives of the national transmission system. Upon the completion of the above transactions, Enel may dispose of the remaining shares it holds in Terna or the resulting entity, through objective and non-discriminatory procedures which are directed toward wide distribution of those shares among public investors and/or institutional investors without compromising the safety and cost objectives of the national transmission system.

The tariff system

Procedures used for calculating the tariff rates and Terna's remuneration

Under current legislation, the Italian Energy Authority determines the tariff mechanism pursuant to which the owners of the Italian grid (including Terna) are remunerated. Pursuant to Italian law, the Italian Energy Authority, after consultation with grid participants, annually calculates the tariff rates based on certain formulae and criteria it issues every four years (each a **four year regulatory period**). By law, the regulatory

periods cannot be less than three years. The tariff rates and the remuneration of the owners of the Italian grid are determined using the following procedure:

- (i) the Italian Energy Authority calculates the transmission tariff rates for the first year of each four year regulatory period (subject to subsequent annual adjustments);
- (ii) the Italian ISO invoices, and Italian electricity producers and distributors pay the Italian ISO, the tariff due for the transmission and dispatching activities on the Italian grid. A certain portion of the proceeds from such payments is applied to cover the Italian ISO's costs; and
- (iii) the Italian ISO distributes the remaining amount to the owners of the Italian grid (including Terna), by way of the payment of annual fees.

Calculation of the electricity transmission tariff rates for the first year of each four-year regulatory period and their adjustment in subsequent years

The electricity transmission tariff mechanism is designed to compensate the transmission companies for costs directly related to their activities. Since the tariff mechanism is applicable to all the companies operating in such sector, the Italian Energy Authority calculates the tariff rates based on the “allowed costs” of the transmission sector, which in turn, are based on the average costs of the transmission companies.

In order to calculate the total allowed costs of the transmission sector, the Italian Energy Authority takes into consideration the operating costs (mainly costs for outside services and work, payroll costs and costs associated with the purchase of materials), the depreciation of property, plant and equipment and the remuneration of net invested capital (RAB). Thus, with respect to the first year of each four-year regulatory period, the Italian Energy Authority calculates the total amount of the allowed costs by determining:

- the amount of the operating costs;
- the amount of depreciation;
- the value of net invested capital (RAB); and
- the rate of return at which RAB is remunerated.

After calculating the total allowed costs, the Italian Energy Authority determines the transmission tariff rates for the first year of each four year regulatory period in such a way that, based on the estimate of the expected electricity consumption volume for the first year, the application of the tariff rates results in a tariff which in the aggregate is equal to the total of the allowed costs of the electricity transmission sector. Finally, also in the first year of each four year regulatory period, the Italian Energy Authority determines the yearly tariff rates' adjustment method which is applied in the second, third, and fourth year of each regulatory period, as described in more detail below in “Adjustment of the tariff rates in subsequent years”.

Adjustment of the tariff rates in subsequent years

Pursuant to the calculation of the tariff rates for the first year of each four year regulatory period, the Italian Energy Authority adjusts the tariff rates for each subsequent year by applying an adjustment mechanism (the “price cap” formula) to certain components of the tariff rates. The price cap is calculated as follows:

$P = I - X + Y + Z$ where:

- “P” is the price cap;
- “I” is the average annual fluctuation rate of the consumer price index for the families of workers and office employees recorded by ISTAT for the prior 12 months (i.e., the inflation rate);
- “X” is the annual reduction rate of the allowed costs for the transmission sector established by the Italian Energy Authority for the entire four-year period (the so-called “productivity recovery factor”);

- “Y” is the tariff fluctuation rate linked to costs derived from exceptional and unforeseen events, changes in the regulatory framework and in the obligations related to providing universal service; and
- “Z” is the fluctuation rate linked to measures by the Italian Government designed to control the electricity demand through the efficient use of resources.

Amounts due to the Italian ISO

Based on these tariff rates, producers and distributors in the Italian electricity industry pay the Italian ISO for every kWh that is respectively input onto the grid and output from the Italian grid. The Italian ISO then withholds from the aggregate proceeds of those payments, a certain amount to cover its own costs.

Payment for our services

After withholding the amount to cover its own costs, the Italian ISO pays Terna and the other Italian grid owners the remainder of the amount that the Italian ISO received from electricity producers and distributors. Pending execution of the framework agreement with the Italian ISO by all the Italian grid owners and despite the terms of the Terna Operating Agreement described above, the payment owed to Terna is currently calculated based on the assumption that Terna owns 94.136 per cent. of the Italian grid, a percentage estimated by the Italian Energy Authority on 11th January, 2001. Therefore, the Italian ISO pays Terna 94.136 per cent. of the aggregate proceeds of the payments it receives, net of its own costs. However, following the expansion and development of the Italian grid, this estimate is under review by the Italian Energy Authority, and the Company expects it will be revised downward to a lower percentage.

When the framework agreement with the Italian ISO is eventually signed by all the Italian grid owners the terms of the Terna Operating Agreement are likely to apply in lieu of the above method of calculation. These terms provide for a detailed mechanism to calculate the annual fees for existing elements of the Terna Grid.

The Terna Operating Agreement provides that such fees shall be the sum of:

- a fixed component to cover operating costs, depreciation and remuneration of invested capital (Terna’s share of the allowed sector costs); and
- a variable component linked to the level of the quality of the service, measured in terms of availability of the Terna Grid (the bonus/penalty mechanism).

For the purposes of this calculation, the Terna Operating Agreement envisages a complex mechanism which divides the Italian grid into separate grid elements and identifies such elements based on functional criteria associated with transmission activity (e.g., the types of transmission line and of power station components). For the first regulatory period 2000-2003, these grid elements were assigned annual unit fees that were set by the Italian Energy Authority. These fees are due to be updated shortly for the 2004-2007 regulatory period. The annual unit fees are intended to compensate Terna for its allowed costs. Therefore, the annual fee related to the fixed component is theoretically obtained by multiplying the unit fees by the number of grid elements owned by, or available to, Terna.

In addition, each grid element is then assigned a variable component which is determined by taking into account the availability criteria established by the Italian Energy Authority. The availability criteria are based on the number of hours that a grid element should be available during one year, as determined by the Italian Energy Authority. If Terna in the aggregate outperforms the established criteria (i.e., its grid elements are available for more hours than that established by the Italian Energy Authority), it receives a bonus. If Terna underperforms, the variable component actually becomes a penalty which reduces the annual fee. As of the date of this Offering Circular, the Italian Energy Authority has not yet determined the availability criteria. As a result, the annual fees for existing elements of the Terna Grid are currently comprised only of the fixed component.

In addition to the annual fees for existing elements of the Terna Grid, the Company is paid for its activities in connection with development projects for the Terna Grid that relate to functional requirements and decommissioning, and to legal and regulatory compliance. For most of these activities, the Company signs

separate agreements with the Italian ISO, each of which assesses annual fees as compensation for our services. However, these annual fees are paid to Terna in monthly installments. See “Description of the Issuer—Business—Operation, maintenance and development of the Terna Grid—Development”.

Pursuant to the terms of the Terna Operating Agreement, Terna’s Annual Fees are subject to an additional adjustment mechanism. The Terna Operating Agreement prevents the Italian ISO from paying the Italian grid owners more compensation than the proceeds it has actually received. Therefore, in order to account for possible discrepancies between the aggregate amount of the annual fee that is due to the various owners and the overall proceeds that are collected by the Italian ISO, the agreement provides the fees due to Italian grid owners may be increased or decreased by multiplying them by a coefficient k above or below 1. If the amount due is greater than the available proceeds, k will be a number smaller than 1 and vice versa. This adjustment does not apply to the portion of the fees related to development activities awarded through competitive bidding and the indemnifications related to the plants’ decommissioning.

However, as stated above, the above mechanism for the calculation of the payment due to the Company is not yet in force and Terna’s remuneration is currently calculated simply based on the assumption that the Company owns 94.136 per cent. of the Italian grid. On the other hand, the tariff rates for the 2004-2007 second regulatory period were determined based on the formulae described above and based on the following data.

The first regulatory period 2000-2003

In determining the allowed costs and tariff rates of the transmission sector for the first regulatory period 2000-2003, the Italian Energy Authority used the following criteria and data:

With respect to the calculation of the total allowed costs for the first year of the four year regulatory period:

- *Operating Costs.* For the purpose of calculating the operating costs, Enel’s operating costs for the fiscal year ending 31st December, 1997 applied to 100 per cent. of the Italian Grid.
- *Depreciation.* For the amount of the allowed sector costs relative to depreciation, Enel’s book value for fiscal year ending 31st December, 1997 applied to 100 per cent. of the Italian Grid.
- *RAB.* For RAB, the book value that the Italian Energy Authority had for the invested capital made by Enel in 1997 calculated net of depreciation and certain other adjustments.
- *Annual rate of return on RAB.* An annual rate of return on RAB (“RR”) of 5.6 per cent.

With respect to the adjustment mechanism of the tariff rates for the subsequent years of the four year regulatory period, the Italian Energy Authority applied the price cap to all of the components of the tariff rates using the following data:

- For the years 2001, 2002, 2003, the fluctuation rate related to I was 2.1 per cent., 2.8 per cent. and 2.5 per cent. respectively.
- X. The annual cost reduction rate which had as an objective the reduction of the allowed costs of the transmission sector was four per cent.
- Y. For 2001, the fluctuation rate of Y was zero. For 2002, the Italian Energy Authority set the rate at a level to ensure an increase in the allowed costs of the transmission sector which was due to certain upward changes in Terna’s invested capital which amounted to approximately €31 million. For 2003, the Italian Energy Authority set the rate at 5.5 per cent., taking into account an increase in allowed costs because of the enlargement of the Italian Grid, certain costs associated with the execution of several international agreements regarding cross-border tariffs and certain costs related to expenses incurred by the Italian Energy Authority in order to consolidate its own structures and organisation.
- Z. The rate for Z was zero throughout the applicable years of the first regulatory period (2001-2003).

The second regulatory period 2004-2007

The criteria and data that the Italian Energy Authority applied to determine the allowed costs and the tariff rates for the second regulatory period 2004-2007, are as follows:

With respect to the calculation of the total allowed costs for the first year of the regulatory period:

- *Operating costs.* For the purposes of calculating the “allowed sector costs”, the operating costs will be the sum of:
 - the actual costs for companies operating in the transmission sector during 2001 applied to 2004, adjusted (i) upward, taking into account the percentage fluctuation of the consumer price index and (ii) downward, by applying X (the annual cost reduction rate); and
 - 50 per cent. of the productivity recovery greater than X during 2001 (calculated as the difference between the average allowed costs and the actual costs for 2001) adjusted for the amount of electricity demand estimated for 2004 and allocated to all the owners of the Italian grid (known as “profit sharing”).
- *Depreciation.* After it had performed a reassessment of the value of the Italian grid components and a revision of their useful life, the Italian Energy Authority determined the depreciation component used for the calculation of the allowed costs based on the amount of depreciation for year 2001. This resulted in a reduction of the tariff component relating to depreciation.
- *The value imputed to RAB.* To calculate RAB, the Italian Energy Authority added:
 - the net value of the property plant and equipment for year 1997 (appropriately reassessed utilising the revised useful life relative to depreciation);
 - the net investments made in the 1998—2002 period (appropriately reassessed);
 - an appraisal of net investments made in the year 2003; and
 - the value of net working capital (conventionally determined as one per cent of the value of net invested capital) and certain other adjustments.

Based on this method (which resulted in an increase in RAB, and as a result, of the tariff component relating to RAB), the Italian Energy Authority attributes to the entire Italian grid a value of €5.2 billion of which, according to the preliminary calculations made by Terna, €4.9 billion can be attributed to the Terna Grid. However, the above value does not constitute an appraisal of the market value of the Terna Grid.

- *Annual rate of return on RAB (RR).* The Italian Energy Authority determined that the RR applicable to the electricity transmission sector (before taxes) will be 6.7 per cent.. Furthermore, in order to encourage the expansion of the Italian grid, the Italian Energy Authority decided that the RR for development activities related to functional requirements will be two per cent higher (therefore, a total of 8.7 per cent.). In order to receive this premium remuneration, such development investments must be completed by 30th June of the preceding year. See “Description of the Issuer—Business—Operation, maintenance and development of the Terna Grid—Development”.

With respect to the adjustment mechanism applicable in the subsequent years of the four year regulatory period, the Italian Energy Authority decided that it shall adjust certain components of the transmission tariff rates by:

- applying the price cap only to the tariff rate components related to operating costs and depreciation of the previous year, and in relation to this:
 - setting the annual reduction rate X at 2.5 per cent. (I, Y and Z will be determined annually in each subsequent year);
- deciding that the price cap will not apply to the tariff rate component related to the RR; and

- applying to the tariff rate component related to RR for the previous year:
 - the annual investment deflator published by ISTAT;
 - the expected volume of electricity demand in Italy;
 - the change in net investments made during the previous year; and
 - the higher remuneration allowed for completed development activities.

In light of the differences listed above between the first and second regulatory period, the Company estimates that the amount of the payment the Company will receive for 2004 will slightly increase as compared to the payment the Company received for 2003.

Strategy

The Company goal is to continue to maximise value for Terna shareholders and employees, the end-users of Terna Group transmission networks (including electricity producers and distributors) and the system operators of the countries in which Terna Group conducts its business, by pursuing the following strategies:

- continuing to achieve operating excellence in electricity transmission businesses;
- pursuing selected growth opportunities in relation to the engineering, construction, operation and maintenance of high and very-high voltage infrastructures in Italy and abroad; and
- managing Terna Group capital structure efficiently.

Operating excellence in Terna Group electricity transmission businesses

Terna Group plans to continue to achieve operating excellence in Terna Group electricity transmission businesses by implementing the three strategic initiatives described below:

Increased efficiency

In order to maximise the efficiency of the Company's operations, Terna plans to implement a number of initiatives aimed at optimising the efficiency of the use of its resources, technologies and management systems.

Resources. The Company plans to minimise its personnel and overhead costs by seeking the right balance between employed personnel and outsourced services, and to increase the productivity of its employees by enabling the wider use of information systems and work methods which rely on new and more efficient technologies. The Company also plan to develop further its core managerial and operating expertise through ongoing technical and professional training. Finally, the Company is committed to reducing its costs for materials and services by introducing new technologies to reduce the overall volume of services required, and through the increased use of e-procurement.

Technologies. The Company also plans to increase the use of cutting-edge technologies for its plant operations, including digital plant management tools. The Company believes that such technologies can improve the reliability of its plants and may therefore reduce the maintenance work and, in general, the overall amount of resources required for its operations.

Management systems. Finally, the Company is working towards continuous quality and efficiency improvements to its internal management processes, particularly through the use of integrated computer systems that enable more streamlined decision-making and maintenance activities.

Optimisation of investment activities

The Company is currently in the process of increasing the use of "condition-based" maintenance processes (instead of scheduled maintenance programmes), which the Company believes will lead to reductions in

ordinary and extraordinary maintenance expenses and extend the useful life of its assets. Furthermore, the Company intends to maximise returns on development projects awarded to the same Company by the Italian ISO by improving cost controls and time-to-completion for its investment activities and efficiently balancing internal resources and outsourced services for such activities.

Improved availability and reliability of Terna Group services

While the Company intends to achieve the efficiency improvements outlined above, one of its primary strategic objectives is to maintain the availability and reliability levels on the Terna Grid required by the Italian ISO and to ensure that the availability and reliability levels on the Brazilian Subsidiaries Grid are in line with the levels contemplated by Terna Group bids for the Brazilian concessions. To that end, the Company plans to improve the quality of its services by increasing the use of the “live works” method of maintenance (which will reduce plant downtime and disconnections) by rationalising its scheduled maintenance programmes and by continuously monitoring the quality of its service.

Pursuit of selected growth opportunities in Italy and abroad

The Company plans to pursue the following selected growth opportunities in Italy and abroad.

Development of unregulated activities

The Company intends to leverage its core competencies in the engineering, construction, operation and maintenance of high and very-high voltage transmission networks by exploiting existing and future opportunities that may arise as a result of the gradual liberalisation of the electricity sectors in Italy and abroad. One example is the construction, operation and maintenance of transmission lines connecting the Italian grid with other foreign grids, the so-called merchant lines, in partnership with private investors.

Opportunities arising from the restructuring of the electricity transmission sector in Italy

In light of Law 290/03, the Company believes that potential acquisitions of portions of the Italian grid that Terna currently does not own, as well as the integration of the ownership and management of the Italian grid, may generate opportunities for the creation of synergies. The Company considers synergies could be achieved through, among other things, the rationalisation of fixed costs, the optimal use of the Company’s territorial presence, greater co-ordination in the operation of the Italian grid and the planning and implementation of maintenance projects.

Development investments

Furthermore, the Company intends to consolidate its leadership position among the Italian grid owners in the engineering and construction field by seeking a greater market share of development projects put to tender by the Italian ISO.

Selected international expansion

In order to leverage its existing assets, the Company plans to monitor closely future development opportunities in Brazil, where over 12,000km of new lines are expected to be built by 2007. Furthermore, the Company intends to evaluate projects to develop, and subsequently operate and maintain, electricity transmission networks in foreign countries undergoing electricity sector privatisation, such as the countries located in the Balkans region, where the service levels are currently substandard, and the countries located in the Southern Mediterranean, where low electricity production costs may provide opportunities for the development of transnational transmission infrastructures and electricity export activities.

Efficient management of Terna Group capital structure

The Company intends to continue managing its capital structure (as expressed by, among other indicators, its debt-to-equity ratio) as efficiently as possible, also taking into account its expected cash flows from operating activities, its current and future investment programmes, and the applicable tariff for its regulated

activities for the period from 2004 to 2007 (as determined by the Italian Energy Authority). To that end, during the course of the first half of 2004, the Company has increased its leverage in order to reduce its overall cost of capital and bring its leverage closer to that of comparable companies and to the leverage assumed by the Italian Energy Authority in its most recent tariff determination.

The Company has obtained from Moody's and Standard & Poor's a credit rating equivalent to Aa3 and AA-, respectively, on a long term basis.

Furthermore, the Company intends to pursue a dividend policy that is in line with the policies of comparable Italian and European companies operating in highly regulated sectors.

Environmental matters

Italy

The Company has taken the following steps to reduce the environmental impact of its operations and facilities:

- the implementation of new engineering, planning and construction principles for new electricity transmission networks and systems that improve the visual impact of its facilities, including the design and installation of new tubular supports for transmission lines in residential areas;
- the promotion of competitions for designs that are sensitive to environmental concerns;
- the protection of the bird population through the monitoring of nests on its pylons in collaboration with the *Istituto Superiore di Sanità* (National Institute of Health);
- the use of aerial topographical maps in evaluating the environmental impact of planned facilities; and
- the use of satellite mapping techniques for electromagnetic fields, in co-operation with CESI, Terna's research and development arm.

Brazil

TSN and Novatrans hold all material environmental licences required to carry on their businesses and to install connections for electrical transmission networks.

As part of the licensing process, TSN and Novatrans are required to take certain measures (including the provision of an environmental impact study) and to make investments in protected areas to offset the environmental impact of their operations. The *Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis* (the Brazilian Institute for Environment and Renewable Natural Resources, **IBAMA**) determines the amount of the required investment and how and where such investment should be made. The amount of the investment must be equal to at least 0.5 per cent. of the value of the total investments in a new development project. As of 31st December, 2003, Novatrans had invested approximately 43 per cent. of its required investment, while TSN had invested less than 1 per cent. of its required investment. TSN and Novatrans are awaiting IBAMA's further directions and specifications for the balance of their required investments.

Health and safety

In order to protect its employees, Terna has implemented preventive health and safety measures.

Such measures provide for (i) the remote decommissioning of any segment of the Terna Grid and (ii) the grounding of the transmission line or components, before maintenance or decommissioning projects are commenced.

Blackout of 28th September, 2003

On 28th September, 2003, an interruption of the electricity supplied via the Italian grid resulted in a blackout throughout almost all of Italy which is currently the subject of inquiries in Italy and abroad. This blackout was one of a number of major power outages in countries in Europe and North America during 2003 and involved a local or regional imbalance between power production and consumption, with single failures triggering a cascade-like shutdown of lines and power plants following overload or voltage problems.

On 9th June, 2004, the Energy Authority published a preliminary report that, while not making any definitive finding regarding responsibility, raised the possibility that the blackout may have been partially attributable to the conduct of a number of Italian generation, distribution and transmission companies. On 9th September, 2004, the Energy Authority initiated a formal proceeding to determine whether any of the companies identified in the report (including Terna) were actually responsible. At the close of the inquiry, which is currently expected to take approximately five months, the Authority could impose pecuniary administrative sanctions on, or request undertakings from, operators it holds at fault for the incident. The Company believes that the blackout, given its intensity and nature, should be considered an unforeseen and unforeseeable event. As a result, the Company does not believe it may be held liable for this event.

The Company cannot predict the outcome of these inquiries or the actions that may be required to be taken as a result of related findings. Also the Company cannot predict whether the outcome of inquiries or of any claim eventually brought against the Company based on such outcome will have a material adverse effect on its financial condition and results of operation.

Litigation and arbitration proceedings

In the ordinary course of its business, as of 30th June, 2004, Terna is a party to approximately 900 civil and administrative proceedings (almost 200 of which relate to claims of more than €250,000), both as plaintiff and defendant, and some criminal proceedings. Terna is not a party to any arbitration proceedings. The principal civil and administrative proceedings in which Terna is a party fall in the categories of annulment of authorisations, damage to health and requests for modification of the location or operating conditions of the Terna Grid, lawsuits related to easements, labour rights and lawsuits regarding non-payment for the performance of contract work.

The Company has established a provision for litigation and contingent liabilities which, as of 30th June, 2004, totalled €12.2 million. This provision does not cover approximately 440 civil and administrative claims brought against the Company for which the damages have not been quantified or in relation to which the plaintiff's prospects are considered by the Company to be remote.

Due to their nature, the Company is not able to predict the ultimate outcome of the proceedings currently pending against Terna, some of which may be unfavorable to the Company and may require the Company itself to pay damages to the plaintiff(s), incur costs for modifying parts of the Terna Grid or temporarily remove parts of the Terna Grid from service. However, the Company does not believe that a negative outcome in any of these proceedings would compromise the operation of the Terna Grid as a whole and, taken as a whole, the Company believes its provisions for litigation and contingent liabilities are adequate.

The Company does not expect the outcome of the pending proceedings to have, individually or in the aggregate, a material adverse effect on the financial position or results of operations.

MANAGEMENT

Terna is managed by a Board of Directors (the **Board of Directors**) which may delegate some of its powers to an Executive Committee and/or one of its members. In addition, pursuant to the Italian Civil Code, Terna has a supervisory body, the Board of Statutory Auditors (the **Board of Statutory Auditors**).

Board of Directors

General information

Terna's Board of Directors is responsible for the management of the Company. Pursuant to the By-laws, the Board must be comprised of not less than seven and not more than 13 members. Pursuant to Italian privatisation law and Article 6.3 of the By-laws, the Ministry of Economy and Finance, in consultation and agreement with the Ministry of Industry, may appoint (and, in the event of removal or resignation, replace) an additional director without voting rights to the Board of Directors. Currently, none of the current directors has been appointed in such manner.

With the exception of three non-executive independent directors elected on 16th September, 2004 and one non-executive independent director who became a member of the Board on 12th May, 2004, Terna's current Board was elected by Enel at the general shareholders' meeting held on 3rd March, 2004. Based on the By-laws, the Board should remain in office until the approval of the financial statements for the year ended 31st December, 2006. However, future amendments to the By-laws that will be added pursuant to the DPCM will provide that, within 60 days of the Integration, the shareholders of the resulting entity will elect a new board of directors in accordance with the new By-laws and such duly elected board of directors will remain in office until the date Enel reduces its shareholding in Terna to no more than 20 per cent. of the outstanding share capital. The directors hold office for three years and may be re-elected for subsequent terms. In addition, future amendments to the By-laws mandated by the DPCM will prohibit any company (such as Enel) that is involved in the production, importation, distribution, sale or transmission of electricity (or which controls, is controlled by, or is under common control with, any such company), and that owns more than five per cent. of the shares of the resulting entity from the Integration, from voting shares that exceed five per cent. of the voting share capital of the resulting entity in the election of the resulting entity's directors.

As of the date of this Offering Circular, the Board of Directors is composed of the following ten members:

<u>Name</u>	<u>Position with Terna</u>	<u>Year of initial appointment</u>
Fulvio Conti	Chairman	2004
Sergio Mobili	Managing Director	1999
Claudio Machetti	Director	2004
Massimo Romano	Director	2004
Paolo Ruzzino	Director	2003
Salvatore Sardo	Director	2004
Davide Croff	Director	2004
Luca Arnaboldi	Independent non-executive Director	2004
Paolo Cantarella.....	Independent non-executive Director	2004
Salvatore Machi.....	Independent non-executive Director	2004

The current compensation committee comprises three members. The current internal audit committee comprises three members.

The table below sets forth Terna's executive officers, who are not also directors, their ages, their positions and the year they were appointed to such position as of October 2004:

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>Employed at Terna since</u>
Paolo Ricci	63	Head of Engineering and Facility Maintenance	Terna's incorporation
Diego Bisci	62	Head of Facility Operation and Monitoring	Terna's incorporation
Fabio Todeschini	44	CFO	February 2004
Luciano Di Bacco	48	Head of the Administration and Fiscal Department	Terna's incorporation
Filomena Passeggio	52	Head of Legal Department and Corporate Secretary	Terna's incorporation
Alessandro Fiocco	37	Head of Communication, Public and Regulatory Affairs	February 2004
Massimo Cioffi	43	Head of Personnel and Organisation	December 2003
Luigi Celani	56	Head of Purchasing and Contracting	Terna's incorporation
Alessandro Karlin	55	Managing Director of TSN and Novatrans	April 2004
Fulvio De Luca.....	43	Head of Audit	February 2004
Pierfrancesco Zanuzzi	34	Head of Business Development	February 2004

Pursuant to the Italian Civil Code, Terna's shareholders are required to elect a Board of Statutory Auditors.

The Board of Statutory Auditors must supervise Terna's compliance with law and the By-laws, Terna's administration, the adequacy of internal controls and accounting reporting systems, as well as the adequacy of provisions concerning information supply by Terna subsidiaries. At the annual general meeting, called for the approval of Terna's financial statements, the Board of Statutory Auditors must inform shareholders of any irregularities found during the course of its supervision. In addition, the Board of Statutory Auditors must promptly report all material irregularities to CONSOB, to the shareholders and to the courts. Pursuant to the By-laws, Terna's Directors are obligated to keep the Board of Statutory Auditors informed of material activities and transactions carried out by Terna and its subsidiaries on an ongoing basis. Auditors are elected at the shareholders' general meeting for a three-year term, with the right of re-election. The Board of Statutory Auditors' remuneration for the entire term is also determined at the shareholders' general meeting.

The current members of the Board of Statutory Auditors, who were elected by Enel at Terna's general shareholder meeting on 12th March, 2002, and will remain in office until the approval of the financial statements for the year ended 31st December, 2004, are as follows:

<u>Name</u>	<u>Position</u>	<u>Year of initial appointment</u>
Giovanni Ferreri	Chairman	2002
Bruno Franceschetti	Auditor	2002
Giancarlo Russo Corvace	Auditor	2002
Daniela Gallucci	Alternate Auditor	2002
Fabrizio Orazi	Alternate Auditor	2002

Pursuant to the By-laws, the members of the Board of Statutory Auditors will be elected based on a cumulative voting system, whereby each shareholder or group of shareholders holding at least one per cent of the shares with voting rights may propose a list of candidates for nomination to the Board of Statutory Auditors.

In addition, under Italian securities regulations, the Company's accounts must be audited by external auditors appointed by the shareholders. The appointment is communicated to the *Commissione Nazionale per le Società e la Borsa*, or CONSOB. As of the fiscal year 2004, the Company's external auditors for both consolidated and non-consolidated accounts is KPMG S.p.A. Under Italian securities laws, listed companies may not appoint the same auditors for more than three consecutive three year terms. The external auditors issue an opinion that the Company's financial statements are presented fairly in all material respects. Their opinion is made available to the Company's shareholders prior to the annual shareholders meeting.

TAXATION

The statements herein regarding taxation are based on the laws and regulations in force in the Republic of Italy (Italy) and the European Union as at the date of this Offering Circular and are subject to any changes in law occurring after such date, which changes could be made on a retroactive basis. The following summary does not purport to be a comprehensive description of all the tax considerations which may be relevant to a decision to subscribe for, purchase, own or dispose of the Notes and does not purport to deal with the tax consequences applicable to all categories of investors, some of which (such as dealers in securities or commodities) may be subject to special rules.

Italian Taxation

The following is a summary of current Italian law and practice relating to the taxation of the Notes. Prospective purchasers of the Notes are advised to consult their own tax advisers concerning the overall tax consequences of their ownership of the Notes. Law No. 80 of 7th April, 2003 for the reform of the Italian tax system was approved by the Italian Parliament on 26th March, 2003 and authorises the Italian Government, inter alia, to issue, within two years of the entering into force of such law, legislative decrees introducing a general reform of the tax treatment of financial income, which may impact the tax regime of the Notes, as described below. Legislative Decree No. 344 of 12th December, 2003 published in the Italian Official Gazette of 16th December, 2003, No. 261 (Ordinary Supplement No. 190), effective as of 1st January, 2004 introduced the reform of taxation of corporations and of certain financial income amending the Italian Income Taxes Consolidated Code.

Tax treatment of the Notes

Legislative Decree No. 239 of 1st April, 1996, as subsequently amended, (**Decree 239**) provides for the applicable regime with respect to the tax treatment of interest, premium and other income (including the difference between the redemption amount and the issue price) from notes falling within the category of bonds (*obbligazioni*) or debentures similar to bonds (*titoli similari alle obbligazioni*) issued, inter alia, by Italian listed companies, provided that the notes are issued for an original maturity of not less than 18 months.

Italian resident Noteholders

Where an Italian resident Noteholder is (i) an individual not engaged in an entrepreneurial activity to which the Notes are connected (unless he has opted for the application of the *risparmio gestito* regime – see under “*Capital gains tax*”, below); (ii) a non-commercial partnership; (iii) a non-commercial private or public institution; or, (iv) an investor exempt from Italian corporate income taxation, interest, premium and other income relating to the Notes, accrued during the relevant holding period, are subject to a tax withheld at source, referred to as *imposta sostitutiva*, levied at the rate of 12.5 per cent. If the Noteholders described under (i) and (iii) above are engaged in an entrepreneurial activity to which the Notes are connected, the *imposta sostitutiva* applies as a provisional tax.

Where an Italian resident Noteholder is a company or similar commercial entity and the Notes are deposited with an authorised intermediary, interest, premium and other income from the Notes will not be subject to *imposta sostitutiva*, but must be included in the relevant Noteholder’s income tax return and are therefore subject to general Italian corporate taxation (and, in certain circumstances, depending on the “status” of the Noteholder, also to IRAP – the regional tax on productive activities).

Under the current regime provided by Law Decree No. 351 of 25th September, 2001 converted into law with amendments by Law No. 410 of 23rd November, 2001, as clarified by the Italian Revenue Agency through Circular No. 47/E of 8th August, 2003, payments of interests, premiums or other proceeds in respect of the Notes made to Italian resident real estate investment funds established pursuant to Article 37 of Legislative Decree No. 58 of 25th January, 1994 are subject neither to substitute tax nor to any other income tax in the hands of a real estate investment fund.

Pursuant to Article 41*bis*, paragraph 9, of Decree No. 269 (as referred to below), a 12.5 per cent. substitute tax on proceeds deriving from the participation in real estate investment funds is applicable to participants qualified as Italian resident taxpayers or non-Italian resident taxpayers that are resident in a country which does not allow for a satisfactory exchange of information with Italy. Such substitute tax could be applied as a provisional or a final tax, depending on the status of the taxpayer.

Where an Italian resident Noteholder is an open-ended or a closed-ended investment fund (the **Fund**) or a SICAV and the Notes are deposited with an authorised intermediary, interest, premium and other income relating to the Notes and accrued during the holding period will not be subject to *imposta sostitutiva*, but to a 12.5 or to a 5 per cent. annual substitute tax (the **Collective Investment Fund Tax**). The 12.5 per cent. substitute tax is calculated on the net result accrued at the end of the tax period. Pursuant to Article 12 of Law Decree 30th September, 2003, No. 269 (**Decree No. 269**), the 5 per cent. substitute tax on the net result accrued at the end of the tax period applies, if: (i) according to the Fund management regulation or to the SICAV by-laws, the Fund or the SICAV hold a participation of at least two thirds of their portfolio in small or medium capitalised companies listed on EU Stock Exchanges; and, (ii) following the first year from the application of this tax regime and during the subsequent years (with certain days of tolerance in each year), the participation in small or medium capitalised companies is equal at least to two thirds of the portfolio of the Fund or of the SICAV. For the purpose of Article 12 of Decree No. 269, a small or medium capitalised company is a company with a market capitalisation not greater than Euro 800,000,000, calculated with reference to the market price as registered in the last trading day of each quarter.

Where an Italian resident Noteholder is a pension fund (subject to the regime provided for by articles 14, 14-*ter* and 14-*quater*, paragraph 1 of Legislative Decree No. 124 of 21st April, 1993) and the Notes are deposited with an authorised intermediary, interest, premium and other income relating to the Notes and accrued during the holding period will not be subject to *imposta sostitutiva*, but must be included in the result of the relevant portfolio accrued at the end of the tax period, to be subject to an 11 per cent. substitute tax.

Pursuant to Decree 239, *imposta sostitutiva* is applied by banks, SIMs, fiduciary companies, SGRs, stockbrokers and other entities identified by a decree of the Ministry of Economy and Finance (each an **Intermediary**).

An Intermediary must (i) be resident in Italy or be a permanent establishment in Italy of a non-Italian resident financial intermediary; and (ii) intervene, in any way, in the collection of interest or in the transfer of the Notes. For the purpose of the application of the *imposta sostitutiva*, a transfer of Notes includes any assignment or other act, either with or without consideration, which results in a change of the ownership of the relevant Notes or in a change of the Intermediary with which the Notes are deposited.

Where the Notes are not deposited with an Intermediary, the *imposta sostitutiva* is applied and withheld by any entity paying interest to a Noteholder.

Non-Italian resident Noteholders

Where the Noteholder is a non-Italian resident, an exemption from the *imposta sostitutiva* applies provided that the non-Italian resident beneficial owner is (i) resident, for tax purposes, in a country which allows a satisfactory exchange of information with Italy; or (ii) an international body or entity set up in accordance with international agreements which have entered into force in Italy; or (iii) a Central Bank or an entity which manages, *inter alia*, the official reserves of a foreign State; or (iv) an institutional investor which is resident in a country which allows a satisfactory exchange of information with Italy, even if it does not possess the status of a taxpayer in its own country of residence.

The *imposta sostitutiva* will be applicable at the rate of 12.5 per cent. (or at the reduced rate provided for by the applicable double tax treaty, if any) to interest, premium and other income paid to Noteholders which are resident, for tax purposes, in countries which do not allow a satisfactory exchange of information with Italy.

In order to ensure gross payment, non-Italian resident Noteholders must be the beneficial owners of the payments of interest, premium or other income and (i) deposit, directly or indirectly, the Notes with a resident bank or SIM or a permanent establishment in Italy of a non-Italian resident bank or SIM or with a

non-Italian resident entity or company participating in a centralised securities management system which is in contact, via computer, with the Ministry of Economy and Finance; and (ii) file with the relevant depository, prior to or concurrently with the deposit of the Notes, a statement of the relevant Noteholder, which remains valid until withdrawn or revoked, in which the Noteholder declares to be eligible to benefit from the applicable exemption from *imposta sostitutiva*. Such statement, which is not requested for international bodies or entities set up in accordance with international agreements which have entered into force in Italy or in the case of foreign Central Banks or entities which manage, *inter alia*, the official reserves of a foreign State, must comply with the requirements set forth by the ministerial decree of 12th December, 2001.

Early Redemption

Without prejudice to the above provisions, in the event that Notes having an original maturity of at least 18 months are redeemed prior to 18 months from their issue date, the Issuer will be required to pay a tax equal to 20 per cent. of the interest and other amounts accrued from the relevant issue date up to the time of the early redemption. Such payment will be made by the Issuer and will not affect the amounts to be received by the Noteholder by way of interest or other amounts, if any, under the Notes.

Capital gains tax

Any gain obtained from the sale or redemption of the Notes would be treated as part of the taxable income (and, in certain circumstances, depending on the status of the Noteholder, also as part of the net value of production for IRAP purposes) if realised by an Italian company or a similar commercial entity (including the Italian permanent establishment of foreign entities to which the Notes are connected) or Italian resident individuals engaged in an entrepreneurial activity to which the Notes are connected.

Where an Italian resident Noteholder is an individual not holding the Notes in connection with an entrepreneurial activity and certain other persons, any capital gain realised by such Noteholder from the sale or redemption of the Notes would be subject to an *imposta sostitutiva*, levied at the current rate of 12.5 per cent. Noteholders may set off losses with gains.

In respect of the application of the *imposta sostitutiva*, taxpayers may opt for one of the three regimes described below.

Under the tax declaration regime (*regime della dichiarazione*), which is the default regime for Italian resident individuals not engaged in entrepreneurial activity to which the Notes are connected, the *imposta sostitutiva* on capital gains will be chargeable, on a cumulative basis, on all capital gains, net of any incurred capital loss, realised by the Italian resident individual Noteholder holding Notes not in connection with an entrepreneurial activity pursuant to all sales or redemptions of the Notes carried out during any given tax year. Italian resident individuals holding Notes not in connection with an entrepreneurial activity must indicate the overall capital gains realised in any tax year, net of any relevant incurred capital loss, in the annual tax return and pay *imposta sostitutiva* on such gains together with any balance of income tax due for such year. Capital losses in excess of capital gains may be carried forward against capital gains realised in any of the four succeeding tax years.

As an alternative to the tax declaration regime, Italian resident individual Noteholders holding the Notes not in connection with an entrepreneurial activity may elect to pay the *imposta sostitutiva* separately on capital gains realised on each sale or redemption of the Notes (the *risparmio amministrato* regime). Such separate taxation of capital gains is allowed subject to (i) the Notes being deposited with Italian banks, SIMs (*Società di intermediazione mobiliare*) or certain authorised financial intermediaries; and (ii) an express election for the *risparmio amministrato* regime being punctually made in writing by the relevant Noteholder. The depository is responsible for accounting for *imposta sostitutiva* in respect of capital gains realised on each sale or redemption of the Notes (as well as in respect of capital gains realised upon the revocation of its mandate), net of any incurred capital loss, and is required to pay the relevant amount to the Italian tax authorities on behalf of the taxpayer, deducting a corresponding amount from the proceeds to be credited to the Noteholder or using funds provided by the Noteholder for this purpose. Under the *risparmio amministrato* regime, where a sale or redemption of the Notes results in a capital loss, such loss may be

deducted from capital gains subsequently realised, within the same securities management, in the same tax year or in the following tax years up to the fourth. Under the *risparmio amministrato* regime, the Noteholder is not required to declare the capital gains in its annual tax return.

Any capital gains realised by Italian resident individuals holding the Notes not in connection with an entrepreneurial activity who have entrusted the management of their financial assets, including the Notes, to an authorised intermediary and have opted for the *risparmio gestito* regime will be included in the computation of the annual increase in value of the managed assets accrued, even if not realised, at year end, subject to a 12.5 per cent. substitute tax, to be paid by the managing authorised intermediary. Under the *risparmio gestito* regime, any depreciation of the managed assets accrued at year end may be carried forward against increase in value of the managed assets accrued in any of the four succeeding tax years. Under the *risparmio gestito* regime, the Noteholder is not required to declare the capital gains realised in its annual tax return.

Any capital gains realised by a Noteholder which is an Italian open-ended or a closed-ended investment fund or a SICAV will be included in the result of the relevant portfolio accrued at the end of the tax period, to be subject to the Collective Investment Fund Tax.

Any capital gains realised by a Noteholder which is an Italian pension fund (subject to the regime provided for by articles 14, 14-ter and 14-quater, paragraph 1, of Legislative Decree No. 124 of 21st April, 1993) will be included in the result of the relevant portfolio accrued at the end of the tax period, to be subject to the 11 per cent. substitute tax.

Capital gains realised by non-Italian-resident Noteholders from the sale or redemption of Notes traded on regulated markets are not subject to the *imposta sostitutiva*.

Capital gains realised by non-Italian resident Noteholders from the sale or redemption of the Notes not traded on regulated markets are not subject to the *imposta sostitutiva*, provided that the effective beneficiary: (i) is resident in a country which allows a satisfactory exchange of information with Italy; or (ii) is an international entity or body set up in accordance with international agreements which have entered into force in Italy; or (iii) is a Central Bank or an entity which manages, *inter alia*, the official reserves of a foreign State; or (iv) is an institutional investor which is resident in a country which allows a satisfactory exchange of information with Italy, even if it does not possess the status of a taxpayer in its own country of residence.

If none of the conditions described above is met, capital gains realised by non-Italian resident Noteholders from the sale or redemption of the Notes not traded on regulated markets are subject to the *imposta sostitutiva* at the current rate of 12.5 per cent.

In any event, non-Italian resident individuals or entities without a permanent establishment in Italy to which the Notes are connected, that may benefit from a double taxation treaty with Italy providing that capital gains realised upon the sale or redemption of notes are to be taxed only in the country of tax residence of the recipient, will not be subject to *imposta sostitutiva* on any capital gains realised upon the sale or redemption of the Notes.

Italian gift tax

Italian inheritance tax has been abolished by Law No. 383 of 18th October, 2001 in respect of gifts made or succession proceedings started after 25th October, 2001. Transfers of the Notes by reason of gift to persons other than the spouse, siblings, ascendants, descendants or relatives within the fourth degree will be subject to the transfer taxes ordinarily applicable to the relevant transfer for consideration, if due, in respect of the value of the gift received by each person exceeding Euro 180,759.91.

Transfer tax

Pursuant to Italian Legislative Decree No. 435 of 21st November, 1997, which partly amended the regime set forth by Royal Decree No. 3278 of 30th December, 1923, the transfer of the Notes may be subject to the Italian transfer tax, which is currently payable at a rate between a maximum of Euro 0.0083 and a minimum of Euro 0.00465 per Euro 51.65 (or fraction thereof) of the price at which the Notes are transferred. Where

the transfer tax is applied at a rate of Euro 0.00465 per Euro 51.65 (or fraction thereof) of the price at which the Notes are transferred, the transfer tax cannot exceed Euro 929.62.

However, the transfer tax does not apply, *inter alia*, to: (i) contracts entered into on regulated markets relating to the transfer of securities, including contracts between the intermediary and its principal or between qualified intermediaries; (ii) off-market transactions regarding securities listed on regulated markets, provided that the contracts are entered into (a) between banks, SIMs or other financial intermediaries regulated by Legislative Decree No. 415 of 23rd July, 1996, as superseded by Legislative Decree No. 58 of 24th February, 1998, or stockbrokers; (b) between the subjects mentioned in (a) above, on the one hand, and non-Italian residents, on the other hand; and (c) between the subjects mentioned in (a) above, even if non-resident in Italy, on the one hand, and undertakings for collective investment in transferable securities, on the other hand; (iii) contracts related to sales of securities occurring in the context of a public offering (*offerta pubblica di vendita*) aimed at the listing on regulated markets, or involving financial instruments already listed on regulated markets; or (iv) contracts regarding securities not listed on a regulated market entered into between the authorised intermediaries referred to in (ii)(a) above, on the one hand, and non-Italian residents, on the other hand; and (v) contracts for a consideration not exceeding Euro 206.58.

EU Savings Directive

On 3rd June, 2003, the European Council of Economics and Finance Ministers adopted a Directive on the taxation of savings income under which Member States will be required, from a date not earlier than 1st July, 2005, to provide to the tax authorities of another Member State details of payments of interest (or similar income) paid by a person within its jurisdiction to an individual resident in that other Member State, except that, for a transitional period, Belgium, Luxembourg and Austria will instead be required (unless during that period they elect otherwise) to operate a withholding system in relation to such payments (the ending of such transitional period being dependent upon the conclusion of certain other agreements relating to information exchange with certain other countries).

SUBSCRIPTION AND SALE

Credit Suisse First Boston (Europe) Limited, J. P. Morgan Securities Ltd., UBS Limited (together, the **Joint-Lead Managers**), ABN AMRO Bank N.V., Banca Akros S.p.A. – Gruppo Banca Popolare di Milano, Banca Nazionale del Lavoro S.p.A., Banco Bilbao Vizcaya Argentaria, S.A., Banco Santander Central Hispano, S.A., Banc of America Securities Limited, Bayerische Hypo-und Vereinsbank AG, Bear, Stearns International Limited, Daiwa Securities SMBC Europe Limited, Deutsche Bank AG London, Dexia Banque Internationale à Luxembourg, société anonyme acting under the name of Dexia Capital Markets, Dresdner Bank AG London Branch, DZ BANK AG Deutsche Zentral-Genossenschaftsbank, Frankfurt am Main, HSBC Bank plc, ING Belgium SA/NV, Lehman Brothers International (Europe), Mitsubishi Securities International plc, MPS Finance Banca Mobiliare S.p.A., Nomura International plc, RASFIN SIM S.p.A., Société Générale and The Royal Bank of Scotland plc (together with the Joint-Lead Managers, the **Managers**) have, pursuant to a Subscription Agreement (the **Subscription Agreement**) dated 26th October, 2004, jointly and severally agreed to subscribe or procure subscribers for (i) the A Notes at the issue price of 99.624 per cent. of the principal amount of Notes, less a combined selling concession and management and underwriting commission of 0.325 per cent. of the principal amount of the A Notes and (ii) the B Notes at the issue price of 99.968 per cent. of the principal amount of Notes, less a combined selling concession and management and underwriting commission of 0.225 per cent. of the principal amount of the B Notes. The Issuer will also reimburse the Managers in respect of certain of their expenses, and has agreed to indemnify the Managers against certain liabilities, incurred in connection with the issue of the Notes. The Subscription Agreement may be terminated in certain circumstances prior to payment of the Issuer.

United States

The Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except in certain transactions exempt from the registration requirements of the Securities Act.

The Notes are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a United States person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by the U.S. Internal Revenue Code of 1986 and regulations thereunder.

Each Manager has agreed that, except as permitted by the Subscription Agreement, it will not offer, sell or deliver the Notes (a) as part of their distribution at any time or (b) otherwise until 40 days after the later of the commencement of the offering and the Closing Date within the United States or to, or for the account or benefit of, U.S. persons and that it will have sent to each dealer to which it sells any Notes during the distribution compliance period a confirmation or other notice setting forth the restrictions on offers and sales of the Notes within the United States or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S under the Securities Act.

In addition, until 40 days after the commencement of the offering, an offer or sale of Notes within the United States by any dealer that is not participating in the offering may violate the registration requirements of the Securities Act.

United Kingdom

Each Manager has represented and agreed that, except as permitted by the Subscription Agreement:

- (a) it has not offered or sold and, prior to the expiry of the period of six months from the Closing Date, will not offer or sell, any Notes to persons in the United Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 (as amended);

- (b) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue of the Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer; and
- (c) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

The Republic of Italy

Each Manager has represented and agreed that the offering of the Notes has not been cleared by CONSOB (the Italian Securities Exchange Commission) pursuant to Italian securities legislation and, accordingly, no Notes may be offered, sold or delivered, nor may copies of the Offering Circular or of any other document relating to the Notes be distributed in the Republic of Italy, except:

- (i) to professional investors (“*operatori qualificati*”), as defined in Article 31, second paragraph, of CONSOB Regulation No. 11522 of 1st July, 1998, as amended; or
- (ii) in circumstances which are exempted from the rules on solicitation of investments pursuant to Article 100 of Legislative Decree No. 58 of 24th February, 1998 (the **Financial Services Act**) and Article 33, first paragraph, of CONSOB Regulation No. 11971 of 14th May, 1999, as amended.

Each Manager has further represented and agreed that any offer, sale or delivery of the Notes or distribution of copies of the Offering Circular or any other document relating to the Notes in the Republic of Italy under (i) or (ii) above must be:

- (a) made by an investment firm, bank or financial intermediary permitted to conduct such activities in the Republic of Italy in accordance with the Financial Services Act and Legislative Decree No. 385 of 1st September, 1993, as amended (the **Banking Act**); and
- (b) in compliance with Article 129 of the Banking Act and the implementing guidelines of the Bank of Italy pursuant to which the issue or the offer of securities in the Republic of Italy may need to be preceded and followed by an appropriate notice to be filed with the Bank of Italy depending, *inter alia*, on the aggregate value of the securities issued or offered in the Republic of Italy and their characteristics; and
- (c) in accordance with any other applicable laws and regulations.

General

No action has been taken by the Issuer or any of the Managers that would, or is intended to, permit a public offer of the Notes in any country or jurisdiction where any such action for that purpose is required. Accordingly, each Manager has undertaken that it will not, directly or indirectly, offer or sell any Notes or distribute or publish any offering circular, prospectus, form of application, advertisement or other document or information in any country or jurisdiction except under circumstances that will, to the best of its knowledge and belief, result in compliance with any applicable laws and regulations and all offers and sales of Notes by it will be made on the same terms.

GENERAL INFORMATION

Authorisation

1. The issue of the Notes was duly authorised by resolutions of the Board of Directors of the Issuer dated 6th September, 2004 and 29th September, 2004 and the final terms of the Notes were approved by a resolution (*determina*) of the Managing Director of the Issuer dated 12th October, 2004.

Listing

2. Application has been made to list the Notes on the Luxembourg Stock Exchange. A legal notice relating to the issue of the Notes and the constitutional documents of the Issuer are being lodged with the Luxembourg trade and companies register (*Registre de commerce et des sociétés, Luxembourg*) where such documents may be examined and copies obtained.

Clearing Systems

3. The Notes have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The ISIN for the A Notes is XS0203712939 and the Common Code is 020371293. The ISIN for the B Notes is XS0203714802 and the Common Code is 020371480.

No significant change

4. Save as disclosed in this Offering Circular, there has been no significant change in the financial or trading position of the Group since 30th June, 2004 and there has been no material adverse change in the financial position or prospects of the Group since 31st December, 2003.

Litigation

5. Neither the Issuer nor any other member of the Group is involved in any legal or arbitration proceedings (including any proceedings which are pending or threatened of which the Issuer is aware) which may have or have had in the 12 months preceding the date of this document a material adverse effect on the financial position of the Issuer or the Group.

Accounts

6. The auditors of the Issuer are KPMG S.p.A., who have audited the Issuer's accounts, without qualification, in accordance with generally accepted auditing standards in Italy for each of the financial years ended on 31st December, 2002 and 31st December, 2003.

The financial statements of the Issuer for the financial year ended 31st December, 2001 were audited by Deloitte & Touche S.p.A.

U.S. Tax

7. The Notes and Coupons will contain the following legend: "Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in Sections 165(j) and 1287(a) of the Internal Revenue Code."

Documents

8. Copies of the following documents will be available from the specified offices of the Paying Agent for the time being in Luxembourg so long as any of the Notes remains outstanding:
 - (a) the By-laws of the Issuer (with an English translation thereof);

- (b) the audited financial statements of the Issuer in respect of the financial years ended 31st December, 2001, 2002 and 2003 and the audited consolidated financial statements of the Issuer in respect of the financial year ended 31st December, 2003 (with an English translation thereof). The Issuer currently prepares audited consolidated and non-consolidated accounts on an annual basis;
- (c) the most recently published consolidated and non-consolidated audited annual financial statements of the Issuer and the most recently published consolidated and non-consolidated unaudited interim financial statements of the Issuer (with an English translation thereof). The Issuer currently prepares unaudited consolidated and non-consolidated interim accounts on a quarterly basis; and
- (d) the Subscription Agreement, the A Notes Trust Deed, the B Notes Trust Deed, the Agency Agreement relating to the A Notes and the Agency Agreement relating to the B Notes.

APPENDIX
FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT AUDITORS ON TERNA GROUP CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED 31ST DECEMBER, 2003

Report of the independent auditors

To the Board of Directors of
T.E.R.NA.–Trasmissione Elettività Rete Nazionale S.p.A.

1. We have audited the accompanying consolidated balance sheets of T.E.R.NA.–Trasmissione Elettività Rete Nazionale S.p.A. (“Terna”) and its subsidiaries (collectively the “Group”) as of 31 December 2003, the consolidated income statement and the consolidated cash flow statement for the year then ended and the related accompanying notes to the financial statements (herein collectively the “Consolidated Financial Statements”). As described in note 2 to the financial statements, the Consolidated Financial Statements differ from the original Italian consolidated financial statements of the Group approved by the Board of Directors. These Consolidated Financial Statements are the responsibility of the management of Terna. Our responsibility is to express an opinion on these Consolidated 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 consolidated 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.
3. In our opinion, the Consolidated Financial Statements referred to in paragraph 1 above present fairly, in all material respects, the financial position of the Group as of 31 December 2003 and the results of its operations and its cash flows for the year then ended in accordance with the accounting principles described in note 2 to the financial statements.
4. We draw your attention to the disclosures made by the directors in the notes to the financial statements on the following matters.
 - As indicated in note 30, Terna is a defendant in certain lawsuits and is involved in other uncertainties relating primarily to environmental and urban related matters, the outcome of which could result in losses for the Group which at present are not objectively quantifiable.
 - Note 14 discloses the effect of accounting for the extraordinary contribution due upon the cancellation of the Electricity Sector Employee Pension Fund, pursuant to Law 488/1999.

Rome, 10th March, 2004
KPMG S.p.A.

Bruno Mastrangelo
Director

REPORT OF INDEPENDENT AUDITORS ON TERNA S.P.A.'S FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED 31ST DECEMBER, 2003 AND 2002

To the Board of Directors of
T.E.R.NA.-Trasmissione Elettricit  Rete Nazionale S.p.A.

1. We have audited the accompanying balance sheets of T.E.R.NA.-Trasmissione Elettricit  Rete Nazionale S.p.A. ("Terna" or the "Company") as of 31 December 2003 and 2002, and the income statements, the cash flow statements and changes in shareholder's equity for the years then ended and the related accompanying notes to the financial statements (herein collectively the "Financial Statements"). As described in note 2 to the financial statements, the Financial Statements differ from the original Italian financial statements of the Company approved by the respective shareholders' meetings. These Financial Statements are the responsibility of the management of Terna. Our responsibility is to express an opinion on these Financial Statements based on our audits.
2. We conducted our audits 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 audits provide a reasonable basis for our opinion.

The Financial Statements referred to in paragraph 1 above present comparative data and information as of and for the year ended 31 December 2001, which have been not audited by us. Accordingly, our opinion does not extend to such data and information.

3. In our opinion, the Financial Statements referred to in paragraph 1 above present fairly, in all material respects, the financial position of Terna as of 31 December 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with the accounting principles described in note 2 to the financial statements.
4. We draw your attention to the disclosures made by the directors in the notes to the financial statements on the following matters:
 - As indicated in note 30, the Company is a defendant in certain lawsuits and is involved in other uncertainties relating primarily to environmental and urban related matters, the outcome of which could result in losses for the Company which at present are not objectively quantifiable.
 - The useful lives of high and very high power lines were reviewed during the year 2003, with a consequent modification to the estimates of such lives and the depreciation rates of the assets. These new rates have been applied from 1 January 2003. The rationale behind such change in estimate and its effects are described in note 2.
 - Note 2 discloses the effect of items recorded solely for fiscal purposes, regarding the recognition of depreciation in excess of that required to write off assets over their estimated useful lives, and note 14 discloses the effect of accounting for the extraordinary contribution due upon the cancellation of the Electricity Sector Employee Pension Fund, pursuant to Law 488/1999.

Rome, 10th March, 2004
KPMG S.p.A.

Bruno Mastrangelo
Director

**REPORT OF INDEPENDENT AUDITORS ON TERNA S.P.A.'S FINANCIAL STATEMENTS AS
OF AND FOR THE YEAR ENDED 31ST DECEMBER, 2001**

To the Board of Directors of
T.E.R.NA.–Trasmissione Elettricità Rete Nazionale S.p.A.

1. We have audited the accompanying balance sheet of T.E.R.NA.–Trasmissione Elettricità Rete Nazionale S.p.A. as of 31 December 2001, the statements of income, cash flows and changes in shareholder's equity for the year then ended and the related Notes thereto. 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. 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.
3. In our opinion, the financial statements referred to in paragraph 1 above present fairly, in all material respects, the financial position of T.E.R.NA.–Trasmissione Elettricità Rete Nazionale S.p.A. as of 31 December 2001, and the results of its operations and its cash flows for the year then ended in accordance with the accounting principles described in note 2 to the financial statements.
4. We draw your attention to the following matters, which are more fully described in the notes to the financial statements:
 - (a) as in previous years, the Company has applied rates of depreciation within the maximum limits permitted by tax regulations, which are higher than those necessary to allocate the cost of tangible fixed assets over their estimated useful lives. The effects of such an accounting treatment, which is permitted by the Italian regulations related to financial statements, are described in the accompanying notes;
 - (b) as provided for in Law 488 of 23 December 1999, the Company has opted to allocate the extraordinary contribution due as a result of the cancellation of the Electricity Sector Employee Pension Fund ("FPE-Fondo Previdenza Elettrici") over a period of three years, instead of the period of twenty years, also provided for by the above law;
 - (c) as of 31 December 2001, the Company was involved in a number of ongoing disputes and other situations of uncertainty, primarily regarding urban planning and environmental issues linked to the construction and operation of plants and transmission lines. The settlement of such disputes may lead the Company to incur charges that are at present not objectively determinable.

DELOITTE & TOUCHE S.p.A.
Domenico Falcone - Partner

Rome, Italy
1 March 2004

TERNA S.p.A.

**BALANCE SHEETS AS OF 31ST DECEMBER, 2001, 2002 AND 2003
AND
CONSOLIDATED BALANCE SHEET AS OF 31ST DECEMBER, 2003**

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
ASSETS				
Current assets	650.2	840.4	816.7	608.5
– Cash and cash equivalents (note 3)	0.1	0.1	0.1	44.1
– Cash restricted for use (note 4)	–	–	–	6.6
– Intercompany pooled funds held by Enel (note 5)	245.8	583.5	289.3	289.3
– Receivables, net:				
– Third parties (note 6)	346.1	193.5	182.8	190.7
– Enel Group companies (note 7)	30.9	30.7	20.2	20.2
– Subsidiaries (note 8)	–	–	290.0	–
– Inventory and work in progress (note 9)	15.2	17.2	27.7	34.9
– Accrued income and prepayments (note 10)	8.8	13.6	4.2	4.9
– Other current receivables (note 11)	3.3	1.8	2.4	17.8
Non-current assets	3,328.1	3,163.1	3,254.9	4,359.2
– Property plant and equipment, net (note 12)	3,258.3	3,122.0	3,051.4	4,195.8
– Investments (note 13)	1.6	3.5	159.7	3.5
– Intangible assets, net (note 14)	34.8	–	–	115.5
– Deferred tax assets (note 15)	9.9	13.9	22.3	22.3
– Other receivables (note 16)	23.5	23.7	21.5	22.1
Total Assets	3,978.3	4,003.5	4,071.6	4,967.7

TERNA S.p.A.

BALANCE SHEETS AS OF 31ST DECEMBER, 2001, 2002 AND 2003
AND
CONSOLIDATED BALANCE SHEET AS OF 31ST DECEMBER, 2003

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
LIABILITIES AND SHAREHOLDERS' EQUITY				
Short-term liabilities	395.8	280.5	281.7	319.1
– Current portion of amounts due to banks (note 17)	–	–	6.8	8.5
– Current portion of third-party advances (note 18)	47.1	12.6	17.2	17.2
– Trade accounts payable				
– Third parties (note 19)	124.5	100.4	126.7	148.6
– Enel Group companies (note 20)	76.7	63.6	29.9	35.3
– Current portion of amounts due to Enel (note 21)	53.0	23.7	21.6	21.6
– Taxes payable (note 22)	5.8	48.9	34.7	40.2
– Accrued liabilities and deferred income (note 23)	23.9	7.2	6.7	6.7
– Other current liabilities (note 24)	64.8	24.1	38.1	41.0
Long-term liabilities	1,201.1	1,268.6	1,256.0	1,682.2
– Long-term portion of amounts due to banks (note 17)	325.0	325.0	318.2	480.7
– Long-term portion of third-party advances (note 18)	28.7	36.3	30.5	30.5
– Trade accounts payable	1.3	0.8	0.8	0.8
– Long-term portion of amounts due to Enel (note 21)	478.5	456.2	436.3	436.3
– Accrued liabilities and deferred income (note 23)	91.0	147.7	142.7	148.0
– Employee termination indemnity (note 25).....	73.1	75.7	70.7	70.7
– Deferred tax liabilities (note 26)	138.3	151.1	159.3	417.2
– Contingent liabilities (note 27)	65.2	75.8	97.5	98.0
Shareholders' equity (note 28)	2,381.4	2,454.4	2,533.9	2,966.4
– Share capital,	2,036.1	2,036.1	2,036.1	2,036.1
– Other reserves	283.8	330.0	374.0	374.0
– Retained earnings	0.2	0.2	0.3	335.7
– Interim dividend	(6.7)	–	–	–
– Net income	68.0	88.1	123.5	220.4
– Minority interest	–	–	–	0.2
Total Liability and Shareholders' equity	3,978.3	4,003.5	4,071.6	4,967.7

TERNA S.p.A.

STATEMENTS OF INCOME FOR THE YEARS ENDED
31ST DECEMBER, 2001, 2002 AND 2003
AND

CONSOLIDATED STATEMENT OF INCOME FOR THE YEAR ENDED 31ST DECEMBER, 2003

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Operating revenues (note 33)				
Revenues from regulated activities in Italy	738.5	755.0	812.1	806.8
Revenues from other activities and other income in Italy	54.2	74.8	65.0	65.0
Total operating revenues	792.7	829.8	877.1	871.8
Operating expenses (note 34)				
Salaries and benefits	164.5	165.9	163.8	163.8
Raw materials and changes in inventories	14.4	18.9	14.4	14.4
Services	114.1	99.9	90.4	90.4
Rental and lease expenses	15.3	13.8	14.5	14.5
Miscellaneous operating expenses	16.9	17.3	15.8	15.8
Capitalized expenditures	(12.5)	(14.8)	(17.4)	(17.4)
Total operating expenses.....	312.7	301.0	281.5	281.5
Gross operating margin	480.0	528.8	595.6	590.3
Amortization, depreciation and other allowances				
Amortization of intangible assets	–	–	–	–
Depreciation of property, plant and equipment (note 35)	235.4	242.2	139.6	139.6
Other allowances and write-downs (note 36)	10.4	6.7	37.1	37.1
Total amortization, depreciation and other allowances	245.8	248.9	176.7	176.7
Earnings before interest and taxes	234.2	279.9	418.9	413.6
Interest income	7.2	11.3	16.1	16.1
Interest expense	(48.8)	(50.5)	(51.2)	(51.2)
Net interest income (expense) (note 37)	(41.6)	(39.2)	(35.1)	(35.1)
Income from continuing operations	192.6	240.7	383.8	378.5
Extraordinary expenses, net (note 38)	(2.6)	(9.2)	(15.0)	(15.0)
Earnings before taxes and other posted items	190.0	231.5	368.8	363.5
Taxes (note 39)	(70.7)	(93.8)	(151.8)	(143.1)
Net income before other posted items	119.3	137.7	217.0	220.4
Additional depreciation of property, plant and equipment	(47.7)	(45.1)	(151.4)	–
Extraordinary contribution due upon cancellation of FPE	(35.6)	(35.4)	–	–
Tax effect of other posted items	32.0	30.9	57.9	–
Total net effect of other posted items	(51.3)	(49.6)	(93.5)	–
Net income	68.0	88.1	123.5	220.4

**STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED 31ST DECEMBER, 2001, 2002 AND 2003**

	Share capital	Legal reserve	Accelerated depreciation reserve	Retained earnings	Net income	Total
(millions of euro)						
Balance at 1st January, 2000	2,103.1	0.6	157.5	0.2	58.7	2,320.1
Authorized capital reduction due to						
Euro conversion	(67.0)	67.0	–	–	–	–
Allocation of 2000 net income.....	–	2.9	55.8	–	(58.7)	–
Net income	–	–	–	–	68.0	68.0
2001 interim dividend	–	–	–	–	(6.7)	(6.7)
Balance at 31st December, 2001	2,036.1	70.5	213.3	0.2	61.3	2,381.4
Allocation of 2001 net income.....	–	3.4	42.8	–	(46.2)	–
Dividends	–	–	–	–	(15.1)	(15.1)
Net income	–	–	–	–	88.1	88.1
Balance at 31st December, 2002	2,036.1	73.9	256.1	0.2	88.1	2,454.4
Allocation of 2002 net income.....	–	4.4	39.6	0.1	(44.1)	–
Dividends	–	–	–	–	(44.0)	(44.0)
Net income	–	–	–	–	123.5	123.5
Balance at 31st December, 2003	2,036.1	78.3	295.7	0.3	123.5	2,533.9

**CASH FLOW STATEMENTS FOR THE YEARS ENDED
31ST DECEMBER, 2001, 2002 AND 2003 AND
CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31ST DECEMBER, 2003**

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
CASH FLOWS FROM (USED IN) OPERATING ACTIVITIES				
Net income	68.0	88.1	123.5	220.4
Depreciation and amortization	283.1	287.3	291.0	139.6
Write-downs	1.0	6.3	–	–
Net change in reserves	5.9	19.8	18.8	67.9
Net change in termination indemnity	6.1	2.6	(5.0)	(5.0)
Net loss (gain) on disposal of assets	(0.4)	6.2	1.4	1.4
	363.7	410.3	429.7	424.3
Change in working capital:				
–(Increase) decrease in short-term receivables	(240.4)	150.4	22.9	22.9
–Increase (decrease) in trade accounts payable and other payables	42.6	(5.2)	(21.3)	(21.3)
–Change in other assets and liabilities	27.7	11.8	7.8	13.2
Cash flows from operating activities	193.6	567.3	439.1	439.1
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES				
Intangible assets	–	–	–	(115.5)
Property, plant and equipment	(190.9)	(163.9)	(221.8)	(221.8)
Long-term investments	(0.9)	(1.4)	(155.3)	0.8
Acquisition of subsidiaries' non-current assets	–	–	–	(449.3)
Acquisition of subsidiaries' working capital	–	–	–	5.2
Cash flows used in investing activities	(191.8)	(165.3)	(377.1)	(780.6)
CASH FLOWS FROM (USED IN) FINANCING ACTIVITIES				
New short-term loans	–	–	(289.8)	–
Return of capital	–	–	–	–
New medium and long-term loans	250.0	–	–	164.3
Repayment of medium and long-term loans	(57.0)	(49.2)	(22.4)	(22.4)
Dividends	(6.7)	(15.1)	(44.0)	(44.0)
Total cash flows from (used in) financing activities	186.3	(64.3)	(356.2)	97.9
Cash flows	188.1	337.7	(294.2)	(243.6)
Cash and cash equivalents, beginning of period (*)	57.8	245.9	583.6	583.6
Cash and cash equivalents, end of period (*) (see note 5)	245.9	583.6	289.4	340.0

(*) Includes intercompany pooled funds held by Enel

NOTES TO THE FINANCIAL STATEMENTS

(1) General

On 31st May, 1999, Enel established T.E.R.NA.—Trasmissione Elettricità Rete Nazionale S.p.A. (“Terna”) as one of its wholly-owned subsidiaries. Later in the same year, Enel assigned substantially all of its electricity transmission systems and assets to Terna, in response to Legislative Decree 79 of 16th March, 1999, “Application of Directive 96/92/EC on the common norms for the domestic electric power markets” (the “Bersani Decree”). Pursuant to the agreement, Terna acquired the assets and assumed related liabilities at book value under a neutral taxation regime. Terna owns over 90% of the electricity transmission networks of the *Rete di Trasmissione Nazionale* (national transmission grid) (“the Italian Grid”), and is responsible for the operation, maintenance and development of its portions of the Italian Grid (the “Terna Grid”) in accordance with its agreement (the “Terna Operating Agreement”) with *Gestore delle Rete di Trasmissione Nazionale S.p.A.* (National Grid Manager) (the “Italian ISO”).

On 31st December, 2003, Terna acquired from Enelpower S.p.A. (“Enelpower”), a subsidiary of Enel S.p.A. (“Enel”), all of the issued and outstanding shares of Novatrans Energia S.A. (“Novatrans”), for €0.7 million, and 99.74% of the issued and outstanding shares of Transmissora Sudeste —Nordeste S.A. (“TSN”), for €155.5 million (in each case, including the shares required under Brazilian law to be held by a member of management). Both TSN and Novatrans operate in the electricity transmission sector in Brazil through their respective concessions to operate and maintain portions (the “Brazilian Subsidiaries Grid”) of Brazil’s national electricity transmission grid (the “Brazilian Grid”). As a part of the acquisition, Terna assumed the loan granted by Enelpower to Novatrans from Enelpower. As of 31st December, 2003, the principal amount outstanding under that loan was €284.8 million, in addition to interest matured for an amount of €5.1 million. The purchase price for each of these acquisitions was determined based on independent valuations obtained by Enelpower and has been adjusted in April 2004 to reflect the net equity of the two subsidiaries at 31st December, 2003. The resulting price adjustments were €6.0 million for TSN and €4.4 million for Novatrans.

(2) Summary of Significant Accounting Principles

Basis of presentation

The financial statements of Terna as of and for the years ended 31st December, 2001, 2002 and 2003 and the consolidated financial statements of Terna and its subsidiaries TSN and Novatrans, presented in this Offering Circular, have been prepared in accordance with Italian accounting principles. In particular, such financial statements and such consolidated financial statements are derived from those prepared for statutory purposes in accordance with Italian regulations governing their preparation, and apply the provisions of the Italian Civil Code, interpreted and integrated, when necessary, by accounting principles issued by the *Consigli Nazionali dei Dottori Commercialisti e dei Ragionieri* (“Italian GAAP”). These financial statements and consolidated financial statements differ from the original Italian Financial Statements as of and for the years ended 31st December, 2001, 2002 and 2003 of Terna approved in the respective meetings of Shareholders for the respective years, and from the consolidated financial statements of the Group approved by the Board of Directors, for certain reclassifications, as follows:

- to classify assets and liabilities between current and non-current and short-term and long-term, respectively;
- to condense certain categories of assets and liabilities and personnel expenses;
- to classify operating revenues by business activities;
- to reclassify capitalized expenditures from operating revenues to operating expenses;
- to reclassify additional depreciation charged by Terna for tax purposes in addition to the depreciation rates estimated based on the assets’ economic useful lives and up to the allowed depreciation rate for tax purposes. The additional depreciation charged by Terna was €151.4 million in 2003, €45.3 million in 2002 and €47.7 million in 2001;

- to reclassify the annual amounts paid as extraordinary contributions due to the cancellation of the Electricity Sector Employee Pension Provision (FPE), pursuant to Law No. 488 of 23rd December, 1999, amounting to €35.4 million and €35.6 million in 2002 and 2001, respectively, originally classified as extraordinary items; and
- to reclassify the tax effect related to the reclassified additional depreciation and extraordinary contribution. The tax effect has been determined by applying the income tax rate (34% IRPEG for 2003, 36% for 2001 and 2002) and the corporate tax rate (4.25% IRAP for 2003, 2002 and 2001) to the additional depreciation charges and only the income tax (IRPEG) to the extraordinary contributions (FPE). The tax effect of the above mentioned entries was €57.9 million in 2003, €30.9 million in 2002 and €32.0 million in 2001.

Such reclassifications consist primarily of changes in the format of the balance sheets and income statements and the elimination of certain nonmaterial information.

Financial statements accounting principles

The accounting principles used in the preparation of the Terna financial statements as of and for the years ended 31st December, 2001, 2002 and 2003 are consistent. The most significant principles are illustrated below.

Intangible assets

Intangible assets are recorded at cost and reflect residual amounts of investments whose economic life spans over several years. Amortization is calculated using the straight-line method over the expected economic useful lives of the assets. Start-up and organization costs are amortized over a five-year period and have been fully amortized as of 31st December, 2003. The extraordinary contribution paid in 2000, 2001 and 2002 upon suppression of the Electricity Sector Employee Pension Fund, pursuant to Law No. 488 of 23rd December, 1999 (2000 Budget Law) was amortized by Terna over three years, instead of the other option of amortizing the contribution over 20 years, also permitted by the law.

Tangible assets

Tangible assets are recorded at cost of purchase or production cost, inclusive of any additional expense incurred and of revaluations made by Enel, as transferor of the business unit relating to the Terna Grid, in accordance with specific laws.

The value of tangible assets excludes costs incurred in maintaining or restoring the state of efficiency and proper functioning of plants. Since these costs do not affect the magnitude of the actual or potential capacity of the plants, such costs are expensed as incurred.

In the event of permanent impairment in value, the assets are written-down to their respective recoverable value. If the circumstances for a write-down no longer exist, the book value is increased to the original amount, net of depreciation.

Depreciation on assets is calculated using the straight-line method over their expected useful lives, as specified below.

Depreciation rates:

	2001	2002	2003	2003
		Economic Useful Life		Fiscal Life
Buildings and real estate	2.50%	2.50%	2.50%	3.00%
Power lines	2.85%	2.85%	2.50%	4.00%
Switching substation:				
– electrical equipment	5.00%	5.00%	2.38%	7.00%
– other electrical equipment	5.00%	5.00%	3.13%	7.00%
– automation and control system	10.00%	10.00%	6.70%	10.00%
Central systems for management and control:				
– equipment	5.00%	5.00%	5.00%	9.00%
– electronics/computers	20.00%	20.00%	10.00%	20.00%
Others	14.00%	14.00%	14.00%	16.00%

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

The economic depreciation rates used until 2002 for Terna's high voltage and very high voltage plants were determined in 1994 by a special Enel working group.

Recent diagnostic methods, used in conjunction with sophisticated calculation tools, made possible a more accurate determination of the plants' technical condition. Therefore, the economic depreciation rates were revised in order to better reflect the estimated economic useful life of the facilities. The analysis performed, based on specific factors such as preventive maintenance and improved reliability of the components, resulted in the extension of the assets' economic useful lives, specifically with regards to the plants forming the Terna Grid (lines and stations) and the linked facilities (remote management and control).

The new economic depreciation rates were used starting 1st January, 2003. The revised economic rates resulted in a €104.2 million decrease in 2003 economic depreciation, gross of the theoretical tax effect of €39.9 million, compared with the economic depreciation that would have occurred had the prior years' rates been applied. The comparability of the tangible assets' economic depreciation percentages for years 2001, 2002 and 2003 and the amount of future years' economic depreciation are influenced by this change in the expected economic useful lives.

In addition, as permitted by applicable law for financial statements, and in application of tax regulations, Terna depreciates utility plant over prescribed fiscal tax lives which are shorter than the economic useful lives ("additional depreciation") and doubles the fiscal depreciation in the first three years an asset is placed in service ("accelerated depreciation").

In accordance with Accounting Principle No. 25 of the *Consigli Nazionali dei Dottori Commercialisti e dei Ragionieri*, accelerated depreciation is credited directly to a nondistributable shareholders' equity reserve as an appropriation of earnings, without impact on the income statement or the carrying amount of plant, property or equipment, at the time of the annual shareholders' meeting in the following year, while the current tax benefit and related deferred tax amount are accrued in the income statement of the period to which the accelerated depreciation charge relates.

Accelerated depreciation accumulated up to 1999 was reclassified in 2000 to a specific undistributable reserve, net of the related tax effect. The reserve is progressively transferred to other available equity reserve upon taxation of the said accelerated depreciation charges.

Financial assets—Equity investments

Equity investments in subsidiaries and in other companies are accounted for under the cost method. The investment is written-down in the event of a permanent impairment in value and restored in the event that conditions for such impairment cease to exist. The revaluation is recognized in the income statement as a write-up.

Inventories

Raw materials, 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 or slow moving inventories are written-down to their estimated realizable value.

“Contract work in progress” is valued on the basis of agreed contractual amounts, if those amounts can be determined with reasonable certainty, according to the “percentage-of-completion” method.

Advances received from customers for contractual work not yet completed are recorded as deferred revenue.

Receivables

Receivables are recorded at their expected net recoverable value and are classified among “Non-current assets” and “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.

Contingent Liabilities

Provisions for retirement benefits

The provision includes compensation payable in lieu of notice to existing personnel pursuant to collective bargaining agreements and union agreements currently in force.

Provisions for risks and charges

These provisions are recorded against known or probable losses and charges for which the amount and timing is undetermined at the balance sheet date. The amount recorded reflects the best possible estimate based on available information.

Provision for employee termination indemnities

The provision is in compliance with the law and collective bargaining agreements in force as of the balance sheet date, and reflects the liability accrued toward employees as of the balance sheet date, net of advances made, pursuant to law, as well as contributions made to the *Fondo Pensioni Gruppo Enel* (“Fondenel”).

Accounts payable

Accounts payable are stated at face value.

Statements of Income

Costs and revenues are recognized on an accrual basis.

Revenues

Annual fees for the utilization of the Terna Grid are recorded in accordance with the method set forth in the Terna Operating Agreement with the Italian ISO and determined based on the tariff set by the AEEG, the Italian Energy Authority (the “Italian Energy Authority”). Specifically, for the operation, maintenance and development activities performed on the basis of the Terna Operating Agreement, the Italian ISO pays Terna an annual fee (to cover operating costs and depreciation and as a return on the net invested capital) paid in monthly installments, as determined by Resolution No. 228/01 of the Italian Energy Authority. In summary, the amount of the fee paid by the Italian ISO to each owner of a part of the Italian Grid essentially depends on, other than the percentage owned, two factors: tariffs, determined by the Italian Energy Authority on the basis of allowed costs (operating costs and depreciation) and the remuneration for invested capital; and volumes of energy dispatched through the Italian Grid.

Other revenues are recorded at the time services are provided, or when the title of ownership of the goods is transferred.

Capital grants

For plants operating at 31st December, 2002, grants received for a specific purpose, whose value is recorded among tangible assets, are recorded 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 over the depreciable life of the assets to which they relate.

Starting in 2003, capital grants related to new plants put into service are recorded as a reduction in the fixed asset value.

Income taxes

Current income tax for the period is recorded under tax liabilities based on the estimated taxable income according to the provisions currently in force.

Deferred tax assets and liabilities are calculated on the temporary differences between amounts recognized for financial purposes and amounts recognized for tax purposes, on the basis of the applicable tax rates at the time the temporary differences are expected to reverse. Deferred tax assets are recorded among assets to the extent that Terna is reasonably certain that such amounts can be recovered. Deferred tax liabilities are provided to the extent such liability is expected to occur.

Environmental costs

Environmental costs refer to the prevention, reduction and monitoring of the environmental impact of production activities. Recurring environmental costs are recorded in the statement of income when incurred, while costs relating to the extension of the useful life, increase in capacity and improvement in the safety of tangible assets are capitalized as part of the cost of the respective asset.

Contingent liabilities are recorded when it is probable or certain that the liability will occur and the amount can be reasonably estimated.

Financial derivatives

Derivative contracts are entered into in order to hedge against the risk of interest rate fluctuations.

The interest differentials to be received or paid on interest rate swaps at the end of each reporting period are accrued over the life of the contract and classified as “Financial income (expense)”.

Consolidated financial statements

Consolidation and accounting principles

Consolidated financial statements as of and for the year ended 31st December, 2003, are the first such statements prepared by Terna. Terna acquired its interest in the two Brazilian subsidiaries TSN and Novatrans, on 31st December, 2003. Consequently, the consolidated income statement for the year ended 31st December, 2003, does not include the economic results of such subsidiaries.

Consolidation principles

Terna's consolidated financial statements include Terna and the companies in which it exercises control directly or indirectly through a majority of voting rights, or through dominant influence as defined in Art. 2359 of the Italian Civil Code, i.e., in this case, TSN and Novatrans.

The consolidated financial statements include the accounts of the two subsidiaries, as approved by the respective shareholders of the individual consolidated companies. Adjustments are made, as needed, to eliminate the effect of the tax-basis reporting and to comply with accounting principles adopted by the controlling company, Terna. Such adjustments take into account, whenever applicable, the corresponding prepaid or deferred tax effect, recorded under the corresponding items.

The most significant consolidation principles are illustrated below.

The excess of the price paid for the acquisition over the fair value of assets acquired and liabilities assumed at the date of acquisition is recorded as goodwill.

Minority interests in the income and shareholders' equity of consolidated subsidiaries are recorded in the income statement and in shareholders' equity, respectively.

Significant unrealized gains and losses from transactions between Terna and its subsidiaries as well as receivables and payables, and revenues and expenses generated between consolidated companies are eliminated.

Dividends distributed within Terna Group are eliminated from the consolidated income statement and reallocated to the initial shareholders' equity reserves.

Balance sheet items of consolidated companies that operate in countries not included in the Euro zone are converted to euros by applying the year-end exchange rate. The income statement is converted using the average exchange rate for the period. Exchange differences derived from the application of this conversion principle are shown as a separate line item under shareholders' equity.

Terna does not currently operate in hyperinflationary economies.

Accounting principles

The accounting principles applied in the preparation of the Consolidated Financial Statements as of 31st December, 2003 are in line with the provisions of Art. 2426 of the Italian Civil Code supplemented by the accounting principles formulated by the *Consigli Nazionali dei Dottori Commercialisti e dei Ragionieri*.

The most significant principles are illustrated below.

Balance Sheet Items

Intangible assets

Intangible assets are recorded at cost and reflect residual amounts of investments whose economic life spans over several years. Amortization is calculated using the straight-line method over the expected economic useful lives of the assets. Start-up and organization costs are amortized over a five-year period and have been fully amortized as of 31st December, 2003.

Goodwill relates to the acquisition of the Brazilian subsidiaries from Enelpower and it is recorded in the balance sheet when the price paid for the acquisition exceeds the fair value of assets acquired and liabilities assumed at the date of acquisition. Amortization is calculated using the straight-line method over 30 years, which is the period deemed representative of the underlying business value. This criterion is also applied to consolidated goodwill.

Tangible assets

Tangible assets are recorded at cost of purchase or production cost, inclusive of any additional expense incurred and of revaluations made by Enel, as transferor of the business unit relating to the Terna Grid, in accordance with specific laws issued by the Italian government.

The value of tangible assets excludes costs incurred in maintaining or restoring the state of efficiency and proper functioning of plants. Since these costs do not affect the magnitude or potential capacity of the plants, such costs are expensed as incurred.

In the event of permanent impairment in value, the assets are written-down to their respective recoverable value. If the circumstances for a write-down no longer exist, the book value is increased to the original amount, net of depreciation.

Assets are depreciated based on the straight-line method over their expected useful lives, as specified below.

Depreciation rates	TERNA	Subsidiaries
Buildings and real estate	2.50%	4.00%
Power lines	2.50%	2.50—4.50%
Switching substations:		
– electrical equipment	2.38%	2.00—3.00%
– other electrical equipment	3.13%	2.80—4.50%
– automation and control system	6.70%	5.00—6.70%
Central systems for management and control:		
– equipment.....	5.00%	N/A
– electronics/computers.....	10.00%	N/A
Others	14.00%	N/A

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

In addition, as permitted by applicable law for financial statements, and in application of tax regulations, Terna depreciates utility plant over prescribed fiscal tax lives, which are shorter than the economic useful lives (“additional depreciation”). Such additional depreciation is eliminated for consolidation purposes, and the related deferred tax effect is recognized.

In accordance with Accounting Principle No. 25 of the *Consigli Nazionali dei Dottori Commercialisti e dei Ragionieri*, accelerated depreciation is credited directly to a nondistributable shareholders’ equity reserve as an appropriation of earnings, without impact on the income statement or the carrying amount of plant, property or equipment, at the time of the annual shareholders’ meeting in the following year, while the current tax benefit and related deferred tax amount are accrued in the income statement of the period to which the accelerated depreciation charge relates.

Accelerated depreciation accumulated up to 1999 was reclassified in 2000 as a specific undistributable reserve, net of the related tax effect. The reserve is progressively transferred to other available equity reserves upon taxation of the said accelerated depreciation charges.

Financial assets—Equity investments

Equity investments in unconsolidated subsidiaries and in other companies are accounted for under the cost method. The investment is written-down in the event of a permanent impairment in value and restored in the

event that conditions for such impairment cease to exist. 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 or slow moving inventories are written-down to their estimated realizable value.

“Contract work in progress” is valued on the basis of agreed contractual amounts, if those amounts can be determined with reasonable certainty, according to the “percentage-of-completion” method.

Advances received for contractual work not yet completed are recorded as deferred revenue.

Receivables

Receivables are recorded at their net realizable value and are classified among “Financial assets” and “Current assets”, according to their use and to the nature of the debtor.

Accruals and deferrals

Accrual and deferrals are recorded based on the accrual method of accounting.

Provisions for risks and charges

Provisions for retirement benefits

The provision includes compensation payable in lieu of notice to existing personnel pursuant to collective bargaining agreements and union agreements currently in force.

Other provisions for risks and charges

Other provisions for risks and charges are recorded against known or probable losses and charges for which the amount and timing is undetermined at the balance sheet date. The amount recorded reflects management’s best possible estimates based on available information.

Provision for employee termination indemnities

The provision is in compliance with the law and collective bargaining agreements in force as of the balance sheet date, and reflects the liabilities accrued toward employees as of the balance sheet date, net of advances made, pursuant to law, as well as contributions made to the *Fondo Pensioni Gruppo Enel* (“Fondenel”).

Accounts payable

Accounts payable are stated at face value.

Income Statement

Costs and revenues are recognized on an accrual basis.

Revenues

Regulated Activities in Italy

Annual fees for the utilization of the Terna Grid are recorded in accordance with the method set forth in the Terna Operating Agreement with the Italian ISO and determined based on the tariff set by the AEEG, the Italian Energy Authority. Specifically, for the operation, maintenance and development

activities performed on the basis of the Terna Operating Agreement, the Italian ISO pays Terna an annual fee (to cover operating costs and depreciation and as a return on the net invested capital) paid in monthly installments, as determined by Resolution No. 228/01 of the Italian Energy Authority. In summary, the amount of the fee paid by the Italian ISO to each owner of a part of the Italian Grid essentially depends on, other than the percentage owned, two factors: tariffs, determined by the Italian Energy Authority on the basis of allowed costs (operating costs and depreciation) and the remuneration for invested capital; and volumes of energy dispatched through the Italian Grid.

Other Activities and Income in Italy

Other activities and income in Italy are recognized when the service is provided or the title of ownership of the goods is transferred.

Capital grants

For plants operating at 31st December, 2002, grants received for a specific purpose, whose value is recorded among tangible assets, are recorded 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 over the depreciable life of the assets to which they relate.

Starting in 2003, capital grants related to new plants which began operations are recorded as a reduction in the fixed asset value.

Income Taxes

Current income tax for the period is recorded under tax liabilities based on the estimated taxable income according to the provisions currently in force.

Deferred tax assets and liabilities are calculated on the temporary differences between amounts recognized for financial purposes and amounts recognized for tax purposes, on the basis of the applicable tax rate at the time the temporary differences will reverse. Deferred tax assets are recorded among assets to the extent that Terna is reasonably certain that such amounts can be recovered. Deferred tax liabilities are provided to the extent such liability is expected to occur.

Translation of amounts denominated in foreign currencies

Receivables and payables denominated in currencies other than the euro are translated into euro at the exchange rate in effect at the date of the transaction. At the end of the year, amounts denominated in currencies other than the euro are translated into euro at exchange rates at the balance sheet date and differences are recorded in the income statement as financial income and expenses, taking into account possible hedging contracts.

Environmental costs

Environmental costs refer to the prevention, reduction and monitoring of the environmental impact of production activities. Recurring environmental costs are recorded in the statement of income when incurred, while costs relating to the extension of the useful life, increase in capacity and improvement in the safety of tangible assets are capitalized as part of the cost of the respective asset.

Contingent liabilities are recorded when it is probable or certain that the liability will occur and the amount can be reasonably estimated.

Financial Derivatives

Derivative contracts are entered into in order to hedge against the risk of interest-rate and exchange rate fluctuations.

The interest differentials to be received or paid on interest rate swaps at the end of each reporting period are accrued over the life of the contract and classified as “Financial income (expense)”.

Foreign currency hedging instruments are valued at the spot rate at the balance sheet date. Related gains and losses are recorded in the income statement as exchange rate differences under the “Other financial income and expenses” item. Premiums and discounts paid or received on such instruments are deferred and recorded in the income statement over the life of the instrument purchased or sold.

BALANCE SHEET

The balance sheets for the years ended 31st December, 2001, 2002 and 2003 include the accounts of Terna. The consolidated balance sheet of Terna as of 31st December, 2003 consists of the accounts of Terna and its Brazilian subsidiaries, TSN and Novatrans, in which interests were acquired on 31st December, 2003. Total net invested capital of the two subsidiaries as of 31st December, 2003 is €444.4 million.

(3) Cash and cash equivalents

Cash and cash equivalents consists entirely of available funds held by Terna’s eight regional operating facilities. At the consolidated level, cash and cash equivalents at 31st December, 2003 also includes €44.0 million of funds held by the two Brazilian subsidiaries.

(4) Cash restricted for use

At the consolidated level, cash restricted for use at 31st December, 2003, consists of €6.6 million relating to amounts which are required to be held on a restricted account under the terms of the project financing granted to TSN by the Brazilian bank *Banco Nacional de Desenvolvimento Econômico e Social* (the “BNDES”). The restriction will be gradually released once repayment commences.

(5) Intercompany pooled funds held by Enel

Intercompany pooled funds held by Enel includes amounts deposited with Enel according to the centralized treasury management agreement. The balance at 31st December, 2003 also includes interest earned. Interest earned in previous years is classified as accrued income. The amounts are considered cash and cash equivalents for the purpose of the cash flow statements.

(6) Receivables, net

Receivables, net, from third parties, as of 31st December is as follows:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Italian ISO for Annual Fee for the use of the Terna Grid	329.9	178.9	168.7	168.7
Other	19.0	18.4	15.1	23.0
Allowance for doubtful accounts	(2.8)	(3.8)	(1.0)	(1.0)
	346.1	193.5	182.8	190.7

The receivables related to fees for the use of the Terna Grid as of 31st December, 2003, primarily relate to fees for November and December 2003, which become due in 2004. The 2003 consolidated balance sheet includes €7.9 million of receivables due to the two Brazilian subsidiaries for use of the Brazilian Subsidiaries Grid.

The significant decrease in receivables from 2001 to 2002 relates to the fact that, prior to 2002, no formal agreement existed between Terna and the Italian ISO. With the signing of the Terna Operating Agreement, various operating terms were agreed, including the more timely payment of amounts due.

Changes in the allowance for doubtful accounts for the years ending 31st December are shown in the table below:

Allowance for doubtful accounts	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Beginning balance	1.1	2.8	3.8	3.8
Bad debt expense	1.7	1.0	–	–
Write-offs of accounts receivable	–	–	(2.8)	(2.8)
	2.8	3.8	1.0	1.0

The 2003 write-offs relate to receivables due from the Italian ISO from 2000. The total amount written off related to fees earned in 2000 was €5.1 million, however, the residual part of the write-off was provided for as a contingent loss.

(7) *Receivables from Enel Group companies*

Receivables from Enel Group companies, consist of the following at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Enel Distribuzione S.p.A	11.0	11.1	11.4	11.4
Enel.it S.p.A	12.1	17.1	0.4	0.4
Enel.Net S.p.A	–	–	5.0	5.0
Wind Telecomunicazioni S.p.A	4.5	1.3	1.1	1.1
Enel Produzione S.p.A	1.2	0.4	1.2	1.2
Enelpower S.p.A	0.6	0.3	0.2	0.2
Other Enel Group companies	1.5	0.5	0.9	0.9
	30.9	30.7	20.2	20.2

The significant decrease at 31st December, 2003 of receivables due from Enel.it S.p.A. (“Enel.it”) relates to the receipt of the receivables for the sale of the fiberoptic cable for the Italy-Greece connection (€10.8 million at 31st December, 2002) sold in 2002, as well as the transfer during 2003 of the related telecom business from Enel.it to Enel.Net S.p.A. (“Enel.Net”), which included €2.6 million of trade receivables. Consequently, the increase in receivables from Enel.Net at 31st December, 2003 is related to services provided related to fiberoptic cable support, maintenance and development, after the transfer of the telecom business took place.

Receivables from Enel Distribuzione S.p.A. (“Enel Distribuzione”) relate to high-voltage network operation and maintenance services, while those from Wind Telecomunicazioni S.p.A. (“Wind”) relate to the supply of telephony and telecommunication services, including data transmission services by Wind for Terna’s remote management and control systems.

(8) *Trade receivables from subsidiaries*

Trade receivables from subsidiaries at 31st December, 2003 primarily consist of a loan made to Novatrans pursuant to Terna’s assumption of the intercompany loan originally granted by Enelpower. The loan amount at 31st December, 2003 includes €5.0 million of accrued interest on amounts owed.

(9) *Inventory and Work in Progress*

Inventory includes raw materials, auxiliary and consumption goods used for plant operation, maintenance and plant construction activities. In addition, the balance at 31st December, 2003 includes spare transformers which have been strategically placed throughout Italy in order to be prepared in case of a plant failure.

Work in progress at 31st December, 2003 includes an upgrade to the SCTI-Net control system (€11.0 million), an expansion and upgrade of electricity lines for *Ferrovie dello Stato* (the national railway company) (€1.9 million), work relating to the construction of the Chieti electrical bus system for SEAP (€1.5 million) and work relating to the construction of a plant control system for Edipower (€1.8 million).

The consolidated balance sheet at 31st December, 2003 includes €15.6 million related to inventories held by the Brazilian subsidiaries.

(10) *Accrued income and prepayments*

Accrued income and prepayments include the following at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Accrued income due to financial components	6.8	10.9	–	–
Prepaid expenses and deferred charges	2.0	2.7	4.2	4.9
	8.8	13.6	4.2	4.9

Accrued income due to financial components relates to interest earned on amounts held by Enel in conjunction with the centralized treasury management agreement. At 31st December, 2003, accrued interest is recorded as part of cash and cash equivalents. Prepaid expenses include primarily prepaid insurance premiums and prepaid fees resulting from the assignment of contracts by Enel Distribuzione, the prepaid rent pursuant to the fiberoptic housing contract with Enel.Net and the prepaid rent for the use of telephone lines and radio transmission equipment with Wind.

The consolidated balance sheet at 31st December, 2003 includes €0.7 million related to prepaid expenses of the Brazilian subsidiaries.

(11) *Other current receivables*

Other current receivables consist of the following at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Loans to employees and other items	0.4	0.4	0.4	0.4
Receivables from others	2.9	1.4	2.0	17.4
	3.3	1.8	2.4	17.8

Other current receivables mainly consists of amounts receivable from Greek Tax Authorities related to credits for indirect taxes and the current portion of employee loans.

The consolidated balance sheet at 31st December, 2003 primarily includes €11.9 million related to gains from hedging contracts related to the foreign exchange risk on the Novatrans loan outstanding as of the balance sheet date, as well as other minor items relating to the Brazilian subsidiaries.

Non-current assets

(12) Property, plant and equipment, net

Property, plant and equipment, net, is as follows at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Land and buildings.....	316.3	313.7	311.7	326.8
Plant and machinery	2,502.7	2,513.3	2,410.2	3,419.8
Commercial and industrial equipment	10.6	10.9	10.9	11.0
Other assets	1.3	1.0	0.9	1.1
Work in progress and advances	427.4	283.1	317.7	437.1
	3,258.3	3,122.0	3,051.4	4,195.8

“Plant and machinery” includes the Terna Grid. In 2003, according to the MAP Decree of 23rd December, 2002, Terna acquired from Enel Distribuzione, Enel Produzione S.p.A. (“Enel Produzione”) and Enel Green Power S.p.A. (“Enel Green Power”), all Enel Group companies, additional portions of the Italian Grid. The power lines increased by 874 km and the stations increased by 18, for a total price of €35.4 million.

The consolidated balance sheet at 31st December, 2003, other than reflecting the effect of the elimination of the accumulated additional depreciation charges (see note 2), includes property, plant and equipment of €448.9 million belonging to the Brazilian subsidiaries.

The detailed activity by asset category is as follows:

	Book value, net 31st December, 2000			Book value, net 31st December, 2001			Book value, net 31st December, 2002			Book value, net 31st December, 2003		
	Investments	Depreciation	Reclassification and other movements	Investments	Depreciation	Reclassification and other movements	Investments	Depreciation	Reclassification and other movements	Investments	Depreciation	Reclassification and other movements
	(millions of euro)											
Land and Buildings	315.8	4.4	(14.4)	316.3	7.1	(14.8)	313.7	6.5	(15.0)	6.5	311.7	
Plant and machinery	2,523.2	72.7	(266.3)	2,502.7	158.7	(270.5)	2,513.3	105.2	(273.8)	65.5	2,410.2	
Commercial and industrial equipment	6.8	2.1	(1.4)	10.6	1.8	(1.7)	10.9	1.9	(1.9)	–	10.9	
Other assets	2.1	0.2	(1.0)	1.3	0.2	(0.5)	1.0	0.2	(0.3)	–	0.9	
	2,847.9	79.4	(283.1)	2,830.9	167.8	(287.5)	2,838.9	113.8	(291.0)	72.0	2,733.7	
Work in progress and advances	501.5	111.5	–	427.4	(3.8)	(0.4)	283.1	127.0	–	(92.4)	317.7	
Total	3,349.4	190.9	(283.1)	3,258.3	164.0	(287.9)	3,122.0	240.8	(291.0)	(20.4)	3,051.4	

Changes in property, plant, and equipment, net in the Company's balance sheet is as follows for the years ending 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)
	(millions of euro)		
Initial book value, net	3,349.4	3,258.3	3,122.0
Investments	190.9	164.0	240.8
Depreciation and write-downs:			
Economic depreciation	(235.4)	(242.2)	(139.6)
Additional depreciation	(47.7)	(45.1)	(151.4)
Write-downs	–	(0.6)	–
Disposals and other movements	1.1	(12.4)	(20.4)
	3,258.3	3,122.0	3,051.4

The increase in additional depreciation for the year ended 31st December, 2003, and the corresponding decrease in the economic depreciation charge, are related to the revision of the economic depreciation rates used by Terna in 2003 (see note 2).

In order to illustrate the differences in depreciation generated by the application of tax regulations, in the Company's financial statements, depreciation has been broken down to an economic depreciation charge based on assets' useful economic lives and an additional depreciation charge that relates to the incremental depreciation resulting from the application of fiscal depreciation rates.

If depreciation had been charged in the Company's financial statements based only on economic depreciation rates, the effect on shareholders' equity and net income would have been as follows:

	Increase (decrease)		
	2001 (Company)	2002 (Company)	2003 (Company)
	(millions of euro)		
<i>Impact on Shareholders' equity</i>			
Lower accumulated depreciation of property, plant and equipment	503.0	544.2	690.2
Higher deferred tax liability at the end of the year	(202.5)	(219.0)	(257.9)
Increase in shareholders' equity at the end of the year	300.5	325.2	432.3
<i>Impact on net income</i>			
Lower depreciation charges for the period, net of grant contribution	47.7	42.9	146.0
Additional deferred tax accruals	(19.2)	(17.3)	(49.1)
Increase in net income	28.5	25.6	96.9

As of 31st December, 2003, the net book value of property, plant and equipment in the Company's balance sheet, net of only the accumulated economic depreciation charge (based on economic useful lives and excluding any additional or accelerated depreciation) would have been €3,428.0 million and the average residual economic useful life is 28.2 years. The estimated useful life of Terna's property, plant and equipment for tax purposes is 12.2 years.

Accelerated depreciation recorded in fiscal years 2001, 2002 and 2003, amounting to €42.8 million, €39.6 million and €36.9 million, respectively, did not impact net income, as the relevant amounts were recorded in undistributable equity reserve at the time of allocation of earnings made by Terna's shareholders during the shareholders' general meeting for each respective year (see note 2).

(13) *Investments*

Investments consist of the following as of 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Subsidiaries	—	—	156.2	—
Other investments	1.6	3.5	3.5	3.5
	1.6	3.5	159.7	3.5

On 31st December, 2003, Terna acquired from Enelpower its holdings in two Brazilian companies, TSN and Novatrans, whose core activities consist of building and maintaining high voltage transmission networks in Brazil. Details of Terna's interest in each of the two Brazilian companies is as follows:

	Share capital (millions of reais)	Share- holders' equity at 31 December 2003 (millions of euro)	Profit (loss) for the year ended 31 December 2003 (millions of euro)	Partici- pation share	Book value at 31 December 2003 (millions of euro)
TSN	250.0	147.3	10.2	99.74%	155.5
Novatrans	2.0	(3.4)	(3.9)	100.00%	0.7

The price originally paid for the acquisition was adjusted in April 2004, for an amount of €10.4 million, of which €6.0 million relates to TSN and €4.4 million relates to Novatrans. Such adjustments were made in order to reflect the net equity of both subsidiaries as of 31st December, 2003.

Shares of TSN are deposited with BNDES as a pledge for amounts borrowed. Dividends and voting rights remain with Terna.

At 31st December, 2003, other investments relate to Sfera S.p.A. (an Enel Group company) and Cesi S.p.A., reflecting interests of 4.71% and 15%, respectively. Sfera S.p.A. operates in learning and specialized training and Cesi S.p.A. operates in the research sector.

(14) *Intangible assets, net*

Intangible assets, net, consist of the following at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Electricity Sector Employee Pension Fund (FPE) Contribution	34.8	—	—	—
Goodwill.....	—	—	—	115.5
	34.8	—	—	115.5

The contribution due upon the cancellation of the Electricity Sector Employee Pension Fund (FPE), totalling €100.0 million, was paid in three installments: €29.0 million in 2000; €35.6 million in 2001 and €35.4 million in 2002. The balance recorded as at 31st December, 2001 was completely offset by the liability representing the residual amount payable to the Social Security Institutions at such date.

Had Terna amortized the contribution over the allowed 20-year period, instead of a three-year period as it chose to do, as permitted by the 2000 Budget Law, the unamortized balances in the Company's balance sheet

would have been €90.0 million, €85.0 million and €80.0, gross of tax effect, at 31st December, 2001, 2002 and 2003, respectively, while in the consolidated balance sheet would have been €80.0 million at 31st December, 2003.

Goodwill relates to the 31st December, 2003 acquisitions of TSN and Novatrans. The amount represents the excess of purchase price over the fair value of assets acquired and liabilities assumed as of the acquisition date and is amortized using the straight-line method over 27 years, which is the residual life of the government concessions. Amortization will start in 2004.

(15) Deferred tax assets

Deferred tax assets consist of the following at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Beginning Balance	12.9	9.9	13.9	13.9
Accruals and other movements	4.3	5.6	8.4	8.4
Uses	(7.3)	(1.6)	–	–
	9.9	13.9	22.3	22.3

The increases in the periods shown are essentially caused by taxable provisions for risks and charges made in the respective years.

(16) Other receivables, non-current

Other receivables, non-current consist of the following at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Greek VAT receivables	–	14.2	12.7	12.7
Tax advance on employee termination indemnities (Law 662/1996)	7.2	6.3	5.3	5.3
Loans to employees and other items	2.6	3.0	3.1	3.1
IRPEG receivables	13.7	–	–	–
Other items.....	–	0.2	0.4	1.0
	23.5	23.7	21.5	22.1

Greek VAT receivables relate to invoices issued by the Greek branch of Enelpower to the Greek branch of Terna for the sale of the fiberoptic cable for the Italy-Greece connection.

Tax advance on employee termination indemnities relates to the amount paid to the State in compliance with specific laws. The same laws allow Terna to recover such advances at the time the termination indemnity is paid to retired employees. The outstanding value of the tax advance is revalued as the employee termination indemnity. Decreases during the periods relate to personnel reductions.

Loans to employees and other items relate mainly to loans made to employees at current rates of interest for the acquisition of their first home and to face exceptional economic needs.

Non-current liabilities

(17) Amounts due to Banks

Amounts due to banks are as follows at 31st December:

	Maturity period	2001	2002	2003	Current portion	Long-term portion	Maturity				
					at 31 December	at 31 December	2003	2005	2006	2007	2008
(millions of euro)											
EIB (loan n.20271).....	2004-2014	75.0	75.0	75.0	6.8	68.2	6.8	6.8	6.8	6.8	41.0
EIB (loan n.21159).....	2005-2016	250.0	250.0	250.0	–	250.0	11.4	22.7	22.7	22.7	170.5
		325.0	325.0	325.0	6.8	318.2	18.2	29.5	29.5	29.5	211.5
BNDES	2005-2016	–	–	164.2	1.7	162.5	7.8	8.6	9.4	10.2	126.5
		325.0	325.0	489.2	8.5	480.7	26.0	38.1	38.9	39.7	338.0

The €75.0 million loan was granted by the European Investment Bank (“EIB”) on 22nd October, 1999 for the project “Italy-Greece power grid connection”. The €75.0 million loan, due in 22 semiannual installments beginning 15th March, 2004, bears interest semiannually deferred, at a floating rate based on Euribor plus 0.15% (2.11% at 31st December, 2003). Pursuant to the loan agreement, EIB has the right to request early repayment of the €75.0 million loan in the event Enel were to relinquish control of Terna. As of 31st December, 2003, the €75.0 million loan was fully “hedged” against interest rate fluctuations with financial instruments (interest rate swaps).

The €250.0 million loan was granted on 6th July, 2001 by EIB for the “Planning, construction and commencement of operation of approximately 200 power transmission plants”. The €250.0 million loan, due in 22 semiannual installments beginning 15th December, 2005, bears interest semiannually in arrears, at a floating rate based on Euribor plus 0.25% (2.21% at 31st December, 2003). Pursuant to the €250.0 million loan agreement, EIB has the right to request from Terna information regarding the possible consequences of a proposed merger, split or sale, or contribution of a branch and/or Group modifications. If EIB were to consider these transactions to be detrimental, and the parties fail to agree on possible amendments of the existing agreement, EIB has the right to request early repayment of the €250.0 million loan. Furthermore, EIB has the right to request early repayment of the €250.0 million loan if Enel’s medium and long-term debt rating, or the rating of debt guaranteed by Enel, published by Standard & Poor’s and/or Moody’s Investor Services, were to be downgraded to a level lower than A and A2, respectively, which EIB may consider likely to have a negative effect on the creditworthiness of Enel or Terna. Early repayment will not be required if an agreement is reached within 60 days of EIB’s request and/or Terna provides an alternative guarantee for the debt. As of 31st December, 2003, the €250.0 million loan was “hedged” with financial instruments (interest rate swaps), for a nominal value of €217.5 million. Taking into account the hedging, the percentage of the €250.0 million loan still exposed to interest rate fluctuations is 13%.

Included in the consolidated financial statements, in addition to the debt described above, is the debt of the subsidiary TSN. The €164.2 million loan was granted to TSN by BNDES in October 2002 for the construction of the Southeast—Northeast line. Regarding interest terms, the loan for an original amount of R\$556.8 million is divided into two portions. The first portion, R\$418.3 million, bears interest at a floating rate based on TJLP plus 3.50% (TJLP is the cost of long-term debt measured by the central bank of Brazil). In the event TJLP exceeds 6.00%, the excess portion is capitalized on the loan’s residual amount. The second portion, R\$138.5 million, is denominated in a currency basket (variable, but mostly related to the US dollar) with a floating rate based on the average cost incurred by BNDES to fund its foreign currency borrowings plus 3.50%. Interest on both portions is paid monthly in arrears and the principal on both portions is paid in 144 monthly installments starting 15th October, 2004. The debt agreement contains certain covenants including: maintaining, for the duration of the loan, a debt service coverage ratio of at least 1.3; prior authorization by BNDES for share capital decreases, payment of interest on capital or distribution of dividends higher than the mandatory minimum required by applicable Brazilian law (25% of distributable

net income); and prior authorization from BNDES in case of direct or indirect changes of control resulting from any disposal of shares, opening of new lines of credit and granting of guarantees.

The loan is guaranteed by the pledge of all TSN shares owned by Terna. The amount outstanding at 31st December, 2003 is R\$601.5 million, which includes certain capitalized interest.

(18) Third-party advances

Third-party advances include customer prepayments for work in process at 31st December, 2003. The current portion of third-party advances includes customer prepayments for work expected to be completed within twelve months from the balance sheet date and primarily relates to amounts received for the construction of a new integrated control system for the Italian ISO (€9.8 million) and for the construction of a control system for Edipower's generating plant (€1.9 million). The significant balance at 31st December, 2001 relates primarily to the construction of the Italy-Greece connection which was completed in July 2002.

The long-term portion of third-party advances at 31st December, 2003 primarily relates to customer prepayments received for high voltage network connections.

(19) Trade accounts payable to third parties

Trade accounts payable to third parties, both short-term and long-term, consists of invoices received and to be received with regard to contract work, services received and purchases of inventory and assets. At 31st December, 2003, short-term trade accounts payable to third parties includes €32.8 million (€22.5 million as of 31st December, 2002), which was originally due to third parties. These third parties sold the receivables due from Terna to Enel.factor under a factoring arrangement. Due to the original transactions being with a third party, these amounts remain classified as Trade accounts payable to third parties.

The significant balance at 31st December, 2003 relates to higher capital expenditures at year end with respect to the previous year.

The consolidated balance sheet at 31st December, 2003 includes, in addition to the above mentioned items, trade accounts payable owed by the Brazilian subsidiaries to third parties.

(20) Trade accounts payable to Enel Group companies

Trade accounts payable to Enel Group companies is as follows for 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Wind.....	23.2	10.4	10.7	10.7
Enelpower	29.2	35.5	5.1	8.8
Enel Distribuzione	13.5	5.2	6.2	6.2
Enel Real Estate	3.8	4.4	4.3	4.3
Enel.it	4.6	3.6	2.2	2.1
Other Enel Group companies	2.4	4.5	1.4	3.2
	76.7	63.6	29.9	35.3

The decrease in trade accounts payable to Enelpower in 2003 relates to the final payment in 2003 for the Italy-Greece connection project. The €5.1 million due to Enelpower at 31st December, 2003 refers to an adjustment of the loan to Novatrans resulting from the addendum to the share sale agreement between Enelpower and Terna. In the 31st December, 2003 consolidated financial statements, the amount due to Enelpower is increased by amounts due under the Engineering Procurement Contract (EPC) by TSN and Novatrans.

The decrease in the amount due to Enel.it is partly attributable to lower costs resulting from fewer services requested, from the conclusion of the SAP project, and also to the spin-off of the telecommunication activities (fiberoptic) to Enel.Net, which was concluded on 1st July, 2003.

The decrease in 2002 in the amount payable to Wind was mainly due a decrease in Terna's telecommunication costs, partially offset by an increase in accounts payables versus Enelpower following the progress in the completion of the Italy-Greece connection as well as other minor connections.

(21) *Amounts due to Enel*

Amounts due to Enel are as follows for 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Current portion				
Trade accounts payable and others	3.7	1.4	1.7	1.7
Liabilities for the assumption of medium/long-term loans and financing ..	49.3	22.3	19.9	19.9
	<u>53.0</u>	<u>23.7</u>	<u>21.6</u>	<u>21.6</u>
Long-term portion				
Liabilities for the assumption of medium/long-term loans and financing	478.5	456.2	436.3	436.3

Trade accounts payables mainly pertain to amounts owed for assistance and consulting services, in-house and communications services, marketing, corporate image, purchasing strategy and methods, services and e-procurement activities and development.

Liabilities for the assumption of medium/long-term loans and financing relate to portions of loans allocated to Terna as part of the contribution of the business segment from Enel. As part of this arrangement, it was agreed that Terna would be charged for the proportional cost of the financial expenses incurred on said loans, and that Terna would also repay the principal at the respective maturity dates. Likewise, the income and expense accrued on hedging agreements against interest rate fluctuations designated by Enel for such liabilities, will be allocated to Terna.

Financial liabilities for the assumption of medium/long-term loans and financing is as follows at 31st December, 2003.

	Maturity period	2003	2003 Current portion	2003 Long- term portion	Maturity				
					2005	2006	2007	2008	Beyond
(millions of euro)									
Fixed-rate loans	2004-2006	87.4	7.2	80.2	79.5	0.7	—	—	—
Floating-rate loans	2004-2019	368.8	12.7	356.1	12.5	1.7	11.6	10.6	319.7
		<u>456.2</u>	<u>19.9</u>	<u>436.3</u>	<u>92.0</u>	<u>2.4</u>	<u>11.6</u>	<u>10.6</u>	<u>319.7</u>

The breakdown of the above debt for the reference currency as of 31st December, 2003, is as follows:

	Maturity Period	Average interest rate as of 31st December, 2003	Balance as of 31st December, 2003
Euro area currency	2004-2019	6.65%	452.9
Other currency	2004-2006	6.46%	3.3
			456.2

(22) *Taxes payable*

Taxes payable consists of the following at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Tax withheld on wages and consulting income	3.9	3.7	3.9	3.9
VAT charged	–	12.1	–	–
IRPEG for the year	7.6	37.6	75.1	75.1
IRAP for the year	13.7	16.4	19.0	19.0
IRPEG advances	(7.6)	(4.1)	(47.2)	(47.2)
IRAP advances	(11.8)	(13.4)	(16.1)	(16.1)
Tax advances	–	(3.4)	–	–
Other tax	–	–	–	5.5
	5.8	48.9	34.7	40.2

Italian companies pay a national tax (IRPEG) at 34% (36% for year 2001 and 2002) and a local tax on gross margin, adjusted for personnel costs and other minor items (IRAP) at 4.25%. Terna makes advance payments during the year, based on estimated net taxable income, which are recorded as an asset within taxes payables (IRPEG and IRAP advances). When the actual taxes owed are calculated at year end, Terna presents any remaining obligations or receivables in the line item “taxes payable”. Increase in estimated payments made in 2003 relates to a change in tax regulation, effective in the same year, requiring Terna to base estimated payments on current year estimated net taxable income, instead of basing estimated payments on historical net taxable income as previously required.

Included in the 31st December, 2003 consolidated balance sheet, in addition to amounts described above, are other taxes payable owed by the Brazilian subsidiaries related to local taxes and social contributions of €5.5 million.

(23) *Accrued liabilities and deferred income*

Accrued liabilities and deferred income is as follows at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Accrued interest	7.1	6.1	5.4	5.4
Other unearned income	0.4	–	–	–
Unearned grant received and other minor accounts	16.4	1.1	1.3	1.3
Total short-term portion of accrued liabilities and deferred income	23.9	7.2	6.7	6.7
Long-term portion				
Unearned grants received and other minor accounts	91.0	147.7	142.7	148.0

Unearned grant contributions represent amounts received from third parties for grants for construction of power lines or other specific work, which will be recognized as income in accordance with the depreciation of the related assets.

The increase in the long-term portion in 2002 relates to the timing of the grants received for the capital expenditure required for the Italy-Greece connection.

In the 31st December, 2003 consolidated balance sheet, accrued liabilities and deferred income includes €5.3 million resulting from the elimination of the tax interference generated from additional grant contributions recognized on the income statement, relating to additional depreciation of the corresponding assets.

(24) *Other current liabilities*

Other current liabilities consists of the following at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Payables to employees	22.2	15.5	25.7	25.7
Other current liabilities	0.4	1.3	4.9	7.8
Social security payables	42.2	7.3	7.5	7.5
	64.8	24.1	38.1	41.0

Amounts payable to employees represent the current portion of the employee leaving indemnity that will be paid to employees who ceased to be employed during the year, other than personnel incentives and bonuses accrued in the respective years. The increase in 2003 is due to the increase in terminations.

Social security benefits payable pertain to amounts due to INPS, for December social security contributions and contributions for personnel incentives to be paid in the following year. The balance at 31st December, 2001 included the third and last installment of the contribution due upon the cancellation of the FPE (€34.7 million), paid in November 2002.

(25) *Employee termination indemnity*

The amount represents the liability accrued for employee termination indemnity (“TFR”), which is due, pursuant to Italian law, to each employee upon termination for any reason. The amount recorded represents Terna’s obligation if all employees were to be terminated as of the balance sheet date.

Activity for the years ending 31st December is as follows:

	(millions of euro)
Balance at 31st December, 2000	66.9
– accruals	19.8
– payments	(13.6)
Balance at 31st December, 2001	73.1
– accruals	10.2
– payments	(7.6)
Balance at 31st December, 2002	75.7
– accruals	9.7
– payments	(14.7)
Balance at 31st December, 2003	70.7

Amounts are net of advances granted and portions allocated and paid annually to the Enel Group's Pension Fund. Additionally, the amount is also net of the 11% substitute tax on the revaluation of the TFR pursuant to Legislative Decree No. 47/2000.

The significant decrease in 2003 is due to the termination of employees who participated in the early retirement program by 31st December, 2003.

(26) *Deferred tax liabilities*

The changes in deferred tax liabilities are as follows for the years ended 31st December:

	(millions of euro)
Balance at 31st December, 2000	123.9
– accruals	16.8
– uses	(2.4)
Balance at 31st December, 2001	138.3
– accruals	15.1
– uses	(2.3)
Balance at 31st December, 2002	151.1
– accruals	11.4
– uses	(3.2)
Balance at 31st December, 2003	159.3

Deferred tax liabilities as of 31st December, 2003 pertain to deferred taxes related to accelerated depreciation charged through 31st December, 2002, as well as to the allowance for deferred taxes of €13.8 million for the 2003, which will be recorded under reserves upon the appropriation of profits for 2003. The balance at 31st December, 2003 also includes the tax reversal of deductible accelerated depreciation for the period of €3.2 million and the effect of the changes in the tax rate of €2.4 million.

Deferred tax liabilities as of 31st December, 2002 pertains to deferred taxes related to accelerated depreciation charged through 31st December, 2001, as well as to the allowance for deferred taxes of €15.1 million for 2002, which was recorded under reserves upon the appropriation of profits for 2002. The balance at 31st December, 2002 also includes the tax reversal of deductible accelerated depreciation for the period of €2.3 million.

Deferred tax liabilities as of 31st December, 2001 pertains to deferred taxes related to accelerated depreciation charged through 31st December, 2000, as well as the allowance for deferred taxes of €16.8 million for 2001, which was recorded under reserves upon the appropriation of profits for 2001. The balance at 31st December, 2001 also includes the tax reversal of deductible accelerated depreciation for the period of €2.4 million.

In the consolidated balance sheet as of 31st December, 2003, deferred tax liabilities includes an additional amount of €257.9 million for the deferred taxes calculated on consolidation adjustments related to additional depreciation charges recognized by Terna.

(27) *Contingent liabilities and loss allowance*

Contingent liabilities and loss allowances consist of the following at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Provision for retirement and related obligations	0.4	0.8	0.8	0.8
Electricity Sector Employee Pension Fund	39.8	38.6	37.5	37.5
Other reserves	25.0	36.4	59.2	59.7
	65.2	75.8	97.5	98.0

Provision for retirement and related obligations relates to allowances for indemnities that replace the advance-notice and additional monthly payments for active personnel with vested right of notice pursuant to the National Collective Bargaining Agreement for the Electricity Sector and union agreements.

The Electricity Sector Employee Pension Fund is a fund for retired management. Pursuant to the agreement which regulated the transfer of business from Enel to Terna in October 1999, Terna assumed liabilities under the plan and responsibilities for any future contributions needed.

Other reserves consist of the following at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Reserves for disputes and litigation	10.2	12.1	12.2	12.2
Reserves for contingent liabilities and other losses	14.6	16.8	47.0	47.5
Reserves for early retirement incentives	0.2	7.5	-	-
	25.0	36.4	59.2	59.7

Reserves for disputes and litigation, based on the opinion of in-house and independent counsel, is intended to cover potential liabilities existing at year-end that could result from litigation and other proceedings in progress, related mainly to services provided by suppliers, employees and grid operation matters. The reserve does not include the impact of litigation that is expected to be resolved in favor of Terna and those for which the outcome cannot be reasonably quantified or the plaintiffs' prospects are considered by Terna to be remote.

Reserves for contingent liabilities and other losses as of 31st December, 2003 includes, among other items, €18.0 million representing an estimate of liabilities resulting from the adjustments of the annual fee for the utilization of the Terna Grid, based on more conservative estimates of Terna's percentage ownership of the Italian Grid. In addition, at 31st December, 2003, 2002 and 2001, reserves for contingent liabilities and other losses include allocations for refunds to third parties relating contributions received in the past for connections to the Terna Grid for higher amount than actually due, for transformer failures and extraordinary

events pertaining to high voltage plants, and for expenses related to expected decommissioning of plants and other expenses.

Reserves for early retirement incentives include the estimated allowance for extraordinary expenses pertaining to the offer to employees for early retirement. During 2003, reserves for early retirement were liquidated, as all the employees that entered the program were terminated during the period.

(28) *Shareholders' equity*

Shareholders' equity consists of the following at 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Share capital	2,036.1	2,036.1	2,036.1	2,036.1
Other reserves	283.8	330.0	374.0	374.0
Retained earnings	0.2	0.2	0.3	335.7
Interim dividend	(6.7)	–	–	–
Net income	68.0	88.1	123.5	220.4
Minority interest	–	–	–	0.2
	2,381.4	2,454.4	2,533.9	2,966.4

Share capital

At the 21st March, 2001 General Shareholders' Meeting, the Shareholder approved the redenomination of share capital in Euro, bringing the par value of each share from Lire 1,000 to €0.50. The same meeting approved a reverse stock split whereby one share with a face value of €1.0 was to be exchanged for every two shares with a nominal value of €0.50. Pursuant to these transactions, the resulting share capital is represented by 2,036,050,000 common shares with a nominal value of €1.0 held entirely by Enel. Rounding led to a decrease in share capital from €2,103.1 million to €2,036.1 million and an additional legal reserve of €67.0 million (which is approximately 3.1% and therefore within the 5% limit required by Art. 17, paragraph 6 of Legislative Decree No 213 of 24th June, 1998, as amended by Legislative Decree No. 206 of 15th June, 1999).

Appropriation of 2001 net income

At the 26th March, 2002 General Shareholders' Meeting, the Shareholder approved the financial statements and management report as of and for the year ended 31st December, 2001, and allocated the 2001 net income as follows:

- €3.4 million, equal to 5% of net income, to the legal reserve;
- €42.8 million to the allowance for accelerated depreciation;
- €6.7 million as interim dividends distributed during 2001; and
- €15.1 million as a dividend due to the Shareholder, paid in April 2002.

Appropriation of 2002 net income

At the 13th March, 2003 General Shareholders' Meeting, the Shareholder approved the financial statements and management report as of and for the year ended 31st December, 2002, and allocated the 2002 net income as follows:

- €4.4 million, equal to 5% of net income, to the legal reserve;
- €39.6 million to the allowance for accelerated depreciation;

- €44.0 million as dividends due to the Shareholder (€0.0216 per share), paid in April 2003; and
- €0.1 million as retained earnings.

Appropriation of 2003 net income

At the 3rd March, 2004, General Shareholders' Meeting, the Shareholder approved the financial statements and management report as of and for the year ended 31st December, 2003, and allocated 2003 net income as follows:

- €6.2 million, or 5% of net income, to the legal reserve;
- €36.9 million to the allowance for accelerated depreciation;
- €80.2 million as dividends due to the Shareholder (€0.0394 per share); and
- €0.2 million as retained earnings.

Other reserves

Other reserves pertain to the legal reserve and the reserve for accelerated depreciation.

The reserve for accelerated depreciation relates to accelerated depreciation from previous fiscal years. During each year presented, undistributable reserves were provided for the amount corresponding to the accelerated depreciation from the previous year. During each year presented, €5.2 million, €3.5 million and €3.6 million for the years ending 31st December, 2003, 2002 and 2001, respectively, have been reclassified from the undistributable reserve for accelerated depreciation to an available reserve following the tax recovery of deductible accelerated depreciation for each period presented.

Interim dividend

In compliance with the provisions of Article 2433 bis of the Italian Civil Code, and Article 29.3 of the By-laws, the Board of Directors met on 28th September, 2001, and, based on Terna's positive financial performance and equity position as of 31st August, 2001, declared a 2001 interim dividend. The total dividend of €6.7 million was paid on 28th September, 2001.

Minority interest

Minority interest represents the amount of the minority shareholder of TSN.

Reconciliation of shareholders' equity and net income of Terna to consolidated data

The following is a reconciliation of Terna's net income and shareholders' equity as of 31st December, 2003 to the Terna group's net income and consolidated shareholders' equity, not considering minority interest, as of 31st December, 2003:

	Net income for the year ended 31st December, 2003	Shareholders' equity as of 31st December, 2003
	(millions of euro)	
Terna S.p.A	123.5	2,533.9
Equity contributed by consolidated companies	–	41.0
Elimination of the book value of consolidated ownership interests	–	(156.2)
Consolidated goodwill	–	115.4
Minority interests	–	(0.2)
Consolidation adjustment relating to additional depreciation, net of related contributions	96.9	432.3
	220.4	2,966.2

(29) *Commitments*

Commitments are as follows as of 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Guarantees:				
Unsecured guarantees given to third parties	2.0	2.2	7.4	7.4
Other commitments- commitments with suppliers				
Sundry supplies	188.7	205.7	193.4	193.4
Contract work	93.5	134.3	162.7	162.7
	284.2	342.2	363.5	363.5

Guarantees given to third parties are related to performance guarantees on contracts entered by Terna in conjunction with the services they offer.

Other commitments to suppliers include commitments for purchases of materials and equipment and services in the ordinary course of business. The increases recorded over the three-year period are due essentially to the increase in supplies and services needed to conduct operations.

Off-Balance Sheet contingent liabilities and commitments

(30) *Litigation*

Terna is involved, both as plaintiff and defendant, in a substantial number of civil and administrative proceedings, including contractual, human resources, environmental and health matters associated with the construction and operation of a number of power lines. Based on indications given by legal advisors, the Company believes the possibility of negative outcome to be remote. The effects of an adverse ruling could include not only the payment of damages to the plaintiff but also the costs for the modification of parts of the Terna Grid or temporarily remove parts of the same from service. At present, such unfavorable outcomes may not be quantified and therefore are not included in the "Provisions for risks and charges".

(31) *Interest rate risk management*

In order to manage interest rate risk, Terna uses interest rate swaps to reduce the amount of debt subject to interest rate fluctuations and stabilize the cost of capital.

The nominal amount of the existing contracts, associated with Terna and the Group, at 31st December, 2001, 2002 and 2003 is shown in the table below:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Interest rate swaps	344.5	496.5	534.7	534.7

Terna's total debt, as of 31st December, 2001, 2002 and 2003, respectively, was €852.8 million (85.0% at variable rates), €803.5 million (86.7% at variable rates) and €781.2 million (88.8% at variable rates). The amounts presented as Terna's total debt include the amount due to Enel related to the assumption of medium/long-term loans and financing and the amount due to banks, including the current portion.

Considering the interest rate swaps, the percentage of total debt still exposed to the risk of exchange rate fluctuations is estimated to be 44.0%, 24.9% and 20.4%, respectively, as of 31st December, 2001, 2002 and 2003.

Consolidated long-term debt as of 31st December, 2003, is €945.4 million (including 90.8% at variable rates). By virtue of the existing hedging contracts as of 31st December, 2003, the portion of debt still exposed to the risk of exchange rate fluctuations is estimated to be approximately 34.2%.

(32) *Exchange rate risk*

Regarding the Brazilian subsidiaries, the Group is exposed to the risk of exchange rate fluctuation, which could impact the Group's profitability. Specifically, part of TSN's and Novatrans's loans are denominated in a foreign currency. The exposure to foreign exchange risk of the Group as of 31st December, 2003, was equal to €330.5 million, of which €289.8 million relates to Novatrans and €40.7 million relates to TSN. This risk is partially covered through hedges with major financial institutions for a total of €285.7 million, exclusively pertaining to Novatrans' loans, which represents 86.4% of the total exposure of the Brazilian subsidiaries.

The risk of exchange rate fluctuation also impacts cash flows coming from Brazil in the form of dividends, interest or repayment of principal, and any other distribution to Terna in the local currency. It also impacts the value of assets expressed in the local currency at the time of conversion to Terna's reporting currency, which as of 31st December, 2003 represents 12.6% of the Group's net consolidated invested equity.

INCOME STATEMENT

Terna Group's 2003 consolidated income statement does not reflect the economic results of the Brazilian subsidiaries since the companies were acquired on 31st December, 2003.

(33) *Operating Revenues*

The following table shows comparative data for the years ending December 31:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Revenues from Regulated Activities in Italy:				
Annual fees for utilization of the Terna Grid	708.7	730.0	782.3	782.3
Other Regulated Activities	29.8	25.0	29.8	24.5
	738.5	755.0	812.1	806.8
Revenues from Other Activities and income in Italy				
From Enel Group companies	44.7	63.6	47.9	47.9
From third parties	9.5	11.2	17.1	17.1
	54.2	74.8	65.0	65.0
	792.7	829.8	877.1	871.8

Revenues from Regulated Activities in Italy for the year ended 31st December, 2003 mainly consist of the annual fees for the utilization of the Terna Grid relating to the remuneration of the operation, maintenance and development activities of the Terna Grid. The increase in 2003 is due to an increase in electricity demand causing increased use of the Terna Grid and due to the increase in electricity transportation tariffs revised in 2003 by the Italian Energy Authority Deliberation No. 152/02.

The increase in fees for the utilization of the Terna Grid in 2002 mainly results from the effects of the Italian Energy Authority Deliberation No. 228/01 that unified electrical transportation fees for eligible and not eligible customers and provided to Terna additional fees for transmission activity.

Other Regulated Activities revenues mainly result from third-party contributions for connection to the Terna Grid or development activities related to modifications of lines.

The consolidated revenues for Other Regulated Activities do not include €5.3 million due to the consolidation adjustment posted to eliminate the grant contribution amounts recognized solely for tax purposes.

Revenues from Other Activities and income in Italy represents services rendered to Enel Group companies and services rendered to third parties.

In the three years presented, services rendered to Enel Group companies consist of revenues from the maintenance of high voltage lines owned by Enel Distribuzione, housing of fiberoptic cables for Enel.Net and maintenance and development of such cables (€6.3 million). The higher revenues for the year ended 31st December, 2002, relates to the sale of the underwater fiberoptic cable laid between the Italy and Greece to Enel.it (€9.4 million).

Revenues from Other Activities and Income in Italy from third parties mainly relates to the operation and maintenance of high voltage plants owned by third parties and services rendered for plant engineering, constructions, operations and maintenance activities other than for remote network management and control services and telecommunication sector services.

(34) Operating Costs

Operating costs are as follows for the years ending December 31:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Salaries and benefits.....	164.5	165.9	163.8	163.8
Raw materials	14.4	18.9	14.4	14.4
Services.....	114.1	99.9	90.4	90.4
Rental and lease expenses	15.3	13.8	14.5	14.5
Miscellaneous operating expenses	16.9	17.3	15.8	15.8
Capitalized expenditures	(12.5)	(14.8)	(17.4)	(17.4)
	312.7	301.0	281.5	281.5

Salaries and benefits

Salaries and benefits are as follows for the years ending 31st December:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Wages and salaries	115.8	116.9	114.5	114.5
Social security contributions.....	31.7	31.5	31.3	31.3
Employee termination indemnities	9.5	9.9	9.7	9.7
Employee pension and similar obligations	1.6	1.3	1.7	1.7
Other costs	5.9	6.3	6.6	6.6
	164.5	165.9	163.8	163.8

The following table shows the average number of employees of Terna by employment category (as of 31st December) and employees as of 31st December, 2003:

	Average no. of employees			No. of employees as of 31st December, 2003
	2001	2002	2003	
Managers	26	28	28	30
Officers	224	219	215	204
Employees	1,531	1,515	1,492	1,422
Workers	1,437	1,433	1,337	1,165
	3,218	3,195	3,072	2,821

Raw materials and changes in inventories

Costs for materials and inventories charges relating to the purchase of materials and spare parts for plants management and maintenance amount to €14.4 million for the year ended 31st December, 2003, 18.9 million for the year ended 31st December, 2002 and €14.4 million for the year ended 31st December, 2001, net of change in inventory relating to each year presented.

Services

Services for the years ended 31st December are as follows:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Services rendered from Enel Group companies	78.2	56.9	50.4	50.4
Maintenance and repairs	22.8	27.0	21.2	21.2
Insurance	3.1	4.3	5.1	5.1
Transport and leasing	0.6	0.9	0.8	0.8
Other services	9.4	10.8	12.9	12.9
	114.1	99.9	90.4	90.4

Telecommunications costs (services from Wind) and general services' costs (services from Enel Real Estate S.p.A. and Enel.it) are included in services rendered from Enel Group companies.

Cost for services rendered by Enel Group companies constantly decreased over the period due to the reduction in volume required.

Rental and lease expenses

Costs for rental and lease expense relate to rent payable to Enel Group companies and other rent, leasing costs and miscellaneous fees.

Miscellaneous operating expenses

Miscellaneous operating expenses relate mainly to contributions to the Electricity Sector Employee Pension Fund, ordinary plants decommissioning write-downs, energy discounts provided to retired employees and various local taxes.

Capitalized expenditures

Capitalized expenditures for the years ended 31st December are as follows:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Raw materials and other parts.....	2.7	3.2	4.3	4.3
Personnel expenditures	9.8	11.6	13.1	13.1
	12.5	14.8	17.4	17.4

(35) *Amortization and depreciation*

Amortization and depreciation for the years ended 31st December are the following:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Amortization of intangible assets	–	–	–	–
Depreciation of property, plant and equipment:				
– Economic-technical.....	235.4	242.2	139.6	139.6
– Additional	47.7	45.1	151.4	–
	283.1	287.3	291.0	139.6

Depreciation of property, plant and equipment for the year ended 31st December, 2003, has been calculated based on the new depreciation rates, which were revised during 2003 in order to better represent the estimated useful life of the plants of Terna. Additional depreciation is charged to the extent of ordinary depreciation rates, as allowed for tax purposes.

(36) *Other allowances and write-downs*

Other allowances and write-downs for the years ended 31st December are as follows:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Provisions for risks and charges	8.7	5.2	36.1	36.1
Provisions for doubtful debts	1.7	1.1	1.0	1.0
Write-downs of non-current assets	–	0.4	–	–
	10.4	6.7	37.1	37.1

Provisions for risks and charges for the year ended 31st December, 2003 mainly relate to the estimate of liabilities resulting from the adjustments of the annual fee for the utilization of the Terna Grid, based on a conservative estimate of Terna's percentage ownership of the Italian Grid, in addition to other losses for refunds to third parties relating to contributions received in the past for connections to the Terna Grid for a higher amount than that actually due, for transformer failures and extraordinary events pertaining to the high voltage plants.

(37) *Net interest income (expense)*

Net interest income (expense) for the years ended 31st December is as follows:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Interest income:				
Interest accrued on tax credits	0.2	0.2	0.2	0.2
Other financial income	0.2	0.2	0.1	0.1
Interest on current account with Enel	6.8	10.9	15.8	15.8
Total interest income	7.2	11.3	16.1	16.1
Interest expense:				
Interest on loans and medium- and long-term debt transferred	(40.1)	(37.3)	(37.1)	(37.1)
Interest on EIB financing	(8.7)	(11.1)	(8.0)	(8.0)
Interest on derivatives (swaps)	–	(2.1)	(6.1)	(6.1)
Total interest expense	(48.8)	(50.5)	(51.2)	(51.2)
	(41.6)	(39.2)	(35.1)	(35.1)

Interest income mainly relates to the interest earned from cash and cash equivalents in the current account with Enel and constantly increases over the period due to the higher average balances in such account.

Interest expenses remain substantially unchanged since the decrease in the interest on loans and medium to long-term debt transferred by Enel and on EIB financing has been partially offset by the negative margin accrued on interest rate hedging contracts (swaps) entered into by Terna in 2002 and 2003.

(38) *Net extraordinary income (expense)*

Extraordinary income for the year ended 31st December, 2003 amounts to €2.2 million (€3.5 for the year ended 31st December, 2002 and €0.5 million for the year ended 31st December, 2001) and consists mainly of higher income taxes withheld over the previous year compared to the actual tax liability as shown on the tax return (€2.1 million for the year ended 31st December, 2003, €3.4 million for the year ended 31st December, 2002 and €0.5 million for the year ended 31st December, 2001) and from the recovery of legal expenses for judgments in favor of Terna (€0.1 million for the years ended 31st December, 2003 and 2002).

Extraordinary expenses for the year ended 31st December, 2003 amount to €17.2 million (€48.1 million for the year ended 31st December, 2002 and €38.7 million for the year ended 31st December, 2001) and refer mainly to costs paid for the tax amnesty pursuant to Law No. 289/2002 (€2.8 million for the year ended 31st December, 2003), to the temporary offer for early-retirement of employees (€4.3 million for the year ended 31st December, 2003, €12.7 million for the year ended 31st December, 2002 and €2.6 million for the year ended 31st December, 2001) and to contractual penalties (€4.0 million for the year ended 31st December, 2003), pertaining to real property leasing contracts, imposed by Enel Real Estate. Extraordinary expenses for the year ended 31st December, 2003 also include a cumulative adjustment in order to align the amortization of the grant contributions with the effective useful life of the related plants (€6.1 million for the year ended 31st December, 2003).

Extraordinary expenses for the year ended 31st December, 2002 and 2001 include the extraordinary contribution due upon the cancellation of the FPE (€35.4 million for the year ended 31st December, 2002, and €35.6 million for the year ended 31st December, 2001).

(39) Taxes

Current, prepaid and deferred taxes for the years ended 31st December are as follows:

	2001 (Company)	2002 (Company)	2003 (Company)	2003 (Consolidated)
	(millions of euro)			
Current taxes:				
– IRPEG	7.6	37.6	75.1	75.1
– IRAP	13.7	16.4	19.0	19.0
Total current taxes	21.3	54.0	94.1	94.1
Prepaid taxes	3.0	(4.0)	(8.4)	(8.4)
Deferred taxes	14.4	12.9	8.2	57.4
	38.7	62.9	93.9	143.1

The significant increase in the current taxes for the year ended 31st December, 2003 relates to the higher income before taxes for the period and the tax benefits of the so called “Tremonti *bis* Law”, which in 2002 caused a decrease in the taxable amount of €32.2 million (€46.1 million for the year ended 31st December, 2001). The Tremonti *bis* Law was no longer in force in 2003.

Net allocation for prepaid taxes in 2003 reflects the movement in the provisions for risks and charges of the period as well as the adjustment of the tax rate following the introduction of the new income taxes (IRES) which will replace IRPEG.

Deferred taxes reflect the tax benefit related to the accelerated depreciation that will be charged upon the appropriation of profits by the Shareholder in the following year.

The combined statutory tax rate is 43.2% for the year ended 31st December, 2003, 41.7% for the year ended 31st December, 2002 and 36.2% for the year ended 31st December, 2001.

Terna applied the tax amnesty pursuant to Law No. 289 of 27th December, 2002 for its direct taxes for 1999, 2000, 2001 and 2002. Therefore, the open tax position refers only to 2003.

The table below shows the reconciliation between statutory tax rate of Terna and effective tax rate for the periods.

	2001	2002	2003
	(millions of euro)		
Taxable income as per income statements ⁽¹⁾	106.6	151.0	217.4
– Tax benefit as per Law No. 383/01	(46.1)	(32.2)	–
– Accelerated depreciation.....	(36.8)	(34.1)	(28.4)
– Changes in provisions	(7.0)	11.5	22.7
– Other increases	4.4	8.2	9.4
IRPEG taxable income	<u>21.1</u>	<u>104.4</u>	<u>221.1</u>
Rate	36%	36%	34%
Tax expense for the year.....	7.6	37.6	75.1

(1) Income before taxes as per income statements has been determined reclassifying additional depreciation charge, extraordinary contribution and related tax effect to the original line items.

ANNEX A

SUMMARY OF CERTAIN SIGNIFICANT DIFFERENCES BETWEEN ITALIAN GAAP AND IFRS, AS APPLIED TO THE TERNA GROUP

The consolidated financial statements of Terna included in the Offering Circular are extracted from the consolidated financial statements that were prepared for Italian statutory purposes in accordance with the Italian law governing the preparation of consolidated financial statements, as interpreted by, and integrated with, the accounting principles established by the *Consigli Nazionali dei Dottori Commercialisti e dei Ragionieri*, the Italian accounting profession (collectively, "Italian GAAP"). See note 2 to the audited financial statements and audited consolidated financial statements included in this Offering Circular for a more detailed discussion of reclassifications made to the Italian Statutory Financial Statements. Italian GAAP differs in certain significant respects from International Financial Reporting Standards (IFRS), promulgated by the International Accounting Standards Board. From 2005 onwards, Terna will be required to prepare its consolidated financial statements in accordance with IFRS.

The differences may be material to the financial information included in this Offering Circular. In making an investment decision, investors must rely upon their own examination of Terna, the terms of the offering and the financial information included in this Offering Circular. Potential investors should consult their own professional advisors for an understanding of the differences between Italian GAAP and IFRS and how those differences might affect the financial information included in this Offering Circular.

Certain significant differences between Italian GAAP and IFRS relevant to the consolidated financial statements of Terna are summarized below. However, this summary does not provide a comprehensive analysis, including quantification of such differences, but rather it is a listing of potential differences in accounting principles related to the consolidated financial statements of Terna. Terna has not quantified these differences, nor undertaken a reconciliation of its consolidated financial statements prepared in accordance with Italian GAAP to IFRS. Had Terna undertaken any such quantification or reconciliation, other potentially significant accounting and disclosure differences may have come to its attention which are not identified below. Accordingly, Terna can provide no assurance that the identified differences in the summary below represent all the principal differences relating to the consolidated financial statements of Terna. Regulatory bodies that promulgate Italian GAAP and IFRS have significant ongoing projects that could affect a future comparison such as this. In addition, no attempt has been made to identify future differences between Italian GAAP and IFRS resulting from prescribed future changes in accounting standards.

Goodwill

Italian GAAP

Intangible assets are recorded at cost and reflect residual amounts of investments whose economic life spans over several years. Amortization is calculated using the straight-line method over the expected economic useful lives of the assets. Start-up and organization costs are amortized over a five-year period and have been fully amortized as of 31st December, 2003.

Goodwill relates to the acquisition of the Brazilian Subsidiaries from Enelpower and it is recorded in the balance sheet when the price paid for the acquisition exceeds the fair value of assets acquired and liabilities assumed at the date of acquisition. Amortization is calculated using the straight-line method over 30 years, which is the period deemed representative of the underlying business value. This criterion is also applied to consolidated goodwill.

IFRS

Under IFRS, goodwill arises as a residual item after the allocation of the cost of a business acquisition to the fair value of assets acquired and liabilities and contingent liabilities assumed at the date of the acquisition.

After initial recognition, the acquirer must recognize goodwill at cost, less any accumulated impairment losses. After a goodwill impairment loss is recognized, the adjusted carrying amount of goodwill is its new accounting basis.

Tangible Fixed Assets

Italian GAAP

Tangible assets are recorded at the cost of purchase or production cost, inclusive of any additional expense incurred and of revaluations made by Enel, as transferor of the business unit relating to the Terna Grid, in accordance with specific laws issued by the Italian government.

The value of tangible assets excludes costs incurred in maintaining or restoring the state of efficiency and proper functioning of plants. Since these costs do not affect the magnitude or potential capacity of the plants, such costs are expensed as incurred.

In the event of permanent impairment in value, the assets are written down to their respective recoverable value. If the circumstances for a write-down no longer exist, the book value is increased to the original amount, net of depreciation.

IFRS

Property, plant and equipment is initially recognized at its cost, comprising principally its purchase price, directly attributable costs and the initial estimate of costs of dismantling and removing the item. After the initial recognition as an asset, an entity may choose either the cost model or the revaluation model. Under the cost model as its accounting policy, an item of property, plant and equipment must be carried at its cost, less any accumulated depreciation and any accumulated impairment losses. Under the revaluation model, an item of property, plant and equipment is carried at its revalued amount, less any accumulated depreciation and accumulated impairment losses. If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs must be revalued. Depreciation is allocated on a systematic basis over the estimated useful lives of the assets.

Pension and Employee Termination Accounting

Italian GAAP

The provision is in compliance with the law and collective bargaining agreements in force as of the balance sheet date, and reflects the liability accrued toward employees as of the balance sheet date, net of advances made, pursuant to law, as well as contributions made to the *Fondo Pensioni Gruppo Enel* ("Fondenel").

The provision also includes compensation to be paid in lieu of notice to existing personnel pursuant to collective bargaining agreements and union agreements currently in force.

IFRS

Under IFRS, the TFR is accounted for as a defined benefit plan, using actuarial techniques to make a reliable estimate of benefits that employees have earned in return for their service in the current and prior periods. The benefit is computed using the projected unit credit method in order to determine the present value of the defined benefit obligation and the current service cost. Any plan assets are stated at fair value.

Derivative Financial Instruments

Italian GAAP

Derivative contracts are entered into in order to hedge against the risk of interest-rate and exchange rate fluctuations.

The interest differentials to be received or paid on interest rate swaps at the end of each reporting period are accrued over the life of the contract and classified as “Financial income (expense)”.

Foreign currency hedging instruments are valued at the spot rate on the balance sheet date. Related gains and losses are recorded in the income statement as exchange rate differences under the “Other financial income and expenses” item. Premiums and discounts paid or received on such instruments are deferred and recorded in the income statement over the life of the instrument purchased or sold.

IFRS

Derivative financial instruments are recorded initially at fair value, at which date the instrument must be designated as held for trading or as a hedging instrument.

The subsequent recognition of derivative financial instruments continues to be at fair value. The effect from changes in the market value of derivatives is either recorded in the statement of income within results from ordinary operations, for those instruments designated as held for trading, or in equity, if the instrument qualifies as an effective cash flow hedge. Documentation requirements for applying hedge accounting are extensive. The ineffective portion of the hedge is recorded through income, and only the effective portion of qualifying cash flow hedges is recorded as equity.

ANNEX B

SUMMARY HISTORICAL CONSOLIDATED FINANCIAL DATA AND UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL DATA

The following summary historical financial data as of and for the six-month period ended 30th June, 2004, have been derived from our interim consolidated financial statements that appear elsewhere in this Offering Circular. Our independent auditors did not audit our interim consolidated financial statements for the six-month period ended 30th June, 2004.

The following unaudited pro forma consolidated financial data have been prepared by applying pro forma adjustments to our historical audited consolidated financial statements and our historical unaudited interim financial statements, that appear elsewhere in this Offering Circular, and in accordance with the Principles for the Preparation of Pro Forma Information in CONSOB Resolution DEM/1052803 of 5th July, 2001.

The following unaudited pro forma consolidated financial data do not necessarily reflect our consolidated financial position and consolidated cash flows as they would have been if transactions or events contemplated therein actually had occurred on the dates specified below, nor are they indicative of our future operating results.

You should read the following unaudited pro forma consolidated financial data together with “Unaudited Pro Forma Consolidated Financial Statements”.

	As of and for the year ended 31st December, 2003 (pro forma consolidated)	As of and for the six-month period ended 30th June, 2003 (pro forma, consolidated)	30th June, 2004 (historical, consolidated)
(millions of euro)			
Pro forma Income Statement Data:			
Revenues from regulated activities in Italy	806.8	394.2	428.5
Revenues from other activities and other income in Italy	64.8	37.0	38.7
Revenues from regulated activities in Brazil	47.0	20.6	51.7
Total operating revenues.....	918.6	451.8	518.9
Total operating expenses.....	295.4	143.7	171.4
Gross operating margin.....	623.2	308.1	347.5
Amortization, depreciation and other allowances	187.3	130.8	94.3
Earnings before interest and taxes	435.9	177.3	253.2
Earning before taxes	304.7	119.6	190.6
Net income	172.8	59.3	102.2
Pro forma Balance Sheet Data:			
Total assets	4,967.7	4,651.0	4,708.2
– Current	608.5	618.1	322.7
– Cash and cash equivalent.....	340.0	353.7	31.2
– Trade Receivable	210.9	153.1	184.2
– Other	57.6	111.3	107.3
– Non Current	4,359.2	4,032.9	4,385.5
– PP&E	4,195.8	3,871.0	4,235.3
– Intangible	115.5	115.5	113.3
– Other	47.9	46.4	36.9
Total liabilities	3,201.3	3,044.0	2,939.8
– Current	1,519.1	1,652.5	1,887.2
– Current portion of amounts due to banks	8.5	3.4	14.8
– Current portion of amounts due to Enel	1,221.6	1,213.5	1,408.7
– Other	289.0	435.6	463.7
– Non Current	1,682.2	1,374.6	1,052.0
– Long-term portion of amounts due to banks	480.7	363.8	478.7
– Long-term portion of amounts due to Enel.....	436.3	456.1	0.0
– Other	765.2	554.7	573.3
Shareholders' equity	1,766.4	1,607.0	1,769.0
– Share Capital	440.0	440.0	440.0
– Other reserves and retained earnings	1,326.4	1,167.0	1,329.0

UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

The following unaudited pro forma consolidated financial statements as of and for the year ended 31st December, 2003 (the “unaudited pro forma consolidated financial statements”), the unaudited pro forma consolidated interim financial statements as of and for the six-month period ended 30th June, 2003 (the “unaudited pro forma interim consolidated financial statements”) have been prepared by applying pro forma adjustments to our historical audited consolidated financial statements included elsewhere in this Offering Circular and our historical unaudited interim financial statements, in accordance with the “Principles for the Preparation of Pro forma Information” in CONSOB Resolution DEM/1052803 of 5th July, 2001.

The following unaudited pro forma consolidated financial statements and unaudited pro forma consolidated interim financial statements do not necessarily reflect the consolidated financial position, operating results and cash flows as they would have been if transactions or events described therein actually occurred on the dates specified below, nor are they indicative of our future consolidated financial position, operating results and cash flows.

Unaudited pro forma consolidated income statements

The following unaudited pro forma consolidated income statement for the year ended 31st December, 2003 and the unaudited pro forma consolidated interim income statement for the six-month period ended 30th June, 2003 include the effect of:

- (a) the results of TSN and Novatrans for the year ended 31st December, 2003 or for the six-month period ended 30th June, 2003, respectively (the “Brazilian Subsidiaries’ Results”);
- (b) the acquisitions by Terna of TSN and Novatrans (the “Brazilian Acquisitions”) (as described elsewhere in this Offering Circular) on the financial income or expenses for the periods presented, as if such acquisitions had occurred on 1st January, 2003 and therefore at the beginning of the periods presented;
- (c) the short-term line of credit for an amount of €1,200.0 million and bearing interest at the three-month Euribor plus a spread of 25 basis point (the “Enel Line of Credit”) made available on 30th April, 2004, by Enel to Terna to fund the return of capital pursuant to article 2445 of the Italian Civil Code as contemplated by Terna’s resolution relating to the reduction of share capital from €2,036.1 million to €440 million by means of (i) a return of capital in the amount of €1,200 million, (ii) the allocation of €396.1 million to “Other reserves”, and (iii) the reduction of the par value of each ordinary share from €1.00 to €0.22 (together, the “Capital Reduction”), as if the Capital Reduction had occurred on 1st January, 2003 and therefore at the beginning of the periods presented.

Unaudited pro forma consolidated balance sheets

The following unaudited pro forma consolidated balance sheet as of 31st December, 2003 includes (a) the Capital Reduction, and (b) the Enel Line of Credit as if they had occurred or were made available on the balance sheet date.

The following unaudited pro forma consolidated interim balance sheet as of 30th June, 2003 includes, other than the relevant consolidation adjustments, (a) the Brazil Acquisitions, (b) the Capital Reduction and (c) the Enel Line of Credit as if they had occurred or were made available on 30th June, 2003.

**UNAUDITED PRO FORMA CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED 31ST DECEMBER, 2003**

	Pro forma adjustments				Pro forma consolidated for the year ended 31st December, 2003
	Historical consolidated for the year ended 31st December, 2003	TSN and Novatrans results for the year ended 31st December, 2003 ⁽¹⁾	Brazil Acquisitions ⁽²⁾	Capital Reduction ⁽⁴⁾	
(millions of euro)					
Income statement					
Operating Revenues:					
Revenues from regulated activities in Italy	806.8	–			806.8
Revenues from other activities and other income in Italy	65.0	–	(0.2)		64.8
Revenues from regulated activities in Brazil	–	47.0	–		47.0
Total operating revenues	871.8	47.0	(0.2)	–	918.6
Operating expenses:					
Payroll expense	163.8	1.1	–		
Raw materials and changes in inventories	14.4	0.1	–		164.9
Services rendered	90.4	8.2	(0.2)		98.4
Rental and lease expenses.....	14.5	0.2	–		14.7
Miscellaneous operating expenses	15.8	4.5	–		20.3
Capitalized expenditures	(17.4)	–	–		(17.4)
Total operating expenses.....	281.5	14.1	(0.2)	–	295.4
Gross operating margin	590.3	32.9	–	–	623.2
Amortization, depreciation and other allowances:					
Amortization of intangible assets	–	–	4.1		4.1
Depreciation of property, plant and equipment	139.6	6.5	–		146.1
Other allowances and write downs	37.1	–	–		37.1
Total amortization, depreciation and other allowances ..	176.7	6.5	4.1	–	187.3
Earnings before interest and taxes	413.6	26.4	(4.1)	–	435.9
Interest income	16.1	25.7	(10.7)		31.1
Interest expense*	(51.2)	(77.1)	12.3	(31.3)	(147.3)
Net interest income (expense).....	(35.1)	(51.4)	1.6	(31.3)	(116.2)
Income from continuing operations	378.5	(25.0)	(2.5)	(31.3)	319.7
Net extraordinary income (expense)	(15.0)	–	–	–	(15.0)
Earnings before taxes and other ported items.....	363.5	(25.0)	(2.5)	(31.3)	304.7
Taxes	(143.1)	(3.1)	3.7	10.6	(131.9)
Net income	220.4	(28.1)	1.2	(20.7)	172.8

* Includes interest relating to (i) the loan from BNDES to TSN (€14.5 million), (ii) foreign exchange losses (€10.2 million) and expenses relating to foreign exchange hedging contracts for short term loans by Enelpower to TSN pending the grant of the BNDES loan (€7.1 million), (iii) Enelpower's loan to Novatrans (assumed by Terna pursuant to the acquisition of Novatrans), and (iv) expenses relating to foreign-currency hedging contracts for the Enelpower loan (€28.1 million)

**UNAUDITED PRO FORMA CONSOLIDATED INTERIM INCOME STATEMENT
FOR THE SIX-MONTH PERIOD ENDED 30TH JUNE, 2003**

	Pro forma adjustments					Pro forma consolidated for the six month period ended 30th June, 2003
	Historical Terna for the six month period ended 30th June, 2003	TSN and Novatrans results for the six month period ended 30th June, 2003 ⁽¹⁾	Brazil Acquisitions ⁽²⁾	Con-solidation adjust-ments ⁽³⁾	Capital Reduction ⁽⁴⁾	
(millions of euro)						
Income statement						
Operating Revenues:						
Revenues from regulated activities in Italy	394.2					394.2
Revenues from other activities and other income in Italy	37.0					37.0
Revenues from regulated activities in Brazil.....		20.6				20.6
Total operating revenues	431.2	20.6				451.8
Operating expenses:						
Payroll expense	(81.8)	(0.6)				(82.4)
Raw materials and changes in inventories.....	(6.0)	(1.1)				(7.1)
Services rendered	(45.0)	(4.3)				(49.3)
Rental and lease expenses	(6.1)					(6.1)
Miscellaneous operating expenses.....	(4.8)	(3.4)				(8.2)
Capitalized expenditures	9.3	0.1				9.4
Total operating expenses	(134.4)	(9.3)				(143.7)
Gross operating margin.....	296.8	11.3				308.1
Amortization, depreciation and other allowances:						
Amortization of intangible assets.....	-		(2.0)			(2.0)
Depreciation of property, plant and equipment	(145.3)	(4.4)		22.9		(126.8)
Other allowances and write downs	(2.0)					(2.0)
Total amortization, depreciation and other allowances	(147.3)	(4.4)	(2.0)	22.9		(130.8)
Earnings before interest and taxes	149.5	6.9	(2.0)	22.9		177.3
Interest income	8.5	12.2	(4.2)			16.5
Interest expense	(24.4)	(36.0)	4.8		(17.4)	(73.0)
Net interest income (expense)	(15.9)	(23.8)	0.6		(17.4)	(56.5)
Income from continuing operations.....	133.6	(16.9)	(1.4)	22.9	(17.4)	120.8
Net extraordinary income (expense)	(1.4)	0.2				(1.2)
Earnings before taxes	132.2	(16.7)	(1.4)	22.9	(17.4)	119.6
Taxes.....	(56.1)	(2.8)	1.4	(8.8)	5.9	(60.3)
Net result for that period	76.1	(19.5)	0.0	14.1	(11.5)	59.3

NOTES TO UNAUDITED PRO FORMA CONSOLIDATED INCOME STATEMENTS

Note 1 - Pro forma adjustments for Brazilian Subsidiaries' Results

The following pro forma adjustments have been applied to consolidate the Brazilian Subsidiaries' Results. The column for TSN and Novatrans includes the results earned in the period presented by the two Brazilian subsidiaries, disregarding the minority interest (0.26%) held in TSN by Inepar S.A. The economic results are presented in accordance with Terna's accounting principles. TSN commenced full operations in April, 2003 and Novatrans commenced partial operations in June, 2003.

Note 2 - Pro forma adjustments related to the Brazilian Acquisitions

The following pro forma adjustments have been applied to the historical consolidated income statements of the Terna Group for the year ended 31st December, 2003, and to the historical income statement of Terna for the six-month period ended 30th June, 2003, to illustrate the effect of the Brazilian Acquisitions as if they had occurred on 1st January, 2003:

- (a) To adjust "Amortization of intangible assets" to reflect the amortization of goodwill resulting from the Brazilian Acquisitions. The amortization charge of the goodwill has been calculated based on the goodwill carrying value as of 31st December, 2003 (€115.5 million), the residual useful life for the concessions (28 years as of 1st January, 2003) and for the periods presented.
- (b) To adjust "Interest income" to reflect the lower average amount of deposits that would have been held on current account with Enel (pursuant to the Treasury Services Management Agreement) and, therefore, the lower amount of interest that would have been earned on such deposits, if the Brazilian Acquisitions had occurred (and the purchase price was paid) on 1st January, 2003.

Specifically, the adjustment reflects the aggregate payment made by Terna for the Brazilian Acquisitions (€441.0 million, for which €156.2 million was allocated to the purchase of the ownership interests and €284.8 million was allocated to the assumption of the Enelpower loan to Novatrans) as if it was deposited on current account with Enel and the interest that would have been earned on such deposits was calculated using the average interest rate for the periods presented. The result was a pro forma decrease in interest income of €10.7 million for the year ended 31st December, 2003 or €4.2 million for the six-month period ended 30th June, 2003.

- (c) To adjust "Interest expense" to eliminate interest expense of €12.3 million for the year ended 31st December, 2003 or €4.8 million for the six-month period ended 30th June, 2003 incurred by Novatrans under its loan from Enelpower. Terna assumed the loan from Enelpower pursuant to the acquisition of Novatrans. The adjustment treats the interest expense as if Terna had made the loan at the time it was originally granted by Enelpower.
- (d) To record the theoretical tax effect of the pro forma adjustments, calculated by applying the current IRPEG rate of 34% to earnings before taxes excluding consolidated goodwill amortization and the Brazilian Subsidiaries' earnings. There was no theoretical tax effect on the positive adjustment to "Interest expense" referred to in Note 2(d) above, since Novatrans incurred a loss for the relevant year.

Note 3 - Pro forma adjustments related to the consolidation

To adjust "Depreciation of property plant and equipments" to eliminate the additional depreciation and the related additional recognition of grant contributions charged by Terna solely for tax purposes for the six-month period ended 30th June, 2003.

Note 4 - Pro forma adjustments related to the Capital Reduction

To adjust "Interest expense" to reflect the interest expense of €31.3 million for the year ended 31st December, 2003, €17.4 million for the six-month period ended 30th June, 2003 on the Enel Line of Credit, as if the Enel Line of Credit was made available on 1st January, 2003, and therefore at the beginning of the

period presented. Specifically, the interest expense has been calculated on the original amount of the Enel Line of Credit of €1,200.0 million, applying the interest rate of the three-month Euribor plus 25 basis points, applicable in the period, and for the period presented. Also, the theoretical tax effect of this pro forma adjustment has been recorded. This theoretical tax effect is calculated by applying the current IRPEG rate of 34% to earnings before taxes.

**UNAUDITED PRO FORMA CONSOLIDATED BALANCE SHEET
AS OF 31ST DECEMBER, 2003**

	Historical consolidated as of 31st December, 2003	Pro forma adjustments for Capital Reduction ⁽⁴⁾	Consolidated as of 31st December, 2003
(millions of euro)			
Assets			
Current assets	608.5	–	608.5
Cash and cash equivalents	333.4	–	333.4
Cash restricted for use	6.6	–	6.6
Trade receivables:			
Third parties	190.7	–	190.7
Enel Group companies	20.2	–	20.2
Other current receivables	17.8	–	17.8
Inventory	34.9	–	34.9
Prepaid expenses and deferred charges	4.9	–	4.9
Non-current assets	4,359.2	–	4,359.2
Other receivables	44.4	–	44.4
Investments	3.5	–	3.5
Intangible assets	115.5	–	115.5
Property plant and equipment, net	4,195.8	–	4,195.8
Total Assets	4,967.7	–	4,967.7
Liabilities and Shareholders' Equity			
Short-term liabilities	319.1	1,200.0	1,519.1
Current portion of amounts due to banks	8.5	–	8.5
Current portion of third party advances	17.2	–	17.2
Trade accounts payable			
Third parties	148.6	–	148.6
Enel group companies.....	35.3	–	35.3
Current portion of amounts due to Enel.....	21.6	1,200.0	1,221.6
Liabilities to social insurance agencies	7.5	–	7.5
Tax liabilities.....	40.2	–	40.2
Other liabilities	33.5	–	33.5
Accrued liabilities and deferred income.....	6.7	–	6.7
Long term liabilities	1,682.2	–	1,682.2
Current portion of amounts due to bank.....	480.7	–	480.7
Current portion of third party advances	30.5	–	30.5
Trade accounts payable.....	0.8	–	0.8
Current portion of amounts due to Enel.....	436.3	–	436.3
Accrued liabilities and deferred income.....	148.0	–	148.0
Employee termination indemnity	70.7	–	70.7
Contingent liabilities.....	515.2	–	515.2
Shareholders' Equity	2,966.4	(1,200.0)	1,766.4
Share capital	2,036.1	(1,596.1)	440.0
Other reserves	374.0	396.1	770.1
Retained earnings	335.7	–	335.7
Net income	220.4	–	220.4
Minority interest	0.2	–	0.2
Total Liability and Shareholders' Equity	4,967.7	–	4,967.7

**UNAUDITED PRO FORMA INTERIM CONSOLIDATED BALANCE SHEET
AS OF 30TH JUNE, 2003**

	Pro forma adjustments					Pro forma consolidated as of 30th June, 2003
	Historical Terna as of 30th June, 2003	Brazilian Subsidiaries' Assets and Liabilities ⁽¹⁾	Brazil Acquisitions ⁽²⁾	Consolidation adjustments ⁽³⁾	Capital Reduction ⁽⁴⁾	
	(millions of euro)					
Assets						
Current assets	945.0	12.4	(339.3)			618.1
Cash and cash equivalents	0.2	5.2				5.4
Enel SpA inter-company current account	687.6		(339.3)			348.3
Trade receivables:						
Third parties	131.1	4.2				135.3
Enel Group companies	17.8					17.8
Other current receivables	71.6	1.2				72.8
Inventory	21.8	1.8				23.6
Prepaid expenses and deferred charges	14.9					14.9
Non-current assets	3,072.6	263.7	339.3	357.3		4,032.9
Other receivables	22.8	3.7	183.1	(166.7)		42.9
Investments.....	3.5		156.2	(156.2)		3.5
Intangible assets				115.5		115.5
Property plant and equipment, net	3,046.3	260.0		564.7		3,871.0
Total Assets	4,017.6	276.1	0.0	357.3		4,651.0
Liabilities and Shareholders' Equity						
Short-term liabilities	427.3	208.2		(183.1)	1200.0	1,652.5
Current portion of amounts due to banks						
Current portion of third party advances.....						
Trade accounts payable						
Third parties	82.3	15.5				97.8
Enel group companies	26.2					26.2
Current portion of amounts due to Parent Company		183.1		(183.1)	1,200.0	1,200.0
Liabilities to social insurance agencies						
Tax liabilities	55.5	0.3				55.8
Other liabilities.....	106.8	9.3				116.1
Accrued liabilities and deferred income	156.5					156.5
Long term liabilities	1,103.7	43.5		244.3	0.0	1,391.5
Long-term portion of amounts due to bank	325.0	42.2				367.2
Long-term portion of third party advances						
Trade accounts payable						
Long-term portion of amounts due to Enel	469.6					469.6
Accrued liabilities and deferred income						
Other non-current liabilities						
Employee termination indemnity	76.8					76.8
Contingent liabilities	232.3	1.3		244.3		477.9
Shareholders' Equity	2,486.6	24.4		296.0	(1,200.0)	1,607.0
Share capital	2,036.1	68.5		(68.5)	(1,596.1)	440.0
Other reserves.....	374.1	73.4		(73.4)	396.1	770.2
Retained earnings.....	0.3	(98.0)		418.4		320.7
Net result for the period	76.1	(19.5)		19.5		76.1
Minority interest.....						
Total Liability and Shareholders' Equity	4,017.6	276.1		357.3	0.0	4,651.0

NOTES TO UNAUDITED PRO FORMA CONSOLIDATED BALANCE SHEETS

Note 1 - Pro forma for the Brazilian Subsidiaries Assets and Liabilities assumed

To reflect the assets acquired and the liabilities existing at 30th June, 2003 and assumed by the Brazilian Subsidiaries, presented in accordance with Terna's accounting policies.

Note 2 - Pro forma adjustments related to the Brazilian Acquisitions

To reflect the cash of €339.3 million, of which €156.2 million related to the Brazilian Acquisitions and €183.1 million related to the loan assumed pursuant to the Brazilian Acquisitions, that would have been used by Terna if it had made the Brazilian Acquisitions and assumed such loan as at 30th June, 2003.

Note 3 - Pro forma adjustments related to the consolidation

The following pro forma adjustments illustrate the effect of the consolidation adjustments on the unaudited interim balance sheet as at 30th June, 2003:

- (a) To eliminate €183.1 million relating to the intercompany loan to Novatrans, which was assumed by Terna pursuant to the acquisition of Novatrans.
- (b) To eliminate €156.2 million relating to the carrying value of Terna's investment in the Brazilian Subsidiaries against €24.4 million relating to their shareholders' equity value as at 30th June, 2003, which results in the recognition of goodwill of €115.5 million as of 31st December, 2003, and to adjust "Other non-current liabilities" to reflect the amount of €16.4 million to balance the consolidation adjustment
- (c) To eliminate €564.7 million of additional depreciation charged by Terna solely for tax purposes and recognized the related tax effect of €244.3 million.

Note 4 - Pro forma adjustments related to the Capital Reduction

The following pro forma adjustments give effect to the Capital Reduction as if it had occurred on the balance sheet date:

- (a) To adjust "Share capital" for an amount of €1,596.1 million to reflect the return of capital and the allocation of €396.1 million to "Other reserves" pursuant to the Capital Reduction.
- (b) To adjust "Short-term liabilities" for an amount of €1,200.0 million to reflect the Enel Line of Credit.

ANNEX C

CONSOLIDATED HALF YEAR REPORT OF THE TERNA GROUP AT 30TH JUNE, 2004

(I) Report on Operations

(II) Consolidated Financial Statements of Terna Group

(III) Notes to the Consolidated Financial Statements

(I)

Report on Operations

Consolidated half year report of T.E.R.NA. at 30th June, 2004

Report on operations

Pursuant to article 82 of CONSOB resolution no. 11971/1999, the company intends to benefit from the provision which relieves it from publishing its quarterly report at 30th June, 2004.

Following the preparation of the consolidated annual report at 31st December, 2003 and as a result of the acquisition of controlling interests in the Brazilian companies Transmissora Sudeste Nordeste S.A. (“TSN”) and Novatrans Energia S.A. (“Novatrans”) on 31st December, 2003, Terna S.p.A. has for the first time drawn up a consolidated half year report. As these equity investments were acquired on 31st December, 2003, comparative figures are only presented for the consolidated balance sheet at 31st December, 2003.

However, in order to provide further information on the development of operations, key pro forma figures relating to the same period of the previous year have been disclosed in the section on the performance of the group.

The main consolidation principles and procedures are described in the notes.

During the first half of 2004, T.E.R.NA. was strongly engaged in activities relating to the placement of 50% of its share capital, which took place in June.

In preparation of this event, the company made a series of changes in both its organizational and management structure. The most important were the following:

- *Reduction of share capital and restructuring of financial payables due to the ultimate parent company.*
- *New organizational structure.*
- *Adoption of the new corporate by-laws, internal regulations for the management and disclosure of confidential information and the internal dealing code of conduct.*

Reduction of share capital and restructuring of financial payables due to the ultimate parent company

In order to optimize the company’s financial structure, the board of directors proposed to the shareholders’ meeting that Terna’s financial structure should be changed by increasing leverage.

On 28th January, 2004, the shareholders’ meeting approved the reduction of T.E.R.NA. S.p.A.’s share capital pursuant to article 2445 of the Civil Code, from €2,036,050,000.00 to €440,000,000.00, by repaying capital of €1,200,000,000.00 and transferring €396,050,000.00 to reserves, subject to the 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 the concurrent reduction of their par value from €1.00 (one//00) to €0.22 (zero point two two) each. This resolution was recorded in the Company Register on 29th January, 2004 and therefore took full effect from 29th April, 2004, as there were no objections from creditors.

During its meeting held on 17th February, 2004, the board of directors approved the restructuring of the liabilities that the company had assumed at the time of its establishment by taking on a part of Enel’s debt as well as the liability in respect of the pension fund for Enel managers, which had also been transferred at the time of establishment. This transaction became effective on 1st March, 2004 when the two liabilities were settled with the acquisition of a single loan granted by ENEL and amounting to €493.6 million.

On 13th April, 2004, ENEL and Terna entered into a loan contract worth €1,200 million; this loan was granted by the ultimate parent company in order to enable Terna to avail of the financial resources required to repay the share capital, as resolved by Terna’s shareholders’ meeting on 28th January, 2004. This loan was issued on 30th April, 2004.

Both loans have a 12 months’ term on which Terna has an annual renewal option. These loans bear interest at the 3-month Euribor plus a 0.25% spread.

At 30th June, 2004, after the above-mentioned transactions, the company's gross and net indebtedness amounted to €1,721.6 million and €1,519.8 million, respectively.

Company's new organizational structure

The listing process required Terna to make a series of changes in its organization, operations and management in order to ensure its independence; at the same time, it had to set up adequate coordination procedures with ENEL and define its personnel structure taking account of the work and services acquired from other Enel Group companies.

As a result of the above, the company set up a new organizational structure with three new governance departments:

- **Regulatory affairs and external relations**
- **Audit**
- **Business development**

New additional responsibilities relating to the stock exchange listing were assigned to the other four existing staff departments ('Personnel and Organization', 'Administration, Finance and Control', 'Purchases and Contract Work' and 'Legal and Corporate Secretary's Office'). In particular, two new units, Finance and Investor Relations, were set up within the Administration, Finance and Control department.

Two new management offices were set up to deal with core activities:

'Plant engineering and maintenance' which controls the following departments:

- 'Power plant technology development',
- 'Plant construction',
- eight local operating facilities dealing with plant control, emergency repairs and maintenance.

'Plant operation and monitoring' which control the three operation and remote control centers.

The new organizational structure became operative in February.

Adoption of the new corporate by-laws, shareholders' meeting regulation, internal regulations for the management and disclosure of confidential information and the internal dealing code of conduct.

The new listed company by-laws approved by the extraordinary shareholders' meeting held on 3rd March, 2004, with the change in share capital, became effective on 23rd June, 2004, date on which stock trading activities commenced on the company's shares, as per Italian Stock Exchange resolution no. 3484 of 21st June, 2004.

The shareholders' meeting regulation became effective on the same date, the contents of which are consistent with the format drawn up by the Italian Joint-stock Companies' Association (Assonime) and the Italian Bankers' Association (ABI); this regulation was approved by the company's ordinary shareholders' meeting held on 3rd March, 2004.

The internal regulations for the management and disclosure of confidential information, including price sensitive information, as well as the internal dealing code of conduct also became effective on 23rd June, 2004; both of them had been approved with a resolution taken by the board of directors on 2nd April, 2004. The internal regulations, adopted in compliance with the provisions of the Code of Conduct, contain the procedures for the disclosure of documents and information concerning the company and its subsidiaries to third parties, in particular price-sensitive information.

The internal dealing code of conduct, in compliance with the regulatory provisions set by the Italian Stock Exchange, regulates transparency obligations towards the market regarding significant financial instruments

transactions of listed companies or their subsidiaries, carried out by persons with relevant decision-making powers in the company and who have access to price-sensitive information (the relevant persons).

Listing

The listing process was completed during the first half of 2004. Terna placed 870 million shares, equal to 43.5% of the company's share capital on the market, plus other 130 million shares relating to the greenshoe option exercised by the global co-ordinators on 29th June, for a total number of one billion shares, equal to 50% of Terna's share capital. Terna shares were placed with a public offering to all Italian investors and a concurrent private placement addressed to institutional investors in Italy and abroad.

The final offer price was fixed at €1.7 per share equal to an equity value of €3.4 billion. Terna shares were listed on the Italian Stock Exchange (MTA) organized and managed by Borsa Italiana S.p.A. starting from 23rd June.

Terna shared part of the placement costs with Enel S.p.A., namely those which involved benefits for the company; in particular, costs incurred for the institutional communication campaign, which took place before the subscription (approximately €9 million during the first half of the year).

Corporate governance and committees

Immediately after the end of the public offering, the company adopted a corporate governance system in line with the recommendations included in the Code of Conduct prepared by the Italian Stock Exchange; the purpose was to facilitate the integration of the board of directors with independent members and to set up the remuneration and internal control committees recommended by the Code itself.

In this respect, the board of directors in its meeting held on 12th May, 2004 resolved, inter alia, to: (i) call the ordinary shareholders' meeting on 16th September on first call and 18th September on second call in order to establish the number of the members of the board of directors and appoint new directors in addition to those in office; (ii) set up two committees within the board, the former dealing with the remuneration of the company's management and key staff and the latter with internal control; the appointment of three members for each committee was postponed to the next board meeting to be held after the above-mentioned ordinary shareholders' meeting.

Regulatory framework governing transmission activities

The regulatory framework governing transmission activities was modified by Law no. 290/03 which established the re-unification of the ownership and management of the National Transmission Network (NTN); the criteria and methods for the unification, and the management of the resulting entity, including the regulation of voting rights and subsequent privatization, were defined later on by a decree of the Prime Minister (DPCM).

It also established that, effective from 1st July, 2007, no company operating in the production, importing, distribution and sale of electricity and natural gas, also through subsidiaries, parent companies or companies controlled by the latter, and no publicly controlled company would be allowed to hold, either directly or indirectly, more than a 20% stake in the share capital of companies owning or managing national electricity and natural gas transmission networks.

Prime Minister's decree of 11th May, 2004

Implementing the general provisions set by Law no. 290 of 27th October, 2003 governing electricity transmission activities in Italy, the Prime Minister's decree of 11th May, 2004 defines, inter alia, the criteria, methods and conditions for the unification of ownership and management of the NTN. In particular, it establishes that:

- except for a few exceptions, all activities, tasks, assets and legal relationships attributable to the Transmission System Operator shall be transferred against consideration to Terna within 31st October, 2005;
- Terna shall assume the title and tasks of the Transmission System Operator, and both of them shall change their company names;
- the entity resulting from the unification shall be managed on the principles of neutrality and impartiality, without discriminations among users or user categories.
- The Transmission System Operator shall prepare an integrated document called “Code of transmission, dispatching, development and safety of the network” with the technical rules for the access and use of the NTN, within 31st December, 2004.

The following points are discussed with reference to the management of the Group during the first half of 2004:

- Regulated activities
- Unregulated activities
- Subsidiaries

Regulated activities - Italy

New regulatory period: 2004-2007

Point 7, article 1 quinquies of Law no. 290/03 enacted in October 2003 established that the Electricity and Gas Authority shall adopt the following criteria when setting the tariffs for the transmission and distribution networks for the second regulatory period, also to guarantee the development requirements of the electricity service: infrastructure revaluation; a risk-free rate of return that is at least in line with that of long-term government securities; and a symmetric distribution between users and operators of the efficiency gains achieved with respect to the objectives set through the price cap mechanism, applied to those tariff components intended to cover operating costs and amortization/depreciation.

On the basis of the above-mentioned principles, with resolution no. 5 of 30th January, 2004, the Electricity and Gas Authority (AEEG) approved the tariff regime for the second 2004–2007 regulatory period. This resolution updates the tariff parameters set by AEEG resolution no. 220/2001 for 2004; however, it specifies that the new values apply from February 2004.

The transmission service fee is calculated by the Electricity and Gas Authority on the basis of “recognized sector costs”, drawn up from the average costs of transmission companies. These costs represent the basis for calculating the tariff for the first year of each regulatory period. This tariff is then updated annually by the Electricity and Gas Authority on the basis of different regulatory mechanisms on recognized cost components, as follows:

- Operating costs and amortization/depreciation are updated for inflation based on the annual index of consumer prices for the families of workers and employees and an annual reduction rate (productivity recovery factor) of 2.5%; this cost component may also change if the mechanism implements costs arising from unforeseeable and exceptional events, changes in the regulatory framework and in obligations relating to the universal service or costs relating to actions taken to control demand through the efficient use of resources.
- The regulatory asset base (RAB) is updated starting from the second year of the current regulatory period based on the following elements: average annual rate of change in the deflator for gross fixed investments published by the Italian National Statistical Institute (ISTAT); expected rate of change in the Italian demand for electricity volumes; rate of change related to net investments made within 30th June of the previous year; rate of change related to greater returns recognized for development initiatives undertaken.

The tariffs for the entire transmission sector (Transmission System Operator and all network owners) are collected according to the following mechanism:

- producers pay a fee per each kWh introduced into the network to the Transmission System Operator, while distribution companies pay a specific tariff component (CTR), which is transferred to end users and varies depending on the time bracket (F1, F2, F3 and F4). These time brackets are established by the above-mentioned resolution no. 5/04, which modifies the provisions set in paragraph b), point 2), title II of CIP resolution no. 45/90, and apply to electricity withdrawn by distributors from the national transmission network;
- the Transmission System Operator keeps a portion of the overall amount of the above-mentioned fees to cover its own operating costs; this portion is recognized through a specific tariff component which is updated annually according to the same parameters used for the above-mentioned fees;
- the Transmission System Operator pays the residual amount to the owners of the various portions of the NTN, based on their percentage of ownership and on the provisions of the operating licenses entered into by the above-mentioned parties.

The following table shows the tariff components paid by distributors and producers and the tariff component which covers the Transmission System Operator's costs for 2004 (February-December), first year of the second regulatory period, compared with those of the first regulatory period (unit amounts):

	2nd regulatory period	1st regulatory period
Fee paid by producers.....	€/kWh 0.0253	€/kWh 0.0253
Fee paid by distributors per time bracket - F1	€/kWh 0.76	€/kWh 0.74
Fee paid by distributors per time bracket - F2	€/kWh 0.49	€/kWh 0.48
Fee paid by distributors per time bracket - F3	€/kWh 0.32	€/kWh 0.33
Fee paid by distributors per time bracket - F4	€/kWh 0.14	€/kWh 0.16
Tariff component which covers the Transmission System Operator's costs	€/kWh 0.0336	€/kWh 0.0407

As to fees paid by distributors, with resolution no. 5/04, the Electricity and Gas Authority also modified the F1, F2, F3 and F4 time brackets for the second regulatory period (effective from April 2004), concentrating withdrawals subject to the highest tariff components in the summer months.

Following the resolutions taken by the Electricity and Gas Authority, network usage fees for the first quarter of 2004 have been entirely calculated using time brackets ruling in 2003 with 2003 unit tariffs for January and 2004 unit tariffs for February and March; network usage fees for the second quarter have been calculated applying both the new unit tariffs and time brackets.

Therefore, considering the redefinition of the time brackets which inverts the seasonality effect by shifting the periods with the greatest concentration of high tariff brackets from the winter to the summer months, network usage fees for the year are expected to increase over 2003.

Unregulated activities

Business activities performed in the field of high-voltage plant operation, maintenance, engineering and construction for third parties and other Enel Group companies continued following plans already started in previous years.

Overall revenues from ENEL Group companies amounted to €23.1 million (2003 first half year: €22.8 million); they mainly refer to the contract for the operation and maintenance of high-voltage plant owned by Enel Distribuzione S.p.A. (€13.5 million; 2003 first half year: €14.5 million) and to a contract for the maintenance, development and laying of fiber optic cable owned by Enel.net S.p.A. (€5.0 million; 2003 first half year: €4.3 million).

Revenues from third parties amounted to approximately €7.1 million (2003 first half year: €6.4 million), including approximately €3.7 million relating to plant engineering activities and approximately €3.4 million to the management of high-voltage plant.

Subsidiaries

During the period, Terna carefully defined the organizational structure dealing with activities in Brazil. Under this structure, employees are organized into five departments which work for both TSN and Novatrans, are entrusted with specific responsibilities and tasks, subject to the policy setting, co-ordination and control activities performed by Terna.

Some general and specific information regarding the operations of the two Brazilian subsidiaries, Transmissora Sudeste Nordeste S.A. (“TSN”) and Novatrans Energia S.A. (“Novatrans”) is provided below.

Brazilian legislative and regulatory context

Law no. 10,848 implementing the new model for the power sector, with effects on generation, distribution and sales activities, was published on 15th March, 2004. Transmission activities remained unchanged, except for the specific powers assigned to the Ministry for Mines and Energy and the National Electricity Regulator (ANEEL) as licensors and for the composition of the executive board of the National System Operator (ONS).

Resolutions and authorizations of the National Electricity Regulator

On 10th March, with resolution no. 83, ANEEL approved the second addendum to license agreement no. 095/2000 signed with Novatrans, ratifying the transfer of ownership of the company’s share capital to Terna and extending the contractual date for the beginning of the commercial operation of all the North-South II line from 8th February, 2004 to 8th April, 2004. This extension was requested due to delays in construction work caused by events beyond the company’s control. This addendum was signed on 29th April by Novatrans, Terna and ANEEL.

On 30th June, ANEEL issued resolution no. 70 which establishes the new licensing fees (RAP) effective from 1st July, 2004 to 30th June, 2005.

The TSN fee is fixed at R\$224,593,053.34 and reflects the adjustment for inflation (based on the IGPM price index) accumulated from June 2003 to May 2004, equal to 7.030%; similarly, the Novatrans fee is fixed at R\$246,929,725.99. A one-off additional fee of R\$279,766.24 is recognized to Novatrans, which reflects the IGPM accumulated on the late billing of certain elements of the project due to the fact that the ONS certification (*Termos de Liberação*) confirming the beginning of the commercial operation was missing.

TSN

This company has a 30-year license agreement with ANEEL expiring on 20th December, 2030 for the operation of the Sudeste-Nordeste line.

This line is 1,080 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, including other substations at Rio das Eguas, Bom Jesus da Lapa and Ibicoara; it was operative during the whole period.

Loan contract to Novatrans

On 30th January, 2004 ANEEL approved the terms of a bridge loan granted by the company to Novatrans Energia S.A., used to finance part of the residual work to complete the North-South II line licensed to Novatrans. The relevant contract was signed on 2nd February and has the following terms:

- maximum amount: R\$135,000,000.00;
- due date: 30th September, 2004 which may be extended to 31st December, 2004;

- interest on the actual amount disbursed: 110% of the CDI index (now 15.80% p.a.).

Upon the disbursement of the project finance to Novatrans, which should be completed by the end of October 2004, this bridge loan will be immediately repaid.

Principal and interest amounted to R\$125,860,000 and R\$3,911,317 respectively at 30th June, 2004.

Loan contract with Banco Nacional de Desenvolvimento Economico e Social (“BNDES”)

This loan, signed on 23rd October, 2002 and entirely issued by BNDES, amounted to R\$650,145,151 at 30th June, 2004, of which R\$482,373,946 referred to tranche A and B, and R\$167,771,204 to tranche C; it is denominated in Brazilian reais adjusted on a daily basis according to the variation of the Brazilian real with respect to a basket of foreign currencies (75% US dollars, 18% yen, 5% euros and 2% other currencies) based on BNDES’ funding mix. Interest on tranches A and B is equal to the TJLP rate plus a 3.50% spread (TJLP is the long-term lending rate published by the Brazilian central bank). Interest on tranche C is equal to: a floating rate updated quarterly based on the BNDES’ average cost of foreign currency plus 3.50%. Principal and interest are repaid in 144 monthly installments (12 years) starting on 15th October, 2004 for tranches A and B and on 15th November, 2004 for tranche C.

All TSN shares owned by Terna have been pledged to secure the loan.

NOVATRANS

This company has a 30-year license agreement with ANEEL expiring on 20th December, 2030 for the operation of the North-South II line.

The share capital of Novatrans amounted to R\$360,750,400.00 at 30th June, 2004 and was made up of 360,750,400 ordinary shares with no par value following the resolutions taken by the extraordinary shareholders’ meeting held on 19th April; during this meeting, the shareholders resolved to transform the 1,306,000 preference shares in ordinary shares and to increase the company’s share capital from R\$1,959,000 to R\$360,750,400. On 29th April, this share capital increase was entirely subscribed by the shareholder (Terna) through the conversion of receivables due from Novatrans (the shareholder loan) of R\$358,791,400 into ordinary shares, on the basis of ANEEL authorization received on 27th April.

The North-South II transmission line, which has a nominal voltage of 500 kV and is 1,278 km long, beginning at the Samambaia substation, in the Federal District, and ending at the Imperatriz substation, in the state of Maranhão, including other substations at Serra da Mesa, Gurupí, Miracema and Colinas became fully operative during the second quarter of the year; the third and last segment (Miracema – Colinas – Imperatriz) and relevant substations were completed and certified by ONS (*Termos de Liberação Provisório*); this enabled the company to start billing the elements which were not yet operative from the beginning of April.

Loan contracts

Shareholder loan agreement

On 30th January, 2004, ANEEL approved the transfer of the shareholder loan agreement from Enelpower S.p.A. to Terna and its addendum which increased the maximum amount of the authorized principal from €284,784,811.25 to €350,000,000.00. This loan has the following terms:

- maximum amount: €350,000,000.00;
- due date: 31st May, 2005 (the company has the right to make early repayments);
- interest: up to 5.35% above the 6-month Euribor (subject to reductions if it exceeds the rates approved by the Brazilian Central Bank).

This loan granted by Terna to Novatrans amounted to €173,839,937.35 (principal) and €14,036,958.10 (interest) at 30th June, 2004, also as a result of the partial conversion described above.

Loan contract with TSN

As described above, TSN granted a bridge loan to Novatrans, the maximum amount of which is R\$135,000,000, used to finance part of the residual work to complete the North-South II line.

Loan contracts with BNDES, and with BANCO ABN AMRO REAL S/A and BANCO ITAU BBA S/A

On 19th April, Novatrans signed two long-term loan contracts under the same terms with Banco Nacional de Desenvolvimento Economico e Social (“BNDES”) and with BANCO ABN AMRO REAL and BANCO ITAU BBA. This loan has the following terms:

- maximum amount: R\$550,565,000 including: (a) R\$431,816,000 as direct loan granted by BNDES; (b) R\$118,749,000 as indirect loan (“repassé”) granted through the following merchant banks: ABN AMRO REAL (R\$45,000,000) and ITAU BBA (R\$73,749,000);
- interest: equal to the TJLP Brazilian interest rate plus a 4.5% spread. If the annual TJLP is above 6%, interest due for this excess will be capitalized and repaid according to the repayment plan of the residual payable;
- repayment period: 12 years with monthly installments starting from 15th November, 2004;
- guarantees issued by Terna S.p.A. (Carta de Fiança), the first one to BNDES and the second one to ABN AMRO REAL and ITAU BBA up to the completion of the project, i.e. upon receipt of ANEEL certification confirming the beginning of the commercial operation as well as the achievement of a series of financial performance ratios;
- maintenance, over the entire duration of the loan, of a debt service coverage ratio equal to at least 1.3 (calculated on a quarterly basis as the ratio between cash flow from operations and interest plus the portion of the payable due for the period);
- creation of a term reserve account with three months’ principal and interest;
- maintenance for Novatrans, over the entire duration of the loan, of shareholders’ equity (including the redeemable preference shares) equal to 30% of its total assets (within 31st December, 2004) and ordinary shares (to be integrated and which have been integrated on 30th April, 2004) equal to at least 30% of its fixed assets.

The residual contracts relating to the BNDES and IDB loan should be signed in the third quarter of the year and the entire amount should be disbursed by the end of October 2004.

1) PERFORMANCE OF THE GROUP

The consolidated half year report at 30th June, 2004 shows net income of €102.2 million, after amortization and depreciation of approximately €79 million, net financial expense of €48.9 million and income taxes of €88.4 million.

The consolidated balance sheet shows net fixed assets of €4,359.7 million, net capital employed of €3,631.3 million, of which shareholders’ equity covers €1,769.0 million (48.7% compared with 83.0% at 31st December, 2003) and net indebtedness of €1,862.3 million (51.3% compared with 17.2% at 31st December, 2003).

Consolidated income statement

The results achieved by the Group during the first half of 2004 may be summarized by the following reclassified consolidated income statement:

RECLASSIFIED CONSOLIDATED INCOME STATEMENT

	2004 first half year
	<i>Millions of euros</i>
Network usage fees	480.2
Other sales and services.....	29.5
Change in contract work in progress	-1.0
Other income and revenues	10.2
Total revenues	518.9
Personnel costs.....	79.9
Services and use of third party assets	62.3
Materials.....	7.1
Other costs	31.2
Capitalized expenses	-9.1
Total operating costs	171.4
GROSS OPERATING INCOME	347.5
Amortization and depreciation.....	79.0
Accruals and write-downs	15.3
Total amortization, depreciation and write-downs	94.3
OPERATING INCOME	253.2
Interest expense and other charges due to ultimate parent company	-14.3
Interest income and other revenues due from ultimate parent company	3.0
Interest expense on medium to long-term loans	-15.5
Other.....	-22.1
INCOME BEFORE EXTRAORDINARY ITEMS AND TAXES	204.3
Extraordinary items	-13.7
INCOME BEFORE TAXES	190.6
Income taxes	88.4
NET INCOME	102.2

Revenues amount to approximately €518.9 million and mainly refer to regulated activities (€480.2 million). In particular, based on calculations resulting from the application of Electricity and Gas Authority (AEEG) resolution no. 05/04 and taking account of the provisions of the Operating License Agreement signed with the Transmission System Operator (GRTN S.p.A.), fees received for the use of the network amount to approximately €428.5 million.

Revenues from regulated activities attributable to Brazilian companies amount to approximately €51.7 million.

Other sales and services attributable to the parent company amount to €29.5 million and mainly refer to the sale of services to Enel Group companies and third parties.

Other income and revenues of €10.2 million are mainly comprised of the portion of grants for plant received for connections to the NTN or the relocation of power lines.

Operating costs amount to €171.4 million (€157.0 million attributable to the parent company and €14.4 million to the Brazilian companies), including €79.9 million for personnel costs (€79.3 million attributable to the parent company and €0.6 to the Brazilian companies); services and use of third party assets mainly refer to maintenance costs for maintaining the efficiency of plant and leases/rentals (€56.7 million attributable to the parent company and €5.6 million attributable to subsidiaries). Materials and equipment amount to €7.1 million, €6.8 million of which is attributable to the parent company; other costs (€7.9 million attributable to subsidiaries and €23.3 million to the parent company) are mainly comprised of prior year items pertaining to the ultimate parent company and relating to the payment of the fee for the usage of the Italian National Electricity Transmission Network (NTN) for 2002 and 2003 (€16.3 million); they also include local indirect taxes, charges of the period for the Management Pension Fund and discounts on electricity supplied to retired personnel. Capitalized expenses of €9.1 million are entirely attributable to the parent company.

Net extraordinary expense of approximately €13.7 million is mainly attributable to the parent company; it consists of differences arising from the application of the new company and tax law (elimination of fiscally-driven entries).

Income taxes for the period amount to €88.4 million, of which €84.6 million is attributable to the parent company and €3.8 million to the Brazilian companies.

Consolidated balance sheet

The reclassified consolidated balance sheet at 30th June, 2004 is shown below:¹

RECLASSIFIED CONSOLIDATED BALANCE SHEET

	30th June, 2004	31st December, 2003	Variations for the period
<i>Millions of euros</i>			
Tangible and intangible assets	4,348.6	4,311.3	37.3
Long-term financial assets	11.1	12.8	-1.7
Total fixed assets, net	4,359.7	4,324.1	35.6
Trade receivables	184.2	226.7	-42.5
Inventories	33.5	34.9	-1.4
Other assets	31.4	19.7	11.7
Trade payables	153.5	232.5	-79.0
Taxes payable, net.....	39.7	40.1	-0.4
Other liabilities	236.8	197.4	39.4
Net current assets	-180.9	-188.7	7.8
GROSS CAPITAL EMPLOYED	4,178.8	4,135.4	43.4
Employee termination indemnities	63.6	70.7	-7.1
Retirement benefits	0.9	38.3	-37.4
Net deferred taxes	414.2	394.9	19.3
Other provisions	68.8	59.7	9.1
Total provisions	547.5	563.6	-16.1
NET CAPITAL EMPLOYED	3,631.3	3,571.8	59.5
Shareholders' equity - Group	1,768.8	2,966.2	-1,197.4
Shareholders' equity - minority interests	0.2	0.2	0.0
Total indebtedness*	1,862.3	605.4	1,256.9
TOTAL	3,631.3	3,571.8	59.5
Total indebtedness*			
EIB loans.....	321.6	325.0	-3.4
Loans granted by ENEL S.p.A.	1,400.0	456.2	943.8
BNDES loan	171.9	164.2	7.7
Cash	-31.2	-340.0	308.8
	1,862.3	605.4	1,256.9

1 For greater clarity, the main reclassifications are as follows:

- Receivables and payables due from/to the ultimate parent company and Group companies have been included under trade receivables and payables;
- Deferred tax assets have been offset against the provision for deferred taxes;
- Payables to the ultimate parent company resulting from taking over the Enel Management Supplementary Pension Fund (PIA) have been posted under retirement benefits (only for 2003).

Tangible assets refer to:

- TERNA S.p.A.: €3.779.0 million (31st December, 2003: €3,747.0 million)
- TSN: €194.7 million (31st December, 2003: €203.2 million)
- Novatrans: €261.5 million (31st December, 2003: 245.6 million)

Intangible assets of €113.3 million refer to goodwill arising on consolidation following the acquisition of the Brazilian companies net of amortization for the period.

Net indebtedness rose by €1,256.9 million, mainly due to the raising of a loan in order to repay €1.2 billion to ENEL following the reduction of Terna's share capital.

The statement of cash flows for the first half of 2004 is provided below:

CONSOLIDATED STATEMENT OF CASH FLOWS

	2004 first half year	2003 first half year	Variations for the period
<i>Millions of euros</i>			
a) OPENING SHORT-TERM NET INDEBTEDNESS(-) LIQUIDITY (+)	340.0	583.6	-243.6
– Cash and banks	50.7	0.1	50.6
– Intercompany current account	289.3	583.5	-294.2
b) CASH FLOW FROM OPERATIONS			
Net income	102.2	220.4	-118.2
Amortization and depreciation	79.0	139.6	-60.6
Net write-downs (revaluations)	0.0	0.0	0.0
Net change in provisions	50.2	67.9	-17.2
Net change in employee termination indemnities	-7.1	-5.0	-2.1
Net loss (gain) on the disposal of assets	0.3	1.4	-1.1
Self-financing	224.6	424.3	-199.7
Change in net current assets:			
– (Increase) decrease in current receivables	-5.5	22.9	-28.4
– Increase (decrease) in trade and other payables	-55.6	-21.3	-34.3
– Changes in other balance sheet captions	-6.2	13.2	-19.4
Total b) - Cash flow from operations	157.3	439.1	-281.8
c) CASH FLOW FROM (FOR) INVESTING ACTIVITIES			
Investments in:			
– Intangible assets	0.0	-115.5	115.5
– Tangible assets	-136.6	-240.8	104.2
– Other changes in fixed assets	0.9	19.8	-18.9
– Other long-term financial assets	1.1	-449.3	450.4
– Change in equity investments	0.6	5.2	-4.6
Total c)	-134.0	-780.6	646.6
d) CASH FLOW FROM (FOR) FINANCING ACTIVITIES			
New medium to long-term loans	1,701.3	164.3	1,537.0
Repayment of medium to long-term loans	-753.2	-22.4	-730.8
Dividends and share capital repayment	-1,280.2	-44.0	-1,236.2
Total d)	-332.1	97.9	-430.0
e) CASH FLOW GENERATED	-308.8	-243.6	-65.2
f) CLOSING SHORT-TERM NET INDEBTEDNESS (-) LIQUIDITY (+)	31.2	340.0	-308.8
Cash and banks	17.3	50.7	-33.4
Intercompany current account	13.9	289.3	-275.4

Cash flow from operations.

Cash flow from operations amounted to approximately €157 million.

Cash flows in respect of net current assets absorbed approximately €67 million.

Cash flow from investing activities.

During the first half of 2004, cash flows employed in investing activities amounted to approximately €134 million. The use of these resources was mainly associated with the core business of plant development and renewal; approximately €108.9 million was attributable to the parent company and approximately €27.7 million to the Brazilian companies.

Cash flow for financing activities.

Cash flow for financing activities amounts to approximately - €332 million and is mainly due to the payment of dividends and partial repayment of the loan to ENEL S.p.A. by the parent company.

Cash flow generated.

Cash flow generated in the period resulted in a net use of funds of approximately €308.8 million.

2004 half year key figures compared with 2003 half year pro forma figures

Pro forma reclassified figures at 30th June, 2003 have been prepared in order to show the theoretical effects of the reduction in share capital and acquisition of equity investments in Novatrans Energia S.A. (“Novatrans”) and Transmissora Sudeste Nordeste S.A. (“TSN”) on the results for the period, as if these transactions had taken place on 1st January, 2003 and therefore at the beginning of the period to which the pro forma consolidated income statement refers.

The information contained in the pro forma reclassified consolidated income statement is based on simulations; therefore, the figures disclosed therein do not necessarily reflect the results which would have been obtained if the above-mentioned transactions had actually taken place on the relevant date.

Pro forma consolidated income statement

The results achieved by the Group during the first half of 2004 compared with the 2003 pro forma figures may be summarized by the following reclassified consolidated income statement:

RECLASSIFIED CONSOLIDATED INCOME STATEMENT

	2004 first half year	2003 first half year pro-forma	Variations for the period
	<i>Millions of euros</i>		
Network usage fees.....	480.2	413.7	66.5
Other sales and services	29.5	25.3	4.2
Change in contract work in progress	-1.0	2.5	-3.5
Other income and revenues	10.2	10.3	0.1
Total revenues	518.9	451.8	67.1
Personnel costs	79.9	82.4	-2.5
Services and use of third party assets.....	62.3	55.4	6.9
Materials	7.1	7.1	0.0
Other costs	31.2	8.2	23.0
Capitalized expenses.....	-9.1	-9.4	0.3
Total operating costs.....	171.4	143.7	27.7
GROSS OPERATING INCOME	347.5	308.1	39.4
Amortization and depreciation	79.0	128.8	-49.8
Accruals and write-downs	15.3	2.0	13.3
Total amortization, depreciation and write-downs	94.3	130.8	-36.5
OPERATING INCOME.....	253.2	177.3	75.9
Interest expense and other charges due to ultimate parent company	-14.3	-35.0	20.7
Interest income and other revenues due from ultimate parent company	3.0	9.1	-6.1
Interest expense on medium to long-term loans.....	-15.5	-42.8	27.3
Other	-22.1	12.2	-34.3
INCOME BEFORE EXTRAORDINARY ITEMS AND TAXES	204.3	120.8	83.5
Extraordinary items.....	-13.7	-1.2	-12.5
INCOME BEFORE TAXES	190.6	119.6	71.0
Income taxes	88.4	60.3	28.1
NET INCOME	102.2	59.3	42.9

2) GROUP CAPITAL EXPENDITURE

A breakdown of capital expenditure by plant type during the first half of 2004 is as follows:

	Parent company	Subsidiaries	Total
– Power lines	57.0	27.7	84.7
– Switching substations	49.7		49.7
– Other	2.2		2.2
Total capital expenditure	108.9	27.7	136.6

3) GROUP PLANT

The following table shows the number of group installations and extent of the network at 30th June, 2004:

	T.E.R.NA		TSN		NOVATRANS	
	No.	Km	No.	Km	No.	Km
Stations.....	298		4		–	
Transformers	566		14		–	
Bays	3,873		29		10	
Lines.....		34,855		1,080		1,278
Double-circuit lines	1,911	38,585	12	1,080	5	1,278

4) TRANSACTIONS WITH RELATED PARTIES

Transactions with related parties refer exclusively to ENEL Group companies and are all covered by specific contracts.

Contracts with ENEL S.p.A. generating expenses for the parent company relate primarily to:

- loans and treasury management;
- provision of institutional or on-request assistance and consulting services;
- communication services.

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

- operation of in-house cafeterias (Enel Facility Management S.p.A.);
- rental of buildings (Enel Facility Management S.p.A.);
- luncheon vouchers – (Ape S.p.A.);
- rental of residential buildings (NewReal S.p.A.);
- supply and management of IT services (ENEL.IT S.p.A.);
- supply of telephony and telecommunications services (WIND S.p.A.);
- staff training services (SFERA S.p.A.);
- human resource management services (Ape S.p.A.);
- EPC (Engineering Procurement & Construction) with EPower/EPower do Brasil.

Contracts generating revenues relate to:

- operation and maintenance of high-voltage network (Enel Distribuzione S.p.A.);
- development, laying and maintenance of fiber optics (ENEL.Net S.p.A.).

The figures for Group companies are reported in the notes.

Relations between the Brazilian companies and other Group companies regard transactions with Enelpower S.p.A. and Enelpower do Brasil Ltda as part of engineering, procurement and construction contracts (EPC) for the construction of power lines and the outsourcing of management and administrative tasks.

5) HUMAN RESOURCES AND TRAINING

The workforce of the parent company and subsidiaries at 30th June, 2004 is shown below.

	T.E.R.NA.	TSN	Novatrans	Total
TOTAL	2,888		62	2,950
Senior management	37			37
Middle management	209		2	211
Office staff.....	1,468		60	1,528
Workers	1,174			1,174

In order to simplify and standardize the management of personnel, all staff working for the Brazilian subsidiaries has been gathered under a single company, Novatrans. Under a service contract (“Contrato de Fruição”), certain personnel costs (accounting department, treasury department and general services) are equally allocated on a monthly basis to Novatrans, TSN and Enelpower do Brasil, from which 37 employees were transferred (most of whom on 1st April, 2004). Other costs (finance department) are equally allocated to TSN and Novatrans.

6) RESEARCH AND INNOVATION

The Group continued to develop innovative projects with Enel.it and CESI, which are due to become operative during 2004:

- GIS (network geo-referencing system integrated with SAP – for all management activities - and with the data base of the Ministry of the Environment for the national mapping system).
- SDSA (advanced station design system - integrated with the budgeting and acquisition of external resources).
- CMS (advanced system to support the acquisition of external resources integrated with SAP and SDSA).
- WI-FI Lan (wireless extension of the company’s intranet for the use of palm-top and portable computers at power stations).
- VTS and SAP WCM (integrated systems to manage safety procedures for work on plant; the former uses a voice recognition platform for conversations with personnel who is not employed by Terna; when fully developed, the latter will use palm-top devices used by personnel).
- Maintenance budget analysis and reporting system (system used to budget and analyze actual figures regarding plant maintenance and renewal activities integrated with SAP, MBI and the service quality control).
- PLANNING system (for the management of the company’s budget considering all business units – including second level AOT business units - consistent with the maintenance budget analysis and reporting system).
- LST (live working methods applied when changing safety cables and cleaning support structure insulators).
- OCVD (digital power line carrier used to transmit with adequate precision or reroute measures and signals using power line conductors. Networks in Sicily and Sardinia are already in service).

Finally, the lines module of the MBI system was completed during the first months of the year.

7) OUTLOOK FOR OPERATIONS IN 2004

Estimated revenues from network usage fees relating to the parent company should drop by approximately 7% compared with those recorded during the first half of 2004; this forecast is based on current energy volume estimates (up 1.5% over 2003) and in line with the criteria established by resolution no. 05/04. However, this forecast could be negatively impacted by the effects of the ruling of the Regional Administrative Court of Lombardy which is described in greater detail in the section below. Revenues relating to the Brazilian companies should increase mainly as a result of the completion of the new line owned by Novatrans.

During the second half of the year, the company will focus on consolidating its leading position in the development and maintenance of the NTN; it will also continue its initiatives designed to ensure network safety and service quality, as well as the creation of value for shareholders.

8) POST BALANCE SHEET EVENTS

Terna

On 19th July, 2004, the company announced the dates of the meetings during which the board of directors will examine the balance sheet and income statement figures for their disclosure:

- 6th September, 2004: half year report at 30th June, 2004
- 8th November, 2004: third quarter report at 30th September, 2004

Furthermore, the ordinary shareholders' meeting of Terna has been called to fix the number of members making up the board of directors and consequently to appoint additional directors. This shareholders' meeting is convened for 16th and 18th September, 2004 on first and second call, respectively.

Ruling of the Regional Administrative Court of Lombardy

As described in further detail elsewhere in this report, resolution no. 05/2004 had changed the tariff bracket regime by shifting the hours with highest tariff rates from the winter to the summer period, effective from April 2004.

On 27th July, 2004, the Regional Administrative Court of Lombardy upheld the appeal filed by a number of electricity consortia and customers against resolution no. 5/2004 (2004-2007 tariffs), in particular the provisions regarding the introduction of the new consumption time brackets.

On 5th August, as proposed by the Electricity and Gas Authority in its Provisional decree no. 3849/2004, the Council of State suspended the ruling of the Regional Administrative Court of Lombardy and confirmed its suspension during the collective meeting held on 31st August, 2004; the hearing for discussion of the matter has been fixed for 21st December, 2004.

Loans to Novatrans

On 8th July, 2004, Novatrans signed a series of loan contracts with Inter-American Development Bank ("IDB").

The main terms of the IDB loan are:

- maximum amount: US\$ 66 million of which (a) US\$ 30 million (Loan A) with IDB funds and (b) US\$ 36 million (Loan B) - issued by IDB and regulated by a single loan contract with funds granted by a banking syndicate (BBVA, Société Générale);
- fixed interest rate over the entire duration of the loan (12 years for Loan A and 11 years for Loan B) using the forward swap curve as benchmark. The fixed rate for Loan A applicable from the first

repayment date (15th November, 2004) is 4.54%. The fixed rate for Loan B will be established within the first outlay and will be applicable from that date. The fixed rate has an applicable spread established in the loan contract which increases over time (from 212.5 bps to 537.5 bps for Loan A; from 200 bps to 525 bps for Loan B);

- half-yearly repayments on 15th May and 15th November of each year starting from 15th November, 2004 through 15th May, 2016 (Loan A) and 15th May, 2015 (Loan B);
- maintenance of an historical and projected debt service coverage ratio (DSCR) of 1.3 (established by contract) in order to repay shareholders;
- creation of a term reserve account equal to six months of the debt service;
- maintenance of a debt to equity ratio which does not exceed 70/30 (established by contract);
- guarantee provided by Terna S.p.A. to IDB (Sponsor Support Agreement). Terna's guarantee is limited to the completion of the project, i.e. upon receipt of ANEEL certification confirming the beginning of the commercial operation as well as the achievement of a series of financial performance ratios.

On 9th and 13th July, 2004, Novatrans also signed part of the contracts which are part of the Security Package shared by IDB, BNDES, ITAU BBA, and ABN AMRO for the loan granted to the same company.

The residual contracts relating to the BNDES and IDB loan should be signed in the third quarter of the year and the entire amount should be disbursed by the end of October 2004.

The first portions of the BNDES loan were granted on 26th-27th August, 2004 for a total amount of R\$423,935,050.

Novatrans entirely repaid the intercompany loan received from TSN with the above-mentioned amount.

Rome, 6th September, 2004

The Chief Executive Officer
Sergio Mobili

(signed on the original)

(II)

Consolidated Financial Statements of Terna Group

CONSOLIDATED FINANCIAL STATEMENTS OF TERNA GROUP

BALANCE SHEET

ASSETS

	At 30th June, 2004	At 31st December, 2003	Variation
A- SHARE CAPITAL NOT PAID IN.....	0.0	0.0	0.0
B- FIXED ASSETS:			
I- Intangible assets			
(1) incorporation cost	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
(6) work in progress and advances	0.0	0.0	0.0
(7) goodwill	113.3	115.5	-2.2
Total	113.3	115.5	-2.2
II- Tangible assets			
(1) land and buildings	324.8	326.7	-1.9
(2) plant and machinery	3,506.3	3,419.9	86.4
(3) industrial and commercial equipment.....	10.9	11.0	-0.1
(4) other assets	1.0	1.1	-0.1
(5) work in progress and advances	392.3	437.1	-44.8
Total	4,235.3	4,195.8	39.5
III- Financial assets			
(1) equity investments in:			
(a) subsidiaries	0.0	0.0	0.0
(b) affiliates	0.0	0.0	0.0
(c) parent companies	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 companies	0.0	0.0	0.0
(d) others	8.2	9.3	-1.1
– due within 12 months	0.3	0.0	0.3
(3) other securities	0.0	0.0	0.0
Total	11.1	12.8	-1.7
TOTAL FIXED ASSETS (B)	4,359.7	4,324.1	35.6

	At 30th June, 2004	At 31st December, 2003	Variation
C- CURRENT ASSETS			
I- Inventories			
(1) raw materials	15.2	15.6	-0.4
(3) contract work in progress	18.3	19.3	-1.0
(5) advances	0.0	0.0	0.0
Total	33.5	34.9	-1.4
II- Receivables			
(1) trade:			
– third parties	164.6	190.8	-26.2
– other Enel Group companies.....	19.6	20.2	-0.6
(2) subsidiaries	0.0	0.0	0.0
(3) affiliates.....	0.0	0.0	0.0
(4) parent companies.....	14.6	289.3	-274.7
(4-bis) taxation	42.4	0.0	42.4
(4-ter) deferred tax assets	25.8	22.3	3.5
(5) others.....	19.7	30.5	-10.8
– <i>due beyond 12 months</i>	39.0	0.0	39.0
Total	286.7	553.1	-266.4
III- Short-term investments			
(4) other equity investments	0.0	0.0	0.0
(6) other securities	0.0	0.0	0.0
Total	0.0	0.0	0.0
IV- Cash and cash equivalents			
(1) bank and post office deposits	17.2	50.6	-33.4
(3) cash on hand	0.1	0.1	0.0
Total	17.3	50.7	-33.4
TOTAL CURRENT ASSETS (C)	337.5	638.7	-301.2
D- ACCRUED INCOME AND PREPAID EXPENSES			
(1) Accrued income	3.2	0.0	3.2
(2) Prepaid expenses:			
– issue discount	0.0	0.0	0.0
– other.....	7.8	4.9	2.9
TOTAL ACCRUED INCOME AND PREPAID EXPENSES (D)	11.0	4.9	6.1
TOTAL ASSETS	4,708.2	4,967.7	-259.5

CONSOLIDATED FINANCIAL STATEMENTS OF TERNA GROUP

BALANCE SHEET

LIABILITIES AND SHAREHOLDERS' EQUITY

	At 30th June, 2004	At 31st December, 2003	Variation
A- SHAREHOLDERS' EQUITY			
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- Reserve for own shares	0.0	0.0	0.0
VI- Statutory reserves.....	0.0	0.0	0.0
VII- Other reserves:	0.0	0.0	0.0
– excess depreciation	421.4	0.0	421.4
– accelerated depreciation	332.6	295.7	36.9
– other.....	396.1	335.6	60.5
VIII- Retained earnings (losses carried forward).....	-8.0	0.1	-8.1
Net income - Group	102.2	220.4	-118.2
Consolidated shareholders' equity - Group	1,768.8	2,966.2	-1,197.4
IX- Capital and reserves - minority interests	0.2	0.2	0.0
Consolidated shareholders' equity - Group and minority interests	1,769.0	2,966.4	-1,197.4
B- PROVISIONS FOR RISKS AND CHARGES			
(1) retirement benefits.....	0.9	0.8	0.1
(2) taxes, including deferred taxes	499.4	417.2	82.2
(3) other.....	68.8	59.7	9.1
Total	569.1	477.7	91.4
C- EMPLOYEE TERMINATION INDEMNITY	63.6	70.7	-7.1

	At 30th June, 2004	At 31st December, 2003	Variation
D- PAYABLES			
(1) bonds	0.0	0.0	0.0
(2) convertible bonds	0.0	0.0	0.0
(3) due to shareholders for loans	1,400.0	456.2	943.8
(4) bank loans:			
– medium and long-term loans	493.5	489.2	4.3
– <i>due beyond 12 months</i>	478.7	318.2	160.5
– short-term loans.....		0.0	0.0
(5) other loans	0.0	0.0	0.0
(6) advances	42.5	47.7	-5.2
– <i>due beyond 12 months</i>	26.3	30.5	-4.2
(7) trade payables:			
– third parties	116.8	149.5	-32.7
– <i>due beyond 12 months</i>	0.7	0.8	-0.1
– other Enel Group companies.....	28.0	35.3	-7.3
(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 companies	8.7	39.2	-30.5
– <i>due beyond 12 months</i>	0.0	14.2	-14.2
(12) taxes payable	22.8	40.2	-17.4
(13) social security payables.....	7.6	7.5	0.1
(14) other payables	10.6	33.5	-22.9
Total	2,130.5	1,298.3	832.2
E- ACCRUED LIABILITIES AND DEFERRED INCOME			
(1) Accrued liabilities	13.9	6.7	7.2
(2) Deferred income:			
– issue premium	0.0	0.0	0.0
– other.....	162.1	148.0	14.1
Total	176.0	154.7	21.3
TOTAL LIABILITIES	2,939.2	2,001.3	937.9
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	4,708.2	4,967.7	-259.5
MEMORANDUM AND CONTINGENCY ACCOUNTS			
Guarantees given	170.9	7.4	163.5
Other commitments	417.3	356.1	61.2
Total	588.2	363.5	224.7

**CONSOLIDATED FINANCIAL STATEMENTS OF TERNA GROUP
AT 30TH JUNE, 2004**

INCOME STATEMENT

	Consolidated figures TERNA Group
(A) PRODUCTION REVENUES	
(1) revenues from sales and services:	
– network usage fees	480.2
– other sales and services	29.4
(3) change in contract work in progress	-1.0
(4) capitalized expenses	9.1
(5) other income and revenues:	
– grants for plant	6.6
– other	3.6
Total production revenues	527.9
(B) PRODUCTION COST	
(6) raw materials	6.8
(7) services	54.9
(8) use of third party assets	7.3
(9) personnel:	
– wages and salaries	56.1
– social security contributions	15.3
– employee termination indemnities	4.6
– retirement benefits	0.7
– other costs	3.2
(10) amortization, depreciation and write-downs	
– intangible assets	2.1
– tangible assets	76.9
– other write-downs of fixed assets	0.0
– write-downs of current receivables	0.0
(11) change in inventories	0.3
(12) accruals to provisions for risks and charges	15.3
(13) other provisions	0.0
(14) other operating costs	31.2
Total production cost	274.7
DIFF. BETWEEN PRODUCTION REVENUES AND COST	253.2

	Consolidated figures TERNA Group
(C) FINANCIAL INCOME AND EXPENSE	
(15) from equity investments in:	
– subsidiaries	0.0
– affiliates	0.0
– other companies	0.0
(16) other financial income:	
(a) from long-term receivables:	
– subsidiaries	0.0
– affiliates	0.0
– other	0.0
(b) from long-term financial assets	0.0
(c) from marketable securities	0.0
(d) other income:	
– subsidiaries	0.0
– affiliates	0.0
– parent companies	3.0
– other	2.4
(17) interest and other financial expense:	
– subsidiaries	0.0
– affiliates	0.0
– parent companies.....	14.3
– other Enel Group companies.....	0.0
– other.....	15.5
(17-bis) exchange rate gains and losses.....	24.5
Total financial income and expense	-48.9
(D) ADJUSTMENTS OF FINANCIAL ASSETS	
(18) revaluations:	
(a) of equity investments	0.0
(b) of long-term financial assets	0.0
(c) of marketable securities	0.0
(19) write-downs:	
(a) of equity investments	0.0
(b) of long-term financial assets	0.0
(c) of marketable securities	0.0
Total adjustments of financial assets	0.0
(E) EXTRAORDINARY ITEMS	
(20) income:	
– profit on sale of assets.....	0.0
– other.....	0.9
(21) expense:.....	
– losses on disposal of assets	0.0
– prior year taxes	2.2
– other.....	12.4
Total extraordinary items	-13.7

	Consolidated figures TERNA Group
INCOME BEFORE TAXES	190.6
(22) income taxes	88.4
– current	62.6
– deferred tax income.....	-3.6
– deferred tax charge	29.4
NET INCOME (including minority interests)	102.2
Net income - minority interests	0.0
NET INCOME - Group	102.2

(III)

Notes to the Consolidated Financial Statements

Consolidated half year report of T.E.R.N.A. at 30th June, 2004

Notes to the consolidated half year report

FORM, STRUCTURE AND SCOPE OF CONSOLIDATION

The 2004 consolidated half year report has been prepared in compliance with Accounting Principle 30, "Interim financial statements", issued by the Consigli Nazionali dei Dottori Commercialisti e dei Ragionieri (the Italian Accounting Profession). It consists 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. The report on operations has also been prepared in accordance with article 2428 of the Civil Code.

Figures relating to the consolidated financial statements at 31st December, 2003 have been duly reclassified to comply with the new balance sheet format introduced by article 2424 of the Civil Code.

The consolidated statement of cash flows is included in the report on operations.

Reference should be made to the report on operations accompanying the consolidated half year report for information on Group activities, significant events subsequent to the balance sheet date and transactions with related parties.

All amounts are stated in millions of euros.

The scope of consolidation includes the parent company, Terna S.p.A., Transmissora Sudeste-Nordeste S.A. and Novatrans Energia S.A., 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 Civil Code.

CONSOLIDATION PRINCIPLES AND PROCEDURES

The 2004 consolidated half year report has been prepared on the basis of the balance sheets and income statements as at and for the six months ended 30th June, 2004 of the consolidated companies. Where necessary, the figures have been adjusted to eliminate fiscally-driven entries in the consolidated financial statements at 31st December, 2003 and to comply with the accounting policies of Terna S.p.A.. Where applicable, these adjustments reflect the related tax effect, which is recorded in the appropriate caption.

The main consolidation principles and procedures are as follows:

- the difference between the acquisition cost of the equity investment and the related portion of shareholders' equity at the time of acquisition is allocated to a specific asset or liability caption on the basis of the valuation conducted at the time of purchase or acquisition of control, if obtained as a result of subsequent acquisitions. Any positive difference is recorded under "goodwill arising on consolidation", under intangible assets; negative differences are recorded under "consolidation reserve", under consolidated shareholders' equity;
- minority interests in the income and shareholders' equity of consolidated subsidiaries are recorded in a specific caption of the income statement and under 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 consolidated income and reallocated to initial equity reserves;
- balance sheet captions of the consolidated companies operating in countries not included in the euro-zone are translated into euros at period end exchange rate (Brazilian real = 3.783820), while income statement captions are translated at the average exchange rate of the period (Brazilian real =

3.642758). Exchange rate differences arising from the application of this method are recorded under a specific shareholders' equity caption.

Valuation criteria and accounting policies

The valuation criteria and accounting policies adopted in preparing the 2004 consolidated half year report are in line with those used for the consolidated financial statements at 31st December, 2003 and comply with article 2426 of the Italian Civil Code, integrated by the accounting principles issued by the Italian Accounting Profession. Where these are silent, reference is made to IFRS (International Financial Reporting Standards) issued by IASB.

The most significant policies are illustrated below.

Balance sheet

Intangible assets

Intangible assets are valued at cost and reflect the residual value of deferred charges yet to be amortized. Amortization is calculated on a straight-line basis based on the estimated useful 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 reflect the future income generating potential of the underlying business. The same policy applies to goodwill arising on consolidation.

Tangible assets

Tangible assets are stated at purchase or production cost, including directly related ancillary charges and monetary revaluations carried out by Enel S.p.A. pursuant to the applicable law. The above 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 reinstated.

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 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 residual useful life of the assets.

Depreciation rates	TERNA	Foreign subsidiaries
Industrial and residential buildings	2.50%	4.00%
Power lines	2.50%	2.50 – 4.50%
Switching substations:		
– 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%
Centralized systems for the remote monitoring and control of equipment:		
– Electronic equipment.....	5.00%	–
– Computers	10.00%	–

Depreciation rates are reduced by 50% for assets acquired during the year.

Pursuant to point 3 of article 67 of Presidential decree no. 917/86, Terna S.p.A. charged accelerated and excess depreciation directly to specific unavailable shareholders' equity reserves, determined when shareholders meet to resolve on the allocation of net income. The related deferred tax is taken to the income statement, in accordance with Accounting Principle 25 issued by the Italian Accounting Profession. Accelerated depreciation up to 1999 was reclassified in 2000 to a specific unavailable equity reserve, net of

the related tax effect. The reserve is transferred to an available shareholders' equity reserve upon taxation of the said accelerated depreciation charges.

Financial assets

– Equity investments

Equity investments in other unconsolidated companies are valued at cost. They are written down in the event of permanent impairment in value. If the factors causing the impairment cease to exist, the value of the equity investment is reinstated and the revalued amount is recognized in the income statement.

Inventories

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

Contract work in progress is valued at the amounts of the contractually agreed payments, according to the percentage-of-completion method.

Advances for contract work in progress are recorded under a liability caption.

Receivables

Receivables are stated at their estimated realizable value, determined by setting up a provision for bad debts shown as a reduction of their nominal value. They are 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 on an accruals basis.

Provisions for risks and charges

– 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 labor contracts and union agreements currently in force.

– Other provisions for risks and charges

They are accrued to cover certain or probable losses or liabilities, the amount and date of occurrence of which are unknown at period end. The accruals reflect the best possible estimate based on the information available.

– Employee termination indemnity

It represents the amount payable as termination indemnity to all employees at period end. It is net of advances paid in accordance with current legislation and national labor contracts and Enel Group pension fund contributions withheld.

Payables

They are stated at nominal value which is held to represent their repayment value.

Memorandum and contingency accounts

Guarantees given consist of performance guarantees and are stated at the contractually-agreed fee.

Commitments with suppliers are determined on the basis of contracts in force at period end and that do not fall within the normal operating cycle, limited to the part of the contract not yet performed.

Income statement

Revenues and expenses are recognized in accordance with the prudence and accruals principles.

Revenues

– Regulated activities in Italy

Revenues from the Italian National Electricity Transmission Network (NTN) are recognized in accordance with the method set forth in the Operating License Agreement entered into with the Transmission System Operator (GRTN), and calculated based on the tariffs set by the Authority for Electricity and Gas.

– Regulated activities in Brazil

Revenues are calculated 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 upon transfer of title.

Grants for plant

Grants received for specific works requested by third parties are recorded under tangible assets as deferred income (for facilities already in operation at 31st December, 2002) and as a decrease of the asset's book value (for facilities purchased from 1st January, 2003), when legal title to the grant is recognized and the amount can be reasonably determined. They are recorded in the income statement under other income and revenues over the depreciable life of the assets to which they relate.

Advances received are recognized in a separate caption under liabilities.

Income taxes

Current taxes of the period are stated in a tax provision and calculated by applying the related estimated annual tax rate to the income/(loss) of the period before taxes of each consolidated company.

Deferred tax assets and liabilities are calculated on temporary differences between the values recognized in the financial statements and the corresponding values recognized for tax purposes, on the basis of the applicable tax rate at the time the differences are expected to reverse.

Deferred tax assets are recorded under other receivables only if their recovery is reasonably certain.

Deferred tax liabilities are not provided for when such liability is unlikely to occur.

Translation of foreign currency amounts

Receivables and payables in currencies other than the Euro are translated at the exchange rates ruling at the date of the related transaction and adjusted at the exchange rate ruling at period end. Exchange rate differences are taken to the income statement under financial income, taking into account any hedging contracts.

Environmental costs

Environmental costs refer to the prevention, reduction and monitoring of the environmental impact of operations. If the costs are recurrent, they are taken to the income statement when incurred. Costs increasing

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 environmental disputes are accrued when it is probable or certain that a liability will be incurred and the amount can be reasonably estimated.

Hedging contracts

The Group takes out hedging contracts as a protection against the risk of fluctuations in interest rates, both against specific transactions and its overall exposure.

The interest differentials to be received or paid on interest rate derivatives are recognized under financial income or expense on an accruals basis, consistently with the charges in respect of the underlying liabilities.

ASSETS

1) SHARE CAPITAL NOT PAID IN

At 30th June, 2004, this caption had a nil balance (31st December, 2003: it was nil).

2) INTANGIBLE ASSETS – €113.3 million

Intangible assets may be analyzed as follows:

€	30th June, 2004	31st Dec., 2003
Other:		
– goodwill arising on consolidation	113.3	115.5
Total.....	113.3	115.5

“Goodwill arising on consolidation” relates to the acquisition of equity investments in TSN and Novatrans on 31st December, 2003 and refers to the difference between the price paid and shareholders’ equity. It is amortized over the residual term of the concession, originally set at 30 years, beginning from this year.

The difference between the balance at 30th June, 2004 and that at 31st December, 2003 is due to the amortization of the period.

3) TANGIBLE ASSETS – €4,235.3 million

Tangible assets amount to €4,235.3 million (31st December, 2003: €4,195.8). They may be broken down as follows:

Millions of euros	31st December, 2003	Increases	Variation of the period	Depreciation	Decreases Other variations	30th June, 2004
Land and buildings.....	326.7	1.4	3.9	-5.9	-1.3	324.8
Plant and machinery.....	3,419.9	9.3	152.9	-69.6	-6.2	3,506.3
Industrial and commercial equipment.....	11.0	0.9		-1.0	0.0	10.9
Other assets	1.1	0.2		-0.3	0.0	1.0
Total	3,758.7	11.8	156.8	-76.8	-7.5	3,843.0
Work in progress and advances	437.1	124.8	-156.8	0.0	-12.8	392.3
TOTAL	4,195.8	136.6	0.0	-76.8	-20.3	4,235.3

“Plant and machinery” includes the electricity transport networks in Italy and Brazil, switching substations and centralized systems for the remote monitoring and control of equipment.

The Brazilian plant includes the Northeast-Southeast 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 (operations began 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 service in June 2003, while the remainder was completed in April 2004.

The following table shows the book values at 30th June, 2004 of assets subject to depreciation, the related accumulated depreciation and the resulting net values. It also gives the percentage incidence of accumulated depreciation with respect to book values:

in millions of euros	Book value	Accumulated depreciation	Net value	Percentage incidence of accumulated depreciation at 30th June, 2004
Land and buildings	527.5	202.7	324.8	38.4%
Plant and machinery:				
– Italian assets.....	6,376.1	3,319.5	3,056.6	52.1%
– Brazilian assets	461.4	11.7	449.7	2.5%
Industrial and commercial equipment	37.6	26.7	10.9	71.0%
Other assets	11.4	10.4	1.0	91.2%
TOTAL	7,414.0	3,571.0	3,843.0	48.2%

As regards work in progress and advances, the main projects for the development and upgrading of the network at 30th June, 2004 are shown below:

	in millions of euros
ITALY	
Power lines:	
– KV 380 MATERA – S.SOFIA.....	64.2
– KV 380 LAINO – FEROLETO – RIZZICONI.....	38.6
380 KV switching substations:	
– VILVALLE	21.6
– CALENZANO	16.3

4) FINANCIAL ASSETS – €11.1 million

Financial assets may be broken down as follows:

in millions of euros	30th June, 2004	31st Dec., 2003
Equity investments:		
– in other companies.....	2.9	3.5
Total equity investments	2.9	3.5
Receivables from others:		
– advance payments of the tax on employee termination indemnities (Law no. 662/1996).....	4.3	5.3
– loans to employees and other items	3.5	3.6
– other	0.4	0.4
Total receivables from others	8.2	9.3
Total.....	11.1	12.8

Equity investments – €2.9 million

Equity investments in other companies total €2.9 million (31st December, 2003: €3.5 million). The €0.6 million decrease is due to the sale of the equity investment in Sfera to Enel S.p.A.. At 30th June, 2004, this caption was entirely comprised of the equity investment in Cesi S.p.A., accounting for 15% of its share capital.

Receivables from others – €8,2 million

Receivables from others amount to €8.2 million (31st December, 2003: €9.3 million) and mainly include the advance payments of the tax on employee termination indemnities of €4.3 million, paid by the parent company pursuant to Law no. 662/1996 and remunerated at the rate used to adjust employee termination indemnities, loans to employees (€3.5 million), bearing interest at market rates, for the purchase of principal residences or serious family needs. The variation for the period of €1.1 million is due to the utilization of the receivable for tax advances on employee termination indemnities following the resignation of several employees.

CURRENT ASSETS

5) INVENTORIES – €33.5 million

Inventories may be broken down as follows:

in millions of euros	30th June, 2004	31st Dec., 2003
Raw materials	15.2	15.6
Contract work in progress	18.3	19.3
Total.....	33.5	34.9

“Contract work in progress” (€18.3 million) is down €1.0 million over 31st December, 2003. It refers to long-term work carried out by the parent company for various clients. The caption includes: contract work in progress for the Transmission System Operator to upgrade the remote monitoring and control of equipment system – SCTI (€11.3 million), which is due for completion in 2004; contract work in progress for Ferrovie dello Stato S.p.A. (the state railway company) involving the upgrading and renovation of transmission plant (€1.9 million) and contract work in progress for SEAP S.r.l. involving the installation of an electric bus system in Chieti (€1.5 million). Finished works include, in particular, the project for the remote control of hydroelectric plant for Edipower S.p.A. (€1.8 million).

Inventories also include stocks of materials and equipment to be used in the operation, maintenance and construction of plant of €15.2 million (31st December, 2003: €15.6 million).

6) RECEIVABLES – €286.7 million

Receivables may be analyzed as follows:

in millions of euros	30th June, 2004	31st Dec., 2003
Trade receivables – third parties	164.6	190.8
Trade receivables – other Enel Group companies.....	19.6	20.2
Parent companies.....	14.6	289.3
Receivables – others	87.9	52.8
Total	286.7	553.1

A breakdown of receivables by due date (due before and after five years) is shown in the table at the end of the analysis of assets.

Trade receivables – third parties – €164,6 million.

These (€137.2 million) mainly include invoices to be issued by the parent company to the Transmission System Operator (G.R.T.N.) in connection with the usage fee of the national electricity transmission network for the period.

Specifically, this receivable mainly consists of usage fees for April/May 2004, falling due in July/August 2004. It also includes adjustments relating to credit notes to be issued for settlements to be paid for the 2002/2003 fee (€16,3 million). A total of €52,7 million of these fees were collected in July 2004.

This caption also includes the share of fees pertaining to the operation of the Brazilian lines, both invoiced and to be invoiced (€15.6 million).

Receivables are stated net of the provision for bad debts, which remained unchanged with respect to 31st December, 2003 (€1.0 million) and covers bad debts.

Trade receivables – other Enel Group companies – €19.6 million

Trade receivables from Enel Group companies are as follows:

in millions of euros	Trade receivables at 30th June, 2004	Trade receivables at 31st Dec., 2003
ENEL Distribuzione S.p.A.	6.2	11.4
Enel.net S.p.A.	10.0	5.0
ENEL Produzione S.p.A.	0.5	1.2
Wind Telecomunicazioni S.p.A.	1.0	1.1
ENEL Green Power S.p.A.	0.2	0.8
Enel.it S.p.A.	0.6	0.4
Enelpower S.p.A.	0.8	0.2
Other	0.3	0.1
Total	19.6	20.2

Receivables from Enel Distribuzione S.p.A. mainly refer to fees falling due at 90 days for the last three months of the period under the maintenance contract for lines owned by the latter.

Receivables from Enel.net S.p.A. comprise items not yet due in respect of the contract for the maintenance, development and laying of fiber optic cable owned by Enel.net on a part of the Terna network.

Receivables from parent companies – €14.6 million

This caption of €14.6 million (31st December, 2003: €289.3 million) consists of a financial receivable of €13.9 million relating to the joint account (paying interest of 1.950% at 30th June, 2004) held for the purposes of centralized treasury management and trade receivables of €0.7 million.

The decrease in the intercompany joint account over 31st December, 2003 is mainly due to the partial repayment (€293.6 million) to the ultimate parent company of the €493.6 million loan it granted on 1st March, 2004. Other decreases include the distribution of dividends to Enel S.p.A. (€80.2 million) and the payment of the advance on employee termination indemnities used by Terna employees to purchase the company's shares (€7.3 million).

Receivables – other – €87.9 million

This caption shows a balance of €87.9 million (31st December, 2003: €52.8 million) consisting mainly of the following amounts:

- tax receivables totaling €42.4 million, €38.6 million of which relates to IRES (€29.5 million) and IRAP (€7.4 million) paid on account, taxes paid by the Greek branch that the parent company will be able to deduct from its tax return (€2.5 million) and tax credits on interest paid by Novatrans to the parent company (€1.1 million);
- deferred tax assets of €25.8 million (31st December, 2003: €22.3 million);
- receivables – others of €19.7 million (31st December, 2003: €15 million) include the receivable from the Greek tax authorities for indirect taxes (VAT) in relation to the activities carried out by the Terna branch in Greece (€12.7 million). It also includes other minor items, most of which refer to various types of advances paid to employees and third parties (€7.0 million).

Deferred tax assets are as follows:

in millions of euros	30th June, 2004	31st Dec., 2003
Taxed provisions for risks and charges	25.6	22.1
Other components:		
– Depreciation of buildings not used in operations	0.2	0.2
Total.....	25.8	22.3

7) CASH AND CASH EQUIVALENTS – €17.3 million

This caption of €17.3 million (31st December 31, 2003: €50.7 million) mainly comprises balances on current accounts held by the Brazilian companies, €6.7 million of which is on a term deposit.

8) ACCRUED INCOME AND PREPAID EXPENSES – €11.0 million

Accrued income and prepaid expenses may be analyzed as follows:

in millions of euros	30th June, 2004	31st Dec., 2003
Accrued income	3.2	–
Prepaid expenses	7.8	4.9
Total.....	11.0	4.9

The €3.2 million increase in accrued income over 31st December, 2003 mainly refers to interest accrued on the parent company intercompany current account during the period.

Prepaid expenses include prepaid insurance premiums, prepaid charges arising from the transfer of contracts from Enel Distribuzione, fees paid to Enel.net for the lease of fiber optic lines for use by Terna, and fees paid for the use of telephone lines and radio relays.

The table below gives a break down of receivables and accrued income by due date.

in millions of euros	Within one year	From 2 to 5 years	Over 5 years	Total
LONG-TERM FINANCIAL RECEIVABLES	0.3	6.7	1.2	8.2
Receivables from others				
Total long-term financial receivables	0.3	6.7	1.2	8.2
CURRENT RECEIVABLES				
Trade receivables – third parties	164.6			164.6
Receivables from parent company	14.6			14.6
Trade receivables – other Enel Group companies	19.6			19.6
Subsidiaries	0.0			0.0
Taxation	42.4			42.4
Deferred tax assets	0.0	25.8		25.8
Receivables from others	6.5	13.2		19.7
Total current receivables	247.7	39.0	0.0	286.7
Accrued income	3.2			3.2
Total	251.2	45.7	1.2	298.1

LIABILITIES AND SHAREHOLDERS' EQUITY

9) SHAREHOLDERS' EQUITY – €1,768.8 million

Variations for the period are as follows:

in millions of euros	Share capital	Legal reserve	Other reserves	Retained earnings	Net income	Total
BALANCE AT 31ST DEC., 2003	2,036.1	78.3	631.3	0.1	220.4	2,966.2
Allocation of 2003 income:						
Legal reserve		6.2			-6.2	0.0
Other reserves (accelerated depreciation)			36.9		-36.9	0.0
Retained earnings.....				0.2	-0.2	0.0
Dividends					-80.2	-80.2
Allocation to other reserves			85.8		-96.9	-11.1
Consolidation differences of subsidiary and affiliated companies.....				-8.3		-8.3
Reduction in share capital	-1,596.1		396.1			-1,200.0
Net income for the period					102.2	102.2
BALANCE AT 30TH JUNE, 2004	440.0	84.5	1,150.1	-8.0	102.2	1,768.8

Share capital – €440.0 million

The shareholders, in their meeting of 28th January, 2004, resolved to reduce the share capital from €2,036.1 million to €440 million, by repaying capital of €1,200 million to Enel S.p.A. and transferring €396,1 to a reserve, in accordance with article 2445 of the Civil Code. This transaction took place on 29th April, 2004. Accordingly, T.E.R.NA. S.p.A. share capital now consists of 2,000,000,000 ordinary shares with a par value of €0.22 each, 50% of which is held by Enel S.p.A.; the remaining 50% (1,000,000,000 shares) was parceled out, following the public offer for sale made to the public and institutional investors and concluded on 23rd June, 2004.

Legal reserve – €84.5 million

The legal reserve accounts for 19.2% of the share capital of the parent company.

Other reserves – €1,150.1 million

Other reserves may be analyzed as follows:

Reserve for accelerated depreciation: this includes accruals made by the parent company exclusively for tax purposes and amounts to €332.6 million (31st December, 2003: €295.7 million); the variation for the period (€36.9 million) is due to the allocation of 2003 accelerated depreciation to this reserve upon the allocation of the parent company's 2003 net income.

Reserve pursuant to Vietti law: this reserve was set up to reflect the elimination of fiscally-driven entries in the financial statements of the parent company at 1st January, 2004, in accordance with article 2426 of the Civil Code, implemented by Legislative decree no. 6 of 17th January, 2003 (the so-called Vietti law). Accordingly, the reserve includes depreciation in excess of the depreciation rates determined by the parent company until 2003, net of the capital grants and related deferred taxes. At 30th June, 2004, the reserve amounted to €421.4 million and comprised excess amortisation/depreciation (€695.6 million), net of capital grants (€22.8 million) and deferred taxes calculated on the basis of the 37.37% rate (€251.4 million).

Other reserves: these reserves were set up following the above reduction in share capital; they amount to €396.1 million.

Retained earnings or losses carried forward – €-8.0 million

Variations for the period refer entirely to consolidation differences and are mainly due to the deterioration of the Brazilian Real exchange ratio during the first six months of the year.

Reconciliation of the shareholders' equity and net income of the parent company and consolidated figures.

in millions of euros	Net income 30th June, 2004	Shareholders' equity at 30th June, 2004	Net income 31st Dec., 2003	Shareholders' equity at 31st Dec., 2003
Parent company financial statements	548.6	1,802.3	123.5	2,533.9
Net income (loss) and equity of consolidated companies	(12.6)	117.6	–	41.0
Elimination of book value of consolidated equity investments	–	(264.6)	–	(156.2)
Goodwill arising on consolidation	(1.3)	113.3	–	115.4
Minority interests	–	(0.2)	–	(0.2)
Goodwill arising on consolidation in respect of excess amortization/depreciation	(11.1)	–	96.9	432.3
Elimination of fiscally-driven entries.....	(421.4)			
Other differences	–	0.4		
Consolidated financial statements	102.2	1,768.8	220.4	2,966.2

10) PROVISIONS FOR RISKS AND CHARGES – €569.1 million

in millions of euros	Balance at 31st Dec., 2003	Accruals	Utilization	Balance at 30th June, 2004
Retirement benefits	0.8	0.6	(0.5)	0.9
Taxes	417.2	88.7	(6.5)	499.4
Other:				
– litigation	12.2	–	(0.1)	12.1
– sundry risks	47.5	15.5	(6.3)	56.7
Total	59.7	15.5	(6.4)	68.8
Total	477.7	104.8	(13.4)	569.1

Retirement benefits – €0.9 million

The provision includes accruals made by the parent company for indemnities in lieu of notice and additional monthly payments to personnel.

Taxes, including deferred taxes – €499.4 million

This caption may be analyzed as follows:

in millions of euros	31st Dec., 2003	Accruals	Other variations	30th June, 2004
Current taxes	–	59.4	–	59.4
Deferred taxes	417.2	29.3	(6.5)	440.0
Total	417.2	88.7	(6.5)	499.4

Current taxes refer to the estimated income tax charge for the period (€58.8 million) of the parent company (€48.6 million and €10.2 million for IRES and IRAP, respectively) and to the estimated tax charge for the period of subsidiaries (€0.6 million).

Deferred tax liabilities of €440.0 million (31st December, 2003: €417.2 million) include deferred tax liabilities relating to previous excess amortization/depreciation of €251.4 million (prior to 2004) determined by the parent company and reclassified to a shareholders' equity reserve as described above (unchanged with respect to 31st December, 2003) and to accelerated/excess depreciation determined by the parent company of €188.6 million (31st December, 2003: €159.3 million). The €29.3 million increase refers to the accrual for deferred tax liabilities of the current period for accelerated and excess depreciation, net of the related capital grants.

Provision for litigation – €12.1 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 legal 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”. This caption decreased by €0.1 million compared with 31st December, 2003.

Provision for risks and charges – other – €56.7 million

The provision of €56.7 million (31st December, 2003: €47.5 million) has been increased by additional accruals made to cover the estimated costs of a likely adjustment to the NTN fees based on a recalculation, underway, of the parent company's percentage of ownership of the NTN.

The provision was also increased to cover pending disputes with third-party producers relating to grants received by the parent company for network connections and accruals made against the risk of transformer breakdown and exceptional events affecting high-voltage power lines, in addition to charges arising from the retirement of plant.

The net increase of the period (€9.2 million) is mainly due to the above accruals made by the parent company for the fee due to the Transmission System Operator (GRTN) to use the transmission network; utilization mainly relates to previous charges repaid to auto producers (€2.7 million) and contractual penalties regarding the maintenance contract of the lines owned by ENEL Distribuzione S.p.A. (€1.4 million).

11) EMPLOYEE TERMINATION INDEMNITY – €63.6 million

The provision of €63.6 million (31st December, 2003: €70.7 million) decreased by €7.1 million over the previous period following the net variation during the period of accruals/transfers (€5.2 million) and utilization (€12.3 million). The provision represents the amount accrued by the parent company in respect of its employees' termination indemnity entitlement, net of advances and contributions to Enel Group pension funds. During the period, the latter increased significantly given the possibility for employees to buy the parent company shares through their termination indemnity (€7.3 million) as part of the recent public offer for sale. The amount is carried net of the 11% flat withholding tax on the revaluation of employee termination indemnities, pursuant to Legislative Decree no. 47/2000.

12) PAYABLES – €2,130.5 million

Payables may be analyzed as follows:

in millions of euros	30th June, 2004	31st Dec., 2003
Due to shareholders for loans.....	1,400.0	–
Bank loans – medium and long-term	493.5	489.2
Advances	42.5	47.7
Trade payables	144.8	184.8
Payables to parent companies	8.7	495.4
Other payables	41.0	81.2
Total	<u>2,130.5</u>	<u>1,298.3</u>

A breakdown of payables by due date (due before and after five years) is shown in the table at the end of the analysis of liabilities.

Due to shareholders for loans – €1,400.0 million

This caption refers to two loans granted by the ultimate parent company Enel S.p.A. to the parent company:

- €493.6 million granted on 1st March, 2004 through which T.E.R.NA. S.p.A. settled a previous payable transferred by Enel S.p.A. on 1st October, 1999 upon contribution of a business activity, of a residual €456.2 million and a payable, again transferred by Enel S.p.A. as part the same transaction, of €37.4 relating to the Management Pension Fund; on 31st May, the parent company made an early repayment of €293.6 million;
- €1,200.0 granted on 30th April, 2004 and used by T.E.R.NA. S.p.A. to repay the share capital to the ultimate parent company Enel S.p.A. as described in detail in these notes.

Both loans bear interest at the 3-month Euribor rate (+ annual spread of 0.25%); interest is paid on a quarterly basis and the last repayment date is 1st July, 2007 with the possibility of an early repayment. Interest rate swaps totaling €500 million have been agreed recently to hedge the risk of fluctuations in interest rates, specifically: plain vanilla (€100 million), step-up (€200 million) and collar step-up (€200 million); the related contracts are “forward starting”, commencing on January 2005 and expiring on 31st December, 2007. Given the above hedging contracts, the portion still exposed to interest rate fluctuations is 64.3%.

Medium/long term bank loans – €493.5 million

This caption of €493.5 million (31st December, 2003: €489.2 million) may be analyzed as follows:

in millions of euros	Repayment period	Balance at 30th June, 2004	Current portion	Long-term portion	2005	2006	2007	2008	Beyond
BNDES	2002 – 2016	171.9	8.0	163.9	7.1	8.0	8.9	9.9	130.0
EIB no. 20271	2004 – 2014	71.6	6.8	64.8	6.8	6.8	6.8	6.8	37.6
EIB no. 21159	2005 – 2016	250.0		250.0	22.7	22.7	22.7	22.7	159.2
Total		<u>493.5</u>	<u>14.8</u>	<u>478.7</u>	<u>36.6</u>	<u>37.5</u>	<u>38.4</u>	<u>39.4</u>	<u>326.8</u>

The BNDES loan, granted to TSN with an original amount of R\$ 556.8 million, was agreed on 23rd October, 2002 and fully disbursed in four installments (26th November, 2002; 18th December, 2002; 22nd April, 2003; August 26, 2003). It has the following terms:

- Interest rate: floating rate of TJLP + 3.50% on the original amount of R\$ 418,3 million (Subloans A and B) (TJLP is the long-term lending rate published by the Brazilian central bank). If the annual TJLP should rise above 6.00%, the excess will be capitalized. The remaining original amount of R\$

138.5 (Subloan C) is subject to a floating rate based on the BNDES' average cost of foreign currency plus 3.50%.

- Interest payments: monthly;
- Repayment of principal: in 144 monthly installments starting on 15th October, 2004 for Subloans A and B and on 15th November, 2004 for Subloan C.

All the TSN shares owned by the parent company have been pledged to secure the loan.

The EIB loan, of €75 million, was granted on 22nd October, 1999 for the “Italy-Greece electricity network interconnection” project, and has the following terms:

- Floating interest rate: Euribor + 0.15% (30th June, 2004: 2.080%);
- Interest payments: on a half-yearly basis (15th March and 15th September);
- Repayment of principal: in 20 equal installments paid half-yearly from 15th March, 2004 to 15th September, 2014.

The first installment of €3.4 million was repaid on 31st March, 2004.

The loan is fully hedged against interest rate risk with interest rate swaps.

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

- Floating interest rate: Euribor + 0.25% (at 30th June, 2004: 2.180%)
- Interest payments: on a half-yearly basis (15th June and 15th December)
- Repayment of principal: in 20 equal installments paid half-yearly from 15th December, 2005 to 15th June, 2016.

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

Advances – €42.5 million

Advances include grants for plant received by the parent company for work in progress at 30th June, 2004.

At 31st December, 2003, this caption amounted to €47.7 million. The decrease for the period is mainly due to the bringing into service of a number of plants; the latter are stated net of the related grants received.

Trade payables – €144.8 million

Trade payables include payables due to third party suppliers (€116.8 million) and payables to other Enel Group companies (€28.0 million).

Payables due to third party suppliers (31st December, 2003: €149.5 million) decreased by €32.7 million due to the settlement of invoices relating to works concluded during the last quarter of previous year.

Trade payables regard invoices received and to be received for contracts, services and purchases of material and equipment.

Payables to other Enel Group companies may be analyzed as follows:

in millions of euros	Trade payables at 30th June, 2004	Trade payables at 31st Dec., 2003
Wind Telecomunicazioni S.p.A.....	11.0	10.7
ENEL Distribuzione S.p.A.	5.3	6.2
Enelpower S.p.A.	3.7	8.8
ENEL Facility Management S.p.A.	4.9	4.3
Enel.it S.p.A.	1.8	2.1
Enelpower do Brasil.....	–	1.7
Ape S.p.A.	0.7	0.7
ENEL Produzione S.p.A.	0.2	0.3
Sfera S.p.A.	0.3	0.3
Other.....	0.1	0.2
Total	28.0	35.3

The payables due to Wind Telecomunicazioni refer to costs for transmission and telephony services provided to the parent company; those due to Enel Distribuzione refer to electricity discounts for employees and sundry technical services.

The payable due to Enelpower refers to amounts accrued on the EPC contract with TSN and Novatrans.

Payables to parent companies – €8.7 million

The payables to ENEL S.p.A. may be analyzed as follows:

in millions of euros	Balance at 30th June, 2004	Balance at 31st Dec., 2003
Trade payables:	8.7	1.1
Financial payables:	–	493.6
– Enel pension fund.....	–	37.4
– Loans and financing	–	456.2
Sundry payables	0.0	0.7
Total	8.7	495.4

Trade payables consist exclusively of costs incurred by ENEL S.p.A. for the flotation of the parent company.

Financial payables are nil following the reclassification of €493.6 million to sums due to shareholders for loans as described above.

Other payables – €41.0 million

This caption may be analyzed as follows:

- taxes payable of €22.8 million mainly relate to the parent company and include VAT settlement for June (€8.3 million), withholding taxes (€6.9 million) and the residual amount for the 2002 tax amnesty (€1.9 million).
- social security payables of €7.6 million (31st December, 2003: €7.5 million) refer to payables of the parent company to INPS for June 2004.
- sundry payables of €10.6 million (31st December, 2003: €33.5 million) refer to payables to employees including termination indemnities due from the parent company and to be disbursed to employees who had left the company at 30th June, 2004; it also includes staff leaving incentives. The significant

decrease for the period (€22.9 million) is due to the payment of the termination indemnities representing the payable at 31st December, 2003.

13) ACCRUED LIABILITIES AND DEFERRED INCOME – €176.0 million

Accrued liabilities and deferred income may be analyzed as follows:

in millions of euros	30th June, 2004	31st Dec., 2003
Interest payable on loans	6.7	5.4
Other accrued liabilities	7.2	1.3
Deferred income for grants for plant	161.4	147.4
Other deferred income	0.7	0.6
Total	176.0	154.7

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

in millions of euros	Within one year	From 2 to 5 years	Over five years	Total
FINANCIAL PAYABLES TO THIRD PARTIES				
Medium and long-term bank loans	14.8	151.9	326.8	493.5
Short-term bank loans				
Total financial payables:	14.8	151.9	326.8	493.5
OTHER PAYABLES				
Advances	16.2	26.3	0.0	42.5
Trade payables.....	116.1	0.7	0.0	116.8
Payables to parent companies:				
– Financial payables	1,400.0			1,400.0
– Other	8.7			8.7
Total payables to parent companies	1,408.7	0.0	0.0	1,408.7
Payables to other Enel Group companies	28.0	0.0	0.0	28.0
Taxes payable	22.8	0.0	0.0	22.8
Social security payables	7.6	0.0	0.0	7.6
Other payables.....	10.6	0.0	0.0	10.6
Total – other payables	1,610.0	27.0	0.0	1,637.0
Accrued liabilities	13.9	0.0	0.0	13.9
Total	1,638.7	178.9	326.8	2,144.4

14) GUARANTEES AND OTHER MEMORANDUM AND CONTINGENCY ACCOUNTS

Memorandum and contingency accounts include amounts relating to guarantees, sureties, risks and other commitments, as detailed below:

in millions of euros	30th June, 2004	31st Dec., 2003
Guarantees given:		
– Sureties given to third parties.....	14.3	7.4
– Own shares pledged to third parties.....	156.6	0
Total	170.9	7.4
Other commitments:		
– Commitments with suppliers for the purchase of:		
Sundry supplies	241.2	193.4
Contract work	176.1	162.7
Total	417.3	356.1
Total	588.2	363.5

Guarantees given refer to TSN shares owned by Terna S.p.A. that have been given as a pledge to BNDES, and sureties given to third parties in connection with contracts signed for work and services provided by the company.

Commitments with 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 involving Terna S.p.A. 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 8th July, 2003, a Prime Minister's Decree was enacted to complete the implementation of the master agreement no. 36 of 22nd February, 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 Transmission System Operator has increasingly been called as a defendant in these proceedings, because it is legally responsible for all matters relating to energy flows transiting on the network owned by Terna.

Legislation governing electrical and magnetic fields

The master agreement on electrical and magnetic fields enacted on 22nd February, 2001 requires the government to adopt specific provisions setting the parameters (exposure limits, thresholds of concern and quality targets) with which electrical plant must be compliant.

In this respect, the master agreement envisages a mechanism for the recovery of related costs in accordance with criteria determined by the Authority for Electricity and Gas (the “Authority”) pursuant to Law no. 481/1995, since such costs are incurred in the general interest.

On 29th August, 2003 the Prime Minister’s decree of 8th July, 2003 setting “Exposure limits, thresholds of concern and quality targets for the protection of the public from the effects of electromagnetic fields generated at network frequency (50 Hz)” and thereby establishing the parameters with which electrical plant must comply was published in the Official Journal.

The potential impact of the provision on the company is currently being assessed.

A number of regions have proposed bills on this subject that establish tighter limits than those envisaged by the Prime Minister’s decrees of 1992 or 8th July, 2003.

However, Constitutional Court ruling no. 307 published on 7th October, 2003 declared some regional laws concerning electromagnetic fields (including the Campania Region’s Law no. 13 of 24th November, 2001) to be unconstitutional. The ruling states the principle that restrictions based on national legislation cannot be modified by regional legislation, even if it sets more stringent limits, since health protection must be safeguarded in a uniform manner throughout the country.

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 negative repercussions, but since the impact cannot be quantified at present they have not been included under the provisions for litigation. An assessment of the suits, which included taking advice from external 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

PRODUCTION REVENUES

This caption may be analyzed as follows:

15) REVENUES FROM SALES AND SERVICES – €509.6 million

They include the following:

in millions of euros	First half of 2004
Network usage fees	480.2
Other sales and services.....	29.4
Total	509.6

Revenues from sales and services mainly relate to fees attributable to Terna for the use of the National Transmission Network (€428.5 million).

Revenues related to Brazilian companies, of €51.7 million, relate to the fixed fee established in the license for the operation of transmission lines issued by the Local Energy Authority (ANEEL).

Other sales and services amount to €29.4 million and mainly refer to the sale of goods and services to Enel group companies, including the contract for the maintenance of high-voltage lines owned by Enel Distribuzione S.p.A. (€14.0 million), and that with Enel.net S.p.A. (€5.0 million) for the laying of fiber optic lines in its plant, as well as the maintenance and development of the same.

16) CAPITALIZED EXPENSES – €9.1 million

Capitalized expenses refer to labor costs (€5.7 million) and the consumption of materials and machinery (€3.4 million) for plant being produced and relating to the parent company.

17) OTHER INCOME AND REVENUES – €10.2 million

Other income and revenues are mainly comprised (€6.6 million) of the portion of capital grants pertaining to the period, recorded under the liability caption “deferred income”; other revenues mainly regard insurance indemnities (€1.2 million), rents, penalties charged to suppliers and other revenues.

PRODUCTION COST

18) RAW MATERIALS – €6.8 million

This caption consists of the costs incurred to purchase various materials and equipment used for the operation and maintenance of facilities mainly relating to the parent company (€6.6 million).

19) SERVICES – €54.9 million

This caption mainly includes maintenance and repairs regarding contracts, works and services for the ordinary maintenance of plant, totaling €49.5 million.

20) USE OF THIRD PARTY ASSETS – €7.3 million

This caption primarily consists of property rent payable to Enel Group companies and third parties, lease costs and miscellaneous costs.

21) PERSONNEL – €79.9 million

This caption mainly consists of wages and salaries, social security contributions and other personnel costs, €79.3 of which relates to the parent company and €0.6 million to the Brazilian companies. These costs can be broken down as follows:

in millions of euros	First half of 2004
Wages and salaries	56.1
Social security contributions	15.3
Employees' termination indemnities	4.6
Other costs	3.9
Total	79.9

The number of employees by category of employment at 30th June, 2004 is shown in the table below:

	Period	Workforce at 30th June, 2004
Senior management		37
Middle management		209
Office staff		1,530
Workers		1,174
Total		2,950

22) AMORTIZATION, DEPRECIATION AND WRITE-DOWNS – €79.0 million

Amortization of intangible assets:

This caption amounts to €2.1 million and refers to the amortization of “goodwill arising from consolidation” recorded in connection with the acquisition of equity investments in TSN and Novatrans.

Depreciation of tangible assets:

This caption amounts to €76.9 million and includes accruals for the period calculated on the basis of the depreciation rates held to represent the estimated useful economic life of plant. Depreciation relating to the parent company amounts to €70.6 million.

23) CHANGE IN INVENTORIES – €0.3 million

This shows the net positive change in inventories during the period and entirely refers to the parent company.

24) PROVISIONS FOR RISKS – €15.3 million

This caption includes accruals made at 30th June, 2004 described in the section on the provision for risks and charges pertaining to the parent company.

25) OTHER OPERATING COSTS – €31.2 million

This caption is mainly comprised of prior year items pertaining to the ultimate parent company and relating to the payment of the fee for the usage of the Italian National Electricity Transmission Network (NTN) for 2002 and 2003 (€16.3 million). The caption also includes local indirect taxes and charges of the period for the Management Pension Fund and discounts on electricity supplied to retired personnel. Of this, €7.9 million relates to subsidiaries and €23.3 million to the parent company.

26) FINANCIAL INCOME AND EXPENSE – €-48.9 million

Other financial income

Other financial income may be analyzed as follows:

in millions of euros	First half of 2004
Interest accrued current accounts with the parent company (Terna)	3.0
Other financial income (TSN)	2.4
Total	5.4

Interest and other financial expense

in millions of euros	First half of 2004
Interest expense from Enel S.p.A. (Terna)	14.3
Interest expense on loans	
– Terna.....	7.4
– TSN	8.1
Exchange rate losses (subsidiaries)	24.5
Total	54.3

27) EXTRAORDINARY ITEMS – €–13.7 million

Extraordinary income derives from excess income taxes paid in the previous year (€0.8 million); extraordinary expense relates to the tax amnesty (€2.1 million) pursuant to Law no. 27/2003 and to temporary early retirement incentives offered to the employees (€1.3 million) of the parent company. It also includes expenses incurred for the elimination of fiscally-driven entries relating to excess grants for plant (€11.1 million) that are recorded under shareholders' equity in the 2003 consolidated financial statements, given that no specific regulation exists to this regard.

28) INCOME TAXES – €88.4 million

in millions of euros	First half of 2004
Current:	
– IRES	48.6
– IRAP.....	10.2
– Brazilian companies.....	3.8
Deferred tax income.....	(3.6)
Deferred tax charge	29.4
Total.....	88.4

Income taxes, which account for 46.4% of income before taxes, are composed of current taxes and net temporary differences for the period.

The reconciliation between expected and effective income tax charge is given below:

Millions of euros	2004
Statutory income	633.2
– Elimination of fiscally-driven entries	-421.4
– Accelerated/excess depreciation	-78.6
– Variation in provisions	9.6
– Other increases/decreases	4.4
IRES taxable amount	147.2
Tax charge (33%) for the period	48.6

The balance of deferred tax income is represented by accruals for:

- tax recovered amounting to €2.4 million, mainly due to the use of provisions taxed in previous years to cover early retirement incentives and the settlement of litigation in the period;
- deferred tax income relating to temporary differences of €6.0 million arisen during the period, following accruals to the provisions for risks and future costs.

Deferred taxes relate to accelerated and excess depreciation, net of the related grants, accrued for tax purposes. This amount is valued on the basis of the rate ruling in the year in which reversal will take place.

30) TRANSACTIONS WITH RELATED PARTIES

Transactions with Enel Group companies are regulated by specific contracts agreed by the parties.

Contracts signed with the ultimate parent company Enel S.p.A., generating expenses for Terna relate primarily to:

- financial indebtedness;
- provision of institutional or on-request assistance and consulting services;

- communication services;

As for other Group companies, contracts generating expenses relate primarily to:

- the operation of in-house cafeterias (Enel Facility Management S.p.A.);
- rental of buildings (Enel Facility Management S.p.A.);
- luncheon vouchers – (Ape S.p.A.);
- rental of residential buildings (NewReal S.p.A.);
- supply and management of IT services; (ENEL.IT S.p.A.);
- supply of telephony and telecommunications services (WIND S.p.A.);
- staff training services (SFERA S.p.A.)
- human resource management services (Ape S.p.A.)
- EPC (Engineering Procurement & Construction) with EPower/EPower do Brasil.

Contracts generating revenues relate to:

- operation and maintenance of high-voltage network (Enel Distribuzione S.p.A.)
- development, laying and maintenance of fiber optics (ENEL.Net S.p.A.).

The following table shows actual costs and revenues for the period, in millions of euros.

Company	Costs	Revenues
APE S.r.l.	2.4	0.0
ENEL Distribuzione S.p.A.	2.0	14.2
ENEL Green Power S.p.A.....	0.0	0.8
ENEL Produzione S.p.A.	0.1	0.8
ENEL Facility Management S.p.A.	2.6	0.0
Enel.it S.p.A.	3.6	0.0
Enel.net S.p.A.	0.0	5.0
Enelpower S.p.A.	0.0	0.3
Sfera S.p.A.	0.4	0.0
ENEL S.p.A.....	39.7	3.7
Novatrans	0.6	0.1
TSN.....	0.1	0.0
New Real S.p.A.....	1.4	0.0
Wind Telecomunicazioni S.p.A.....	11.1	0.9
Other.....	0.1	0.3
Total	64.1	26.1

31) ELIMINATION OF FISCALLY-DRIVEN ENTRIES

Fiscally-driven entries stated in the half year report of the parent company have been eliminated pursuant to article 2426 of the Civil Code, implemented by Legislative decree no. 6 of 17th January, 2003 (Vietti law). Accordingly, excess depreciation was reclassified to a specific reserve, net of the capital grants and related deferred taxes. At 30th June, 2004, this reserve amounted to €421.3 million and includes excess amortization/depreciation (€695.6 million), related grants for plant (€22.9 million) and deferred taxes (€251.4 million), calculated on the basis of the rate ruling in the year in which reversal will take place (37.37%).

32) OTHER INFORMATION

The table below outlines the key figures from the latest financial statements approved by the ultimate parent company (in millions of euros):

ENEL S.p.A.	2003
Production revenues.....	1,142.6
Production cost.....	915.7
Net financial income (expense) and value adjustments	215.2
Net extraordinary income (expense)	432.8
Income taxes	267.5
Net income for the period	607.3
Total assets:	29,521.4
<i>of which financial</i>	23,398.2
Shareholders' equity.....	<u>11,997.1</u>

Pension fund expense

The charge taken in respect of the extraordinary grant due from the ultimate parent company upon the suppression of the Electricity Sector Employee Pension Fund, which was originally recognized as an intangible asset, has been nil since 2003 because the company opted to amortize it over three years (2000, 2001 and 2002), in accordance with the provisions of 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 Group accounting policies, intangible assets would have shown an additional liability of around €76.3 million at 30th June, 2004.

**REVIEW REPORT RELATING TO CONSOLIDATED HALF YEAR REPORT OF THE
TERNA GROUP AT 30TH JUNE, 2004**

(Translation from the Italian original which remains the definitive version)

Review Report

To the shareholders of

T.E.R.NA.–Trasmissione Elettività Rete Nazionale S.p.A.

1. We have reviewed the consolidated balance sheet, the consolidated income statement and the relative notes of the T.E.R.NA.–Trasmissione Elettività Rete Nazionale group as at and for the six months ended 30th June, 2004, which are included in the half year report of T.E.R.NA.–Trasmissione Elettività Rete Nazionale S.p.A.. We have also reviewed that part of the notes describing the activities of the group for the period with the sole objective of verifying consistency with the remainder of the half year report.
2. We conducted our review in accordance with Consob (the Italian Commission for Listed Companies and the Stock Exchange) guidelines set out in Consob resolution no. 10867 dated 31st July, 1997. The review consisted primarily of the collection of information relating to the financial data and the consistency of application of the accounting policies through discussions with group company management and analytical procedures applied to the financial data presented. The review excluded such audit procedures as tests of controls and verification or validation of assets and liabilities and is significantly less than a full scope audit performed in accordance with generally accepted auditing standards. As a consequence, contrary to our report on the annual consolidated financial statements, we do not express an opinion on the half year report.
3. With regard to the comparative figures relative to the annual consolidated financial statements of the previous year, reference should be made to our report dated 27th February, 2004.
4. Based on our review, we are not aware of any material modifications or integrations that should be made to the consolidated balance sheet, consolidated income statement and relative notes described in paragraph 1 above for them to be in conformity with Consob guidelines governing the preparation of half year reports approved with resolution no. 11971 dated 14th May, 1999 and subsequent modifications and integrations.
5. We draw your attention to the disclosures provided by the directors in the half year report on the following matters:
 - The parent company is a defendant in certain lawsuits and is involved in other uncertainties relating primarily to environmental and urbanistic matters, the outcome of which could result in significant losses for the group, at present not objectively quantifiable.
 - The notes disclose the effect of accounting for the extraordinary contribution due upon the suppression of the Electricity Sector Employee Pension Fund, pursuant to Law 488/1999.

Rome, 24th September, 2004

KPMG S.p.A.

(signed on the original)

Bruno Mastrangelo

Director

ANNEX D

REVIEW REPORT AND EXAMINATION REPORT RELATING TO PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

(Translation from the Italian original which remains the definitive version)

Examination report on the pro forma consolidated balance sheet and pro forma consolidated income statement of Terna and its subsidiaries as at and for the year ended 31st December, 2003

To the board of directors of
T.E.R.NA.–Trasmissione Elettricità Rete Nazionale S.p.A.:

- 1 We have examined the pro forma consolidated balance sheet of T.E.R.NA.–Trasmissione Elettricità Rete Nazionale S.p.A. and its subsidiaries as at 31st December, 2003, and the pro forma consolidated income statement for the year then ended and notes thereto.

These pro forma financial statements are derived from the historical consolidated financial statements of T.E.R.NA.–Trasmissione Elettricità Rete Nazionale S.p.A. and its subsidiaries as at and for the year ended 31st December, 2003 and the pro forma adjustments thereto which we have examined. We have audited the consolidated financial statements of T.E.R.NA. – Trasmissione Elettricità Rete Nazionale S.p.A. and its subsidiaries as at and for the year ended 31st December, 2003 with respect to which reference should be made to our report dated 27th February, 2004.

The pro forma consolidated financial statements have been prepared on the basis of the assumptions disclosed in the notes thereto, in order to reflect on a retroactive basis the effects of the capital reduction resolution and the acquisition of the investments in Transmissora Sudeste Nordeste S.A. and Novatrans Energia S.A.

- 2 The pro forma consolidated balance sheet, pro forma consolidated income statement and notes thereto as at and for the year ended 31st December, 2003 have been prepared pursuant to the provisions of article 2.2.1 of the “*Regolamento del Mercati Organizzati e Gestiti dalla Borsa Italiana*”.

The pro forma consolidated balance sheet and pro forma consolidated income statement have been prepared with the objective of showing the effects, stated in accordance with accounting principles and policies consistent with historical data and in compliance with relevant legislation, on the group’s financial position of the capital reduction resolution approved by the sole shareholder of T.E.R.NA. –Trasmissione Elettricità Rete Nazionale S.p.A. in the meeting held on 28th January, 2004, as if it had occurred on 31st December, 2003, and, with respect only to results of operations, the effects of the above mentioned acquisitions of investments and the capital reduction at the beginning of 2003. Had the above transactions actually occurred on such date, the outcome may not necessarily have been that presented.

The pro forma financial statements are the responsibility of the company’s management. Our responsibility is to express an opinion on the assumptions made and the approach adopted by management in preparing these pro forma financial statements, as well as on the valuation criteria and accounting policies adopted.

- 3 Our examination was conducted in accordance with the standards recommended by CONSOB in Communication no. 1061609 dated 9th August, 2001 which regulates the examination of the pro forma financial information. We have carried out all the procedures which we have deemed to be necessary for the purposes of our engagement.
4. In our opinion, the assumptions made by the management of T.E.R.NA. – Trasmissione Elettricità Rete Nazionale S.p.A. in preparing the pro forma consolidated balance sheet, pro forma consolidated income statement and notes thereto as at and for the year ended 31st December, 2003 in order to reflect on a retroactively basis the effects of the acquisitions of investments and the capital reduction are reasonable and the approach adopted has been correctly applied for the disclosure purposes

described above. Furthermore, we believe that the accounting principles and policies applied in preparing the above pro forma consolidated financial statements are appropriate.

Rome, 10th March, 2004

KPMG S.p.A.

(signed in original)

Bruno Mastrangelo
Director

(Translation from the Italian original which remains the definitive version)

Review Report of the Auditors on the Pro Forma Consolidated Balance Sheet as of 30th June, 2003 and Pro Forma Consolidated Income Statement for the six month period then ended

To the board of directors of
TERNA - Trasmissione Elettricità Rete Nazionale S.p.A.:

- 1 We have reviewed the pro forma consolidated balance sheet of TERNA - Trasmissione Elettricità Rete Nazionale S.p.A. (“Terna”) as of 30th June, 2003, and the pro-forma consolidated income statement and notes thereto for the six-month period then ended (herein collectively the “Pro-forma Consolidated Interim Financial Statements”).

These Pro-forma Consolidated Interim Financial Statements are derived from the historical data included in the interim financial statements of Terna as of 30th June, 2003 and for the six-month period then ended and from the pro-forma adjustments thereto which we have reviewed. We have reviewed the interim financial statements of Terna as of 30th June, 2003 and for the six-month period then ended.

The review consisted primarily of the collection of information relating to the financial data and the analysis of the accounting policies adopted through discussions with company management and analytical procedures applied to the interim financial statements data. The review excluded such audit procedures as tests of controls and verification or validation of assets and liabilities and is significantly less than an audit performed in accordance with generally accepted auditing standards. As a consequence, we did not express an opinion on the above interim financial statements.

The Pro-forma Consolidated Interim Financial Statements have been prepared on the basis of the assumptions disclosed in the notes thereto, in order to reflect on a retroactive basis the effects of the capital reduction resolution and the acquisition of the investments in Transmissora Sudeste Nordeste SA and Novatrans Energia SA.

- 2 The Pro-forma Consolidated Interim Financial Statements as of 30th June, 2003 and for the six-month period then ended have been prepared in order to be included in the Offering Circular relating to the issuing of Euro 1,400,000,000 Notes.

The Pro-forma Consolidated Interim Financial Statements have been drawn up with the aim of reflecting the effects, valued in accordance with accounting policies consistent with historical data and in compliance with relevant legislation, on Terna’s financial position of the capital reduction resolution approved by the sole shareholder of Terna in the meeting held on 28th January, 2004 and of the above mentioned acquisitions of investments as if they had occurred on 30th June, 2003, and, with respect only to results, at the beginning of 2003. However, had the above transactions actually occurred on such date, the actual results would not necessarily have been those presented therein.

The Pro-forma Consolidated Interim Financial Statements are the responsibility of Terna’s management. Our responsibility is to express an opinion on the assumptions made and approach adopted by management in preparing these Pro-forma Consolidated Interim Financial Statements as well as on the valuation criteria and accounting policies applied thereto.

- 3 We conducted our review in accordance with the auditing standards recommended by Consob in its Communication no. 1061609 dated 9th August, 2001, regulating the review of pro-forma figures. We have carried out all the procedures which we have deemed to be necessary for the purposes of our engagement.
- 4 Based on our review, nothing came to our attention that caused us to believe that the basic assumptions made by the management of Terna in preparing the Pro-forma Consolidated Interim Financial Statements as of 30th June, 2003 and for the six month period then ended in order to retroactively reflect the effects of the capital reduction resolution and the effects of the acquisitions of

investments are not reasonable, that the approach adopted has not been correctly applied for the disclosure purposes described above or that the valuation criteria and accounting policies applied in preparing the above Pro-forma Consolidated Interim Financial Statements are not correct.

Rome, 3rd October, 2004

KPMG S.p.A.

(signed in original)

Bruno Mastrangelo
Director of Audit

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