



NOTES TO THE FINANCIAL STATEMENTS

A) ACCOUNTING POLICIES AND MEASUREMENT CRITERIA

Following Legislative Decree no. 38 of 28 February 2005, exercising the power granted by EEC Regulation no. 1606/2002, from 2006, companies with shares traded on regulated markets in the members states of the European Union are required to prepare their separate financial statements in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board, including interpretations issued by the International Financial Reporting Interpretation Committee (IFRIS) and the Standing Interpretation Committee (SIC), and endorsed by the European Commission ("IFRS").

Accordingly, Terna SpA has adopted IFRS from 2006, with transition date at 1 January 2005. The last set of separate financial statements prepared in accordance with Italian GAAP are those as of and for the year ended 31 December 2005.

Comparative figures of the previous year have been restated in accordance with IFRS.

Terna SpA, which operates in the electrical energy transmission and dispatching sector, is a public limited company based in Via Arno, 64, Rome.

The Directors approved the publication of these separate financial statements as of and for the year ended 31 December 2006 on 21 March 2007.

International Financial Reporting Standards

The company's separate financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and the interpretations of the International Financial Reporting Interpretation Committee (IFRIC) and the Standing Interpretation Committee (SIC), endorsed by the European Commission ("IFRS") at year end, as well as with the measures issued in implementation of article 9 of Legislative Decree no. 38 of 28 February 2005.

In accordance with the provisions of IFRS 1, the paragraph on the "Transition to IFRS" provides IFRS reconciliation schedules at 1 January 2005 and 31 December 2005 to ensure the comparability with the first set of IFRS-compliant financial statements. The figures contained in the reconciliation schedules have not undergone any changes with respect to those included in the document "Transition to IFRS", which was published with the Terna Group's half year report at 30 June 2006.

Presentation criteria

The separate financial statements are comprised of the balance sheet, income statement, cash flow statement, statement of recognized income and expenses, statement of changes in equity and the notes thereto.

In the balance sheet, assets and liabilities are classified on a current/non-current basis, with specific mention of assets and liabilities held for sale. Current assets, which include cash and cash equivalents, are those held for realization, sale or consumption in the company's normal operating cycle. Current liabilities are those expected to be settled in the company's normal operating cycle or within one year from the balance sheet date.

The income statement is classified on the basis of the nature of costs, while the cash flow statement has been prepared using the indirect method.

The financial statements have been prepared in euros, while the figures in the notes are given in millions of euros, unless otherwise specified.

The financial statements have been prepared using the historic cost method, with the exception of captions that are recognized at fair value in accordance with IFRS, as indicated in the accounting policies for each caption.

Use of estimates

The preparation of the balance sheet and income statement in accordance with IFRS requires the use of estimates and assumptions that affect the carrying amounts of assets and liabilities and related disclosures, in addition to contingent assets and liabilities at the reporting date. The estimates and associated assumptions are based on previous experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions of accounting estimates are recognized in the year in which the estimate is revised if the revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years.

The critical areas for key estimates and assumptions used by management in applying IFRS endorsed by the European Commission that could have significant effects on the financial statements or that could give rise to risks that would entail significant adjustments to the carrying amounts of assets and liabilities in subsequent years are summarized below.

Employee benefits

The liability for employee benefits paid upon or following termination of employment in relation to defined benefit plans or other long-term benefits is recognized net of any plan assets and is measured on the basis of actuarial assumptions, estimating the amount of future benefits that employees have vested at the reporting date.

Provisions for contingencies and charges

Accruals to the provisions for contingencies and charges are recognized when, at the reporting date, there is a legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the effect is material, accruals are measured by discounting estimated future cash flows at a discount rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Recoverable amount of non-current assets

Property, plant and equipment and intangible assets are analyzed at least once a year to check for indications of impairment. If there is an indication that an asset may be impaired, its recoverable amount is estimated. Recoverable amount is the higher of an asset's fair value, net of costs to sell and its value in use, measured by discounting estimated future cash flows considering available information at the time of estimate and on the basis of subjective assessments of the performance of future variables, such as prices, costs, demand growth rates, production profiles - and discounted at a rate that reflects current market assessments of the time value of money with respect to the investment period and the risks specific to the asset.

Investments in subsidiaries and associates

Investments in subsidiaries are those over which Terna has the power to directly or indirectly govern financial and operating policies as to obtain benefits from their activities. Investments in associates are those over which Terna has significant influence.

In assessing whether or not the company has control or significant influence, potential voting rights that are presently exercisable or convertible are considered.

Investments in subsidiaries and associates are measured at cost, reduced to reflect impairment losses. If the reasons for the impairment losses no longer exist, the carrying amount of the investment reinstated within the limits of the impairment losses, and the reversal is taken to profits or losses.

In the event that an investee's losses attributable to the shareholders of the parent exceed that investments' carrying amount, the latter is written off and any excess is recognized in a specific provision, where the parent is required to meet the legal or construction obligations of the investee or, in any case, to cover its losses.

Translation of foreign currency captions

Terna SpA prepares its financial statements in euros. In these financial statements, all transactions in currencies other than the functional currency are recognized at the exchange rate ruling on the date of the transaction. Monetary assets and liabilities in currencies other than the functional currency are subsequently adjusted at the exchange rate ruling at year end. Any exchange rate differences are taken to profits or losses.

Non-monetary assets and liabilities in foreign currency stated at historic cost are converted at the exchange rate ruling when the transaction was initially recognized. Non-monetary assets and liabilities in foreign currency stated at fair value are converted at the exchange rate ruling when fair value was measured.

Business combinations

All business combinations, including acquisitions of minority interests in entities over which control is already held, are recognized using the purchase method, where purchase cost is equal to the fair value, at the date of exchange, of assets given and liabilities incurred or assumed, plus any costs directly attributable to the combination. This cost is allocated by recognizing the identifiable assets, liabilities and contingent liabilities of the acquired business at fair value. If the purchase cost exceeds the fair value of net assets acquired and attributable to the company, this excess amount is recognized as goodwill or, if negative, taken to profits or losses, after having verified once again that the current values of assets and liabilities acquired and the purchase price have been measured correctly.

Decreases in minority interests, following sale or dilution, in subsidiaries, without losing control, are accounted for accordingly. As a result, the portion of losses or gains realized on the disposal in excess of goodwill subsequently realized is taken to profits or losses.

Property, plant and equipment

Property, plant and equipment are recognized at historic cost, including directly costs attributable to putting the asset in the condition necessary for it to be capable of operating in the manner for which it was acquired. In the event of legal or constructive obligations, cost also includes the present value of the estimated cost of disposal or removal of the asset. The corresponding liability is recognized in the provisions for contingencies and charges. Borrowing costs related to loans taken out to acquire assets are taken to profits or losses in the year to which they refer. Expenses incurred after purchase are recognized as an increase in the carrying amount of the asset to which they relate if it is probable that the future benefits of that cost will flow to the company and if the cost can be reliably measured. All other costs are recognized in profits or losses when incurred.

Each element of an item of property, plant and equipment of material value, with respect to the total value of the item to which it belongs, is recognized and depreciated separately.

Certain assets that were revalued at 1 January 2005 (transition date) or previously are recognized at the revalued amount, which is considered deemed cost at the date of the revaluation.

Property, plant and equipment are shown net of accumulated depreciation and any impairment losses, which are measured as described below. Depreciation is calculated on a straight-line basis over the estimated useful life of the asset, which is reviewed annually, with revisions applied on a prospective basis.

The depreciation of assets under construction begins when the assets become available for use.

Liabilities associated with items of property, plant and equipment are taken to a specific provision as a balancing entry to the related asset. The amount is taken to profits or losses through the depreciation of the asset.

The main depreciation rates calculated on the basis of the related asset's useful life are as follows:

DEPRECIATION RATE

Civil and industrial buildings	2.50%
Transmission lines	2.50%
TRANSFORMATION STATIONS	
Electrical machinery	2.38%
Electrical devices and equipment	3.13%
Automated and control systems	6.70%
CENTRAL SYSTEMS FOR REMOTE CONDUCTION AND CONTROL	
Devices, electrical equipment and ancillary plants	5.00%
Electronic calculators	10.00%

Land, regardless of whether it is free of construction or related to civil and industrial buildings, is not depreciated, since it has an indefinite useful life.

The concession granted to the company, with effect from 1 November 2005, on a free basis by the Minister of Production Activities, to carry out electrical energy transmission and dispatching activities in Italy, runs for twenty-five years and is renewable for another twenty-five years. Under the provisions of articles 18 and 19 of the Decree issued by the Ministry of Production Activities on 20 April 2005, in the event of termination and revocation, or expiry of the concession, the Ministry has the right to purchase assets used directly for the transmission and dispatching activities included in the concession owned by the concession-holder, with the exclusion of plants (lines and stations) that make up the National Transmission Grid. If the Ministry decides to purchase the concession-holder's assets, it will pay the latter an amount, agreed upon by the parties, calculated on the basis of adequate parameters, averaging out the value of the assets with their profitability. Accordingly, the assets directly related to the transmission and dispatching activities, including plants (lines and stations) that make up the portion of the electrical energy transmission grid owned by Terna are classified as property, plant and equipment and are depreciated over their useful lives.

As specified further down, in November 2006, the International Financial Reporting Interpretation Committee ("IFRIC") issued IFRIC Interpretation 12 *Service Concession Arrangements*. The company is currently

evaluating the applicability and any effects that would arise from the adoption of this accounting policy.

Property, plant and equipment acquired under finance lease, through which the company has received substantially all the risks and rewards of ownership, are recognized as company assets at the lower of fair value and the present value of minimum lease payments due, including any amounts to be paid to purchase the asset at the end of the lease. The corresponding liability to the lessor is recognized under financial payables. Assets are depreciated using the criteria and rates described above.

Leases in which the lessor maintains substantially all the risks and rewards of ownership are classified as operating leases. Costs related to operating leases are taken systematically to profits or losses over the term of the lease.

Intangible assets

Intangible assets, which all have finite useful lives, are recognized at cost and shown net of accumulated amortization and any impairment losses, measured as described below.

Amortization is calculated on a straight-line basis over the estimated useful life of the related asset, which is reviewed annually. Any revisions are applied on a prospective basis.

Amortization begins when the asset becomes available for use.

The estimated useful lives of the main intangible assets are given in the specific notes to each caption.

Intangible assets are substantially comprised of the exclusive concession to carry out electrical energy transmission and dispatching activities and other intangible assets. In particular, the company acquired the concession for electrical energy transmission and dispatching activities in Italy on 1 November 2005 when it acquired the TSO business activity. As established in the Decree issued by the Ministry of Production Activities on 20 April 2005, this concession runs for twenty-five years from the date of effective transfer of the activities, functions, assets and legal arrangements of the concession from GSE SpA (formerly GRTN) to Terna SpA.

This intangible asset was initially recognized at cost, which reflected fair value.

Other intangible assets mainly relate to the following:

- the development and innovation of application software to manage the energy invoicing process;
- the development and innovation of application software to protect the electrical energy system;
- software applications related to the development of the power exchange, particularly relating to the registration of operators, consumption units and the development of foreign procedures.

These are amortized over their estimated residual useful lives, which are normally three years, given their rapid obsolescence.

Impairment losses

Property, plant and equipment and intangible assets with finite useful lives are tested at least once a year to check for indications of impairment. If there is an indication that an asset may be impaired, its recoverable amount is estimated.

The recoverable amount of goodwill and intangible assets with indefinite useful lives, where present, as well as intangible assets not yet available for use, is estimated annually.

Recoverable amount is the greater of fair value, net of selling costs, and value in use.

Value in use is measured considering the estimated future cash flows discounted at a pre-tax rate that reflects the time value of money for the investment period and risks specific to the asset. If the intangible asset does not generate cash inflows that are largely independent, the asset's recoverable amount is calculated as part of the cash-generating (CGU) unit to which it belongs.

An impairment loss is recognized in the income statement when the asset's carrying amount or the net invested capital of the CGU to which it belongs, is greater than its recoverable amount.

Impairment losses of CGUs are first taken as a reduction in the carrying amount of any allocated goodwill and then as a reduction in other assets of the CGU on a *pro rata* basis. Except for goodwill, impairment losses may be reversed if there is an indication that the impairment loss no longer exists or when there is a change in the methods used to measure recoverable amount.

Inventories

Inventories are stated at the lower of purchase cost and net realizable value. Cost is calculated as the weighted average cost, including related charges.

Contract work in progress

When the profits or losses of a contract can be reliably estimated, the related contract costs and revenues are recognized separately in profits or losses on a percentage of completion basis. Progress is measured based on the work carried out. Differences between the value of completed contracts and payments on account received are recognized under balance sheet assets or liabilities, considering any impairment losses on the work carried out so as to take into account the risks of customers' refusal to recognize the work performed. Expected contract losses are immediately taken to profits or losses under contract costs.

Contract costs include all those costs that relate directly to the specific contract, as well as fixed and variable costs incurred as part of normal operations.

Financial instruments

Financial assets

Financial assets that the company has the positive intention and ability to hold to maturity are recognized at the settlement date at fair value, including transaction costs. They are subsequently measured at amortized cost, using the effective interest method, net of any impairment losses, which are determined as the lower of the asset's carrying amount and the present value of estimated future cash flows, discounted using the original interest rate. The amount of impairment losses is taken to profits or losses of the year. Financial assets are derecognized when, following their transfer or settlement, the company is no longer involved in their management and no longer holds the risks and rewards of the transferred or settled instruments.

Trade receivables

Trade receivables are initially recognized at fair value and subsequently measured at amortized cost, using the effective interest method, and net of any impairment losses due to sums considered non-recoverable, which are taken to the specific provision for bad debts. Impairment losses are calculated on the basis of the present value of estimated future cash flows, discounted using the initial effective interest rate.

Receivables with due dates that fall under normal commercial terms are not discounted.

Cash and cash equivalents

Cash and cash equivalents are stated at nominal value. They include cash on hand, i.e., amounts that are available on demand or with a very short maturity, subject to an insignificant risk and without redemption expenses.

Trade payables

Trade payables are stated at amortized cost. If their due date falls under normal commercial terms, they are not discounted.

Financial liabilities

Financial liabilities other than derivatives are stated at fair value at the settlement date, net of directly related transaction costs.

Subsequently, financial liabilities are measured at amortized cost, using the original effective interest method. If the liabilities are subject to fair value hedges, they are adjusted to reflect changes in fair value with respect to the hedged risk.

Derivative financial instruments

Derivatives are recognized at fair value at the trade date and classified as hedges if the relationship between the derivative and the hedged item is formally documented and the hedge is highly effective and ranging from 80% to 125%, as initially verified and periodically checked. When derivatives cover the risk of fluctuations in the cash flows of the hedged instruments (cash flow hedges), the effective portion of changes in the fair value is initially taken to equity and subsequently to profits or losses, in line with the effects of the hedged transaction.

The ineffective portion of fair value is taken to profits or losses.

When hedging derivatives cover the risk of fluctuations in the fair value of hedged instruments (fair value hedges), they are recognized at fair value through profits or losses. Accordingly, the hedged items are adjusted to reflect changes in the fair value associated with the hedged risk.

Fair value is measured with reference to official quotations for instruments traded in regulated markets. The fair value of instruments not traded in regulated markets is measured by discounting projected cash flows along a yield curve of interest rates at the reporting date, and by converting amounts in currency other than the Euro at the year-end exchange rate.

Employee benefits

The liability related to employee benefits payable upon or after termination of employment relates to defined benefit plans (termination benefits, additional month's pay⁽¹³⁾, indemnity for lack of notice⁽¹⁴⁾, energy discount, ASEM health benefits and other benefits) or other long-term employee benefits (loyalty bonus) is recognized net of any plan assets. It is measured separately for each plan on the basis of actuarial calculations that estimate the amount of future benefits employees have accrued at the reporting date. The liability is recognized on an accruals basis over the vesting period. It is measured by independent actuaries. Actuarial gains and losses at 1 January 2005 (date of transition to IFRS) were recognized in equity. If, after that date, unrecognized actuarial gains and losses arise in excess of 10% of the greater of the present value of the defined benefit plan obligation and the fair value of plan assets, that portion is taken to profits or losses for the average expected term of service of employees participating in the plan. Otherwise, actuarial gains and losses are not recognized.

At the reporting date, the effects of new regulations concerning termination benefits were not considered, as uncertainty remains as to whether the company has an obligation to employees who will opt to have their termination benefits managed by INPS. These employees could make up the entire workforce, if there is no participation in the management plans.

⁽¹³⁾ "IMA"

⁽¹⁴⁾ "ISP"

Share-based payments

The cost of employee service remunerated through stock option plans is measured at the fair value of the options granted to employees at the grant date. The fair value of options granted is recognized under personnel expenses over the vesting period, with a corresponding increase in equity, considering the best possible estimate of the number of options that employees will be able to exercise.

The measurement method used to calculate fair value considers all the characteristics of the options (duration, price and conditions, etc.), as well as the value of the Terna share at the grant date, the volatility of the share and the interest rate curve at the grant date, in line with the duration of the plan. The Cox-Rubinstein pricing method is used. The amount recognized as cost is adjusted to reflect the actual number of vesting options, unless the failure to meet the conditions to obtain the right is based solely on the market.

Provisions for contingencies and charges

Accruals to the provisions for contingencies and charges are recognized when, at the reporting date, the company has a legal or constructive obligation as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the effect of the time value of money is material, accruals are measured by discounting estimated future cash flows using a pre-tax discount rate that reflects current market assessments of the time value of money and those risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an interest expenses. Changes in estimates are taken to profits or losses in the year to which they relate.

Grants

Grants from public and private entities are recognized at fair value when it is reasonably certain that they will be received and that the conditions provided for obtaining the grants will be satisfied.

Grants received for specific expenditure are recognized under other liabilities and taken to the income statement on a systematic basis over the period in which the related costs accrue.

Grants received in relation to specific assets whose value is recognized under non-current assets are, for plants operating before 31 December 2002, recognized under other liabilities and taken to the income statement over the depreciation period of the related assets. From 2003, grants for new plants going into use are taken as a direct reduction in the value of the related asset.

Grants for operating expenses are expenses in full when the conditions for recognition are satisfied.

Revenues

Depending on the type of transaction, revenues are recognized on the basis of the following specific criteria:

- revenues from the sale of goods are recognized when the significant risks and rewards of ownership of the goods have been transferred to the buyer;
- revenues from the rendering of services are recognized with reference to the stage of completion of the transaction. If revenues cannot be reliably measured, they are recognized to the extent of recoverable costs.

In particular, revenues from fees to use the National Transmission Grid are measured based on the tariffs established by the Electricity and Gas Regulator.

Considerations collected on behalf of third parties, such as the consideration paid to other non-Terna grid owners, as well as revenues recognized for managing activities related to the balancing of the national electrical energy system, which do not increase equity, are shown net of the related costs.

Financial income and expenses

Financial income and expenses are recognized on an accruals basis in line with the interest amount of related financial assets and liabilities, using the effective interest method.

Dividends

Dividends are recognized when the shareholders' right to receive payment is established.

Dividends and interim dividends payable to third parties are shown as changes in equity at the date in which they are approved by the shareholders and the Board of Directors, respectively.

Basic earnings per share

Basic earnings per share are calculated by dividing the profits for the year attributable to holders of ordinary shares by the weighted average of outstanding ordinary shares during the year.

Diluted earnings per share are calculated by dividing the profits for the year attributable to holders of ordinary shares by the weighted average of outstanding shares, adjusted to consider the effects all potential ordinary shares, which have a diluting effect.

Income taxes

Current income taxes are recognized as tax liabilities, net of advances paid, or tax assets where the net balance of the captions is positive. They are based on the estimated taxable income and in accordance with current legislation.

Deferred tax assets and liabilities are calculated on the temporary differences between the carrying amounts of assets and liabilities recognized in the consolidated financial statements and the corresponding amounts recognized for tax purposes, in application of current tax rates, or rates expected to be in effect when the temporary differences reverse, based on current rates or those that are substantially approved at the reporting date.

Deferred tax assets are recognized when their recovery is considered probable, i.e., when future taxable profits will be available against which the asset can be used. The recoverability of deferred tax assets is reviewed at each year end.

Deferred tax liabilities are recognized in any case if they exist.

New reporting standards

In 2006, no new standards or interpretations were approved and no amendments were made to the standards and interpretations in effect as from 1 January 2006, with a significant impact on the consolidated financial statements.

Regulations nos. 108/2006, 708/2006 and 1329/2006 issued by the European Commission modified certain standards and interpretations already in place, exclusively with respect to disclosure requirements. The following standards and interpretations were approved, and could become applicable to the company's financial statements in the future.

IFRS 7 - Financial instruments: additional disclosures

IFRS 7 requires additional disclosures on the relevance of financial instruments with respect to the company's performance and financial position. These disclosures incorporate certain requirements that were previously included in IAS 32 - Financial Instruments: Disclosure and Presentation. The new standard also requires information on the level of risk exposure arising from the use of financial instruments and a description of the objectives, policies and procedures implemented by management to manage such risks. IFRS 7 takes effect from years beginning on 1 January 2007 or subsequently.

IFRS 8 - Operating Segments

IFRS 8 establishes how a company should report on operating segments in the annual financial statements and, as an amendment to IAS 14 - Segment Reporting, requires the same information also in interim reports. In addition, it defines disclosure requirements with respect to products and services, the geographical areas in which the company operates and its key customers. The new standard is the result of the comparison of IAS 14 and SFAS 131 - Disclosures about Segments of an Enterprise and Related Information, as part of the IFRS and US GAAP convergence project, to reduce the discrepancies between the two.

IFRS 8 supersedes IAS 14 and is applicable to financial statements for years beginning on 1 January 2009. However, early application is allowed.

IFRIC 8 - Scope of IFRS 2

This interpretation clarifies when IFRS 2 must be applied to transactions in which the company cannot specifically identify a portion or all of the goods or services received. IFRIC 8 takes effect from years beginning on 1 May 2006 or subsequently.

IFRIC 9 - Revaluation of embedded derivatives

This interpretation requires a specific assessment so that embedded derivatives are separated from the host contract and recognized as derivatives when they become part of the contract. IFRIC 9 takes effect from years beginning on 1 June 2006 or subsequently.

Moreover, in 2006, the relevant international bodies issued the following amendments to existing standards and new interpretations, which have not yet been endorsed by the European Commission.

IFRIC 10- Interim financial reporting and impairment

This interpretation clarifies that in the preparation of annual financial statements, companies are not permitted to reverse any impairment losses recognized in previous interim financial statements in relation to the impairment of goodwill, financial investments carried at cost or investments or financial assets carried at cost.

This interpretation is applicable to financial statements for years beginning on 1 November 2006. However, early application is allowed.

IFRIC 11 - IFRS 2 Group and treasury share transactions

This interpretation clarifies the recognition methods for share-based payments (e.g., stock option plans to employees) between Group companies.

This interpretation is applicable to financial statements for years beginning on 1 March 2007. However, early application is allowed.

IFRIC 12 - Service Concession Arrangements

IFRIC 12 substantially confirms the recognition methods provided for by the previous three draft interpretations (D12, D13 and D14) concerning assets (freely transferable assets), liabilities (reclamation provisions), revenues and costs in connection with service concession arrangements between a public body and a private company. It excludes concessions between private companies.

This interpretation is applicable to financial statements for years beginning on 1 January 2008. However, early application is allowed. The company is evaluating the impact that all of the amendments and new standards and interpretations could have on the financial statements, considering the date they take effect. As described below, certain balances of the financial statements at 31 December 2005 have been reclassified, for the purpose of a more correct presentation. However, equity figures as of 31 December 2005 and income statement figures for 2005 have not been modified.

Risk Management

Interest rate risk

In carrying out its operations, Terna is exposed to the risk of fluctuations in interest rates. Its main source of interest rate risk relates to items of net financial indebtedness that generate interest expenses. Terna's strategy for financial indebtedness is to focus on long-term loans, which reflect the useful life of company assets. It pursues an interest rate risk hedging policy that aims to combine this choice with the regulatory context, which every four years establishes the cost of debt as part of the formula to set Regulatory Asset Based (RAB) remuneration.

Accordingly, the hedging instruments used, at various maturity dates, include both derivatives that transform fixed rates into variable rates (fair value hedges) and derivatives that transform variable rates into fixed rates (cash flow hedges and trading).

With the aim of reducing the amount of financial indebtedness exposed to the risks of fluctuations in interest rates and reducing the cost of funding, two types of plain vanilla derivatives have been used, i.e. interest rate swaps and interest rate collars. At year end, considering the transactions in derivatives, 66.1% of Terna SpA's gross indebtedness bears interest at fixed rates, while net indebtedness bearing interests at fixed rates amounts to 67.2%.

All derivative contracts have a notional amount and maturity date less than or equal to that of the underlying financial liability, so that any change in the fair value and/or projected cash flows of the contracts is offset by a corresponding change in the fair value and/or projected cash flows of the underlying position.

In terms of liquidity risk, considering that there is normally a negative difference between interest received on loans granted and interest paid on loans received, financial optimization activities are geared towards minimizing liquidity positions in line with the company's needs.

The following table provides the notional amount and fair value of derivatives, net of accruals, at 31 December 2006. The fair value of derivatives is measured by discounting estimated cash flows at market interest rates at the reporting date.

In millions of euros	NOTIONAL AMOUNT		FAIR VALUE	
	2006	2005	2006	2005
Derivatives hedging the fixed rate bond	1,400.0	1,280.0	11.3	106.1
Derivatives hedging variable rate loans	186.3	269.0	-6.2	-17.8
Other hedging derivatives	1,150.0	850.0	0.7	-11.2
TOTAL	2,736.3	2,399.0	5.8	77.1

The fair value of the two bonds (euros 600 million maturing in 2014 and euros 800 million maturing in 2024), was also measured by discounting estimated cash flows at market interest rates at the reporting dates, for a total of euros 1,406.6 million, net of accruals.

The notes to the balance sheet provide the notional amount and fair value of derivatives in place at year end, grouped by current and non-current financial assets and liabilities.

Sensitivity to interest rate risk

If the Eurozone interest rate curve were to rise or drop 50 bps at 31 December 2006, the average cost of Terna SpA debt would fluctuate by approximately 35 bps, for a total of roughly euros 7 million.

Credit risk

Terna provides its services exclusively to counterparties considered solvent by the market, i.e., they have high credit ratings. Moreover, the company does not have concentrations of credit risk.

Credit risk arising from open positions in derivative financial instruments is considered marginal, since the counterparties are leading Italian and international banks with high ratings and the management of these transactions is fractioned off, in compliance with specific concentration limits.

Exchange rate risk

The company carries out transactions with counterparties residing in non-EU countries. It has marginal exposure to the risk of fluctuations in the US\$/R\$ exchange rate. The company evaluates the individual transactions and sets up hedges where necessary and in compliance with financial risk management policies.

B) SEGMENT REPORTING

The segments were identified and Terna's primary and secondary segments were determined considering the organizational structure and internal reporting system. In particular, since the risks and rewards of the company's investments are exclusively affected by differences in the services provided, the primary reporting segment is based on the activities performed (transmission/dispatching/metering), while the activities are not reported geographically, since they are performed mainly in Italy. Specific allocation parameters have been established for income and expenses and assets and liabilities not specifically attributable to individual sectors (in particular, financial assets and liabilities, tax assets and liabilities and deferred tax assets and liabilities). They are indicated separately.

In addition, intersegment transfers are measured at current market conditions.

Reporting by business segment is provided below for 2005 and 2006:

2005

In millions of euros	REGULATED ACTIVITIES - ITALY			Unregulated activities	Total
	Transmission	Dispatching	Metering		
Revenues	830.2	17.7	1.5	60.9	910.3
Segment revenues	458.5	-2.3	1.5	27.1	484.8
Unallocated expenses					54.3
Operating profits					430.5
Financial income/(expenses)					-10.7
Income taxes					154.2
Profits for the year					265.6
OTHER INFORMATION					
Segment assets	4,285.4	1,090.4	2.2	314.1	5,692.1
Segment liabilities	2,802.2	837.9	-	254.1	3,894.2
Investments	257.8	3.2	-	-	261.0
Amortization, depreciation and impairment losses	150.9	6.2	-	-	157.1
Other non-monetary expenses	0.9	-	-	-	0.9

2006

In millions of euros	REGULATED ACTIVITIES - ITALY				Total
	Transmission	Dispatching	Metering	Unregulated activities	
Revenues	943.2	105.0	9.3	52.7	1,110.2
Segment revenues	631.4	1.4	8.0	20.3	661.1
Unallocated expenses					110.3
Operating profits					550.8
Financial income/(expenses)					16.1
Income taxes					211.1
Profits for the year					355.8
OTHER INFORMATION					
Segment assets	4,656.7	1,345.0	10.4	260.2	6,272.3
Segment liabilities	2,770.3	1,309.4	2.0	288.9	4,370.6
Investments	324.2	20.7	0.1	-	345.0
Amortization, depreciation and impairment losses	167.7	34.1	0.4	-	202.2
Other non-monetary expenses	0.2	-	-	-	0.2

C) NOTES TO THE INCOME STATEMENT

Revenues

1) REVENUES FROM GOODS AND SERVICES - euros 1,083.5 million

The table below details revenues of the year:

In millions of euros	2006	2005	Change
Grid transmission consideration	947.0	786.8	160.2
Adjustments for prior year grid transmission consideration	47.3	34.8	12.5
Other energy revenues	41.9	6.9	35.0
Other revenues from goods and services	47.3	59.3	-12.0
TOTAL	1,083.5	887.8	195.7

Grid transmission consideration

This is revenues from the company's core business. It is the consideration paid to the company for use of the National Transmission Grid, and also includes the additional portion of the grid transmission consideration (AEEG Resolution no. 15/2005) paid to Terna with the integration of the TSO business activity (euros 71.0 million).

The euros 160.2 million increase on 2005 is mainly due to the following two factors:

- increased revenues relating to the remuneration of the national electricity grid (up euros 101.3 million), in Italy, especially following the new tariffs, which took effect in 2006, as well as to the higher volumes of transmitted energy (up 2.2%); during 2005 the AEEG adjusted tariffs (as detailed in the paragraph below), therefore also affecting 2006 tariffs;
- the grid transmission consideration arising from the merger of the TSO business activity (euros 58.9 million) from GSE SpA, recognized for only two months in 2005, since the acquisition took effect on 1 November 2005.

Adjustments for prior year grid transmission consideration

These relate to revenues earned by the company (euros 47.3 million) in accordance with AEEG Resolution no. 162/06 of 27 July 2006, which established the offsetting of the tariff deficit for transmission services provided in 2005 with payment to all owners of portions of the National Transmission Grid.

In 2005, this caption included adjustments from GSE SpA for the grid transmission consideration of previous years (euros 19.8 million) and revenues from the release of the provision for contingencies which had been accrued for doubtful grid transmission considerations (Cip 6 - autoproducers litigation - euros 15.0 million). At 31 December 2005, these amounts totalled euros 34.8 million and were stated under "Other revenues and income".

Other energy revenues

This caption relates to the consideration due to the company by operators for metering activities (MIS component - euros 9.3 million) and to the consideration for the acquisition of resources necessary for dispatching requirements (DIS component - euros 32.3 million). In 2005, these items related to only the last two months of the year, that is from the acquisition date of the business activity from GSE (1 November 2005). The caption also includes the consideration as per AEEG Resolution no. 34/05 (euros 0.3 million) to cover the administrative and management costs incurred to withdraw energy from renewable sources producers with a power not exceeding 10 MVA and similar connected to the National Transmission Grid.

Other energy items - energy in transit revenues/costs

This caption includes the cost and revenues of energy in transit (the balance is nil) arising from daily purchases and sales with operators on the electricity market to carry out transmission and dispatching activities. The components of these transactions are detailed below. Those related to 2005 refer only to the

last two months of the year:

In millions of euros	2006	2005	Change
REVENUES - POWER EXCHANGE			
procurement of resources on the ancillary services market	1,502.4	217.3	1,285.1
unbalancing and others	1,313.1	270.5	1,042.6
sale of energy on the day-ahead market, adjustment market, ancillary services market and others	885.1	106.2	778.9
foreign market - exports	2.9	0.3	2.6
other items - Power exchange	3.5	0.4	3.1
Total revenues - Power Exchange	3,707.0	594.7	3,112.3
REVENUES FROM OUTSIDE THE POWER EXCHANGE			
revenues under Laws no. 168/04 - 237/04 and others	820.0	117.5	702.5
revenue from grid transport considerations of other owners and portion of GRTN CIP/6	113.0	16.9	96.1
other items (returns, CBT)	389.5	11.7	377.8
Total revenues from outside the Power Exchange	1,322.5	146.1	1,176.4
TOTAL REVENUES FROM ENERGY IN TRANSIT	5,029.5	740.8	4,288.7
COSTS - POWER EXCHANGE			
to provide the dispatching service	2,800.6	450.2	2,350.4
for unbalancing	478.5	39.0	439.5
on the day-ahead and adjustment markets	323.3	64.0	259.3
on the foreign market - imports	91.7	39.7	52.0
Electricity market operator fees	8.0	1.4	6.6
other items	4.9	0.4	4.5
Total costs - Power Exchange	3,707.0	594.7	3,112.3
COSTS FROM OUTSIDE THE POWER EXCHANGE			
costs under Laws no. 168/04 - 237/04 and others	820.0	117.5	702.5
fees to be paid to National Transmission Grid owners, GRTN and others	113.0	16.9	96.1
other items (returns, CBT)	389.5	11.7	377.8
Total costs from outside the Power Exchange	1,322.5	146.1	1,176.4
TOTAL EXPENSES FOR ENERGY IN TRANSIT	5,029.5	740.8	4,288.7

Other revenues from goods and services

Other revenues from goods and services amounted to euros 47.3 million (2005: euros 59.3 million) and mainly relate to revenues from a variety of specialized high and extra high voltage services, which the company provides to third party customers:

- revenues from Enel Distribuzione SpA (euros 16.1 million) arising from the maintenance agreement for the high-voltage lines owned by that company (down euros 4.4 million on 2005);
- revenues from the Wind Group (Enel.net/Wind: euros 7.1 million) for the operating, maintenance and

development of the optical fibre owned by Wind Group on Terna SpA plants (safety cables);

- a variety of specialized services in the maintenance of high-voltage plants owned by third parties for several customers (euros 20.7 million);
- requests to connect to the National Transmission Grid as per AEEG Resolution no. 281/05 (euros 1.4 million);
- revenues from RTL Group subsidiaries (euros 2.0 million) for:
 - management fee services (euros 0.6 million) and high-voltage plant operating and maintenance services (euros 1.0 million) provided to RTL SpA;
 - high-voltage line operating and maintenance services (euros 0.4 million) provided to RTM1 SpA.

2) OTHER REVENUES - euros 26.7 million

Other revenues and income

Other revenues is detailed as follows:

In millions of euros	2006	2005	Change
Third party contributions for highvoltage connections	12.1	10.2	1.9
Other revenues	9.7	7.0	2.7
Gains on the sale of plant parts	1.7	0.8	0.9
Prior year income	3.2	4.5	-1.3
TOTAL	26.7	22.5	4.2

This caption includes, in particular, portions of third party contributions for connections to the National Transmission Grid pertaining to the year (euros 12.1 million), rental income (euros 6.8 million, including invoices of the year, relating to second half of the year only, issued to the Wind Group in connection with the housing of optical fibre on the company's grids - euros 4.7 million), other sales (euros 1.0 million), insurance compensation for damage to plants (euros 0.5 million), prior year income (euros 3.2 million) and gains on the sale of plant parts to third parties (euros 1.7 million). The prior year income for adjustments from GSE SpA on the grid transmission consideration of previous years (euros 19.8 million) and the release of the provision for contingencies already accrued for the grid transmission consideration (euros 15.0 million) recognized in 2005, were reclassified to "Revenues from goods and services".

Operating Expenses

3) RAW MATERIALS AND CONSUMABLES - euros 18.1 million

In millions of euros	2006	2005	Change
Inventory procurement	10.7	10.7	-
Supply of materials and equipment	5.3	8.4	-3.1
Other supplies	2.7	1.9	0.8
Change in inventories	-0.6	2.9	-3.5
TOTAL	18.1	23.9	-5.8

This caption includes costs incurred to purchase materials and sundry equipment used in ordinary operations and plant maintenance. It also includes the change in inventories during the year.

4) SERVICES - euros 123.7 million

In millions of euros	2006	2005	Change
Tenders on plants	22.3	20.1	2.2
Sundry services	48.3	34.3	14.0
Insurance	3.9	4.7	-0.8
Remote transmission and telephone	18.2	21.4	-3.2
IT services	12.9	13.5	-0.6
Use of third party assets	18.1	12.7	5.4
TOTAL	123.7	106.7	17.0

This caption increased by euros 17.0 million on 2005 mainly because the company was fully operative as TSO integrated operator for the entire year. These costs related to the last two months of 2005 only.

This caption mainly includes the costs of maintenance and repairs in relation to tenders and services for ordinary maintenance activities, as well as maintaining the efficiency of plants (euros 22.3 million). It also relates to remote transmission and telephone services (euros 18.2 million), IT services (euros 12.9 million), leases, rentals (euros 18.1 million) and general services. It includes the fees paid to the members of the Board of Statutory Auditors for the year (euros 0.2 million).

The following table summarizes fees paid to Terna SpA Directors and Statutory Auditors. It shows their term of office and has been prepared on an accruals basis.

Surname and Name	Position	Term of office	Expiry	Fees	Bonuses and other incentives **	Total
Roth Luigi	Chairman/Director	Jan-06/Dec-06	Approval of the 2007 financial statements	254,999.98		254,999.98
Cattaneo Flavio	CEO	Jan-06/Dec-06	Approval of the 2007 financial statements	233,333.34	16,666.67	250,000.01
De Paoli Luigi	Director	Jan-06/Dec-06	Approval of the 2007 financial statements	55,000.00		55,000.00
Garaffo Mario	Director	Jan-06/Dec-06	Approval of the 2007 financial statements	95,000.00		95,000.00
Machi Salvatore	Director	Jan-06/Dec-06	Approval of the 2007 financial statements	55,000.00		55,000.00
Macri Carmine	Director	Jan-06/Dec-06	Approval of the 2007 financial statements	55,000.00		55,000.00
Maranesi Piero Giuseppe	Director	Jan-06/Dec-06	Approval of the 2007 financial statements	55,000.00		55,000.00
Rispoli Vittorio	Director	July-06/Dec-06	Approval of the 2007 financial statements	16,250.00		16,250.00
Smurro Franco	Director	Jan-06/Dec-06	Approval of the 2007 financial statements	55,000.00		55,000.00
Romano * Massimo	Director	Jan-06/Dec-06	Approval of the 2007 financial statements	55,000.00		55,000.00
Ponzellini Massimo	Director	Jan-06/July-06	Approval of the 2007 financial statements	32,500.00		32,500.00
Total fees - Directors				962,083.32	16,666.67	978,749.99
Ferreri Giovanni	Chairman of the Board of Statutory Auditors	Jan-06/Dec-06	Approval of the 2007 financial statements	55,000.00		55,000.00
Corvace Giancarlo	Standing auditor	Jan-06/Dec-06	Approval of the 2007 financial statements	45,000.00		45,000.00
Tasca Roberto	Standing auditor	Jan-06/Dec-06	Approval of the 2007 financial statements	45,000.00		45,000.00
Total fees - statutory auditors				145,000.00		145,000.00
TOTAL				1,107,083.32	16,666.67	1,123,749.99

* With respect to the positions held, fees totalling euros 55,000.00 were transferred to Enel SpA.

** This amount relates to the variable portion of the fee for 2005, approved and disbursed in 2006.

5) PERSONNEL EXPENSES - euros 237.0 million

In millions of euros	2006	2005	Change
SHORT-TERM EMPLOYEE BENEFITS			
wages and salaries	155.8	126.9	28.9
social security contributions	48.5	32.1	16.4
other	3.3	2.6	0.7
directors	1.1	1.1	-
POST-EMPLOYMENT BENEFITS			
Defined benefit plans			
electricity discount	2.5	8.8	-6.3
asem-acem	0.6	1.7	-1.1
Defined contribution plans			
fopen	1.3	1.1	0.2
fondenel	0.4	0.2	0.2
EMPLOYEES' TERMINATION BENEFITS			
leaving incentives	13.1	15.2	-2.1
Employees' stock option plans	0.8	0.2	0.6
Termination benefits	9.6	8.7	0.9
TOTAL	237.0	198.6	38.4

This caption includes the cost of wages and salaries, social security contributions and other costs incurred by the company for leaving incentives, as well as benefits paid to employees who stay with the company and termination benefits provided for by the current national labour contract for the electrical energy sector. Personnel expenses increased by euros 38.4 million, mainly due to the costs following the acquisition of the TSO business activity and the addition of its personnel (wages, salaries, social security contributions and termination benefits up euros 39 million on 2005). The main changes were as follows:

- additional social security contributions borne by the company for CIG and CIGS (euros 9.8 million);
- lower termination benefits (down euros 7.7 million) mainly related to the electricity discount which decreased, *inter alia*, following the reorganization of the criteria for eligible parties;
- financial effects (euros 2.4 million) of the renewal of employees' labour contract which was signed in July 2006.

The following table shows the number of employees by category at year end and the average number for the year:

	Average number 2006	Average number 2005	Number at 31.12.2006	Number at 31.12.2005
Managers	72	43	71	74
Junior managers	419	248	431	403
White collars	1,810	1,532	1,816	1,813
Blue collars	1,069	1,143	1,049	1,098
TOTAL	3,370	2,966	3,367	3,388

The net change with respect to 31 December 2005 is a decrease of 21 employees.

Reference should be made to paragraph "22) Termination benefits and other employee-related provisions" for the reconciliation of the opening and closing present value of the liability for employee benefits and the main assumptions used in the actuarial estimate.

6) AMORTIZATION, DEPRECIATION AND IMPAIRMENT LOSSES - euros 202.2 million

These relate to accruals during the year calculated on the basis of amortization and depreciation rates that reflect the useful lives of the company's plant, property and equipment and intangible assets. This caption increased by euros 45.1 million on 2005, mainly following the acquisition of the TSO business activity (euros 13.3 million) and the new plants that began operating during the year (euros 6.0 million), as well as the redetermination of the residual useful lives of certain plants (euros 6.9 million).

The caption also includes accruals to the provision for bad debts of euros 12.1 million, relating to receivables due to the company for energy items which are reasonably unlikely to be collected.

7) OTHER OPERATING EXPENSES - euros 15.0 million

In millions of euros	2006	2005	Change
Local taxes and duties	4.5	10.5	-6.07
Prior year expenses	2.4	3.5	-1.1
Losses on the sale/disposal of plants	2.8	3.2	-0.4
Other operating expenses	5.3	2.7	2.6
TOTAL	15.0	19.9	-4.9

This caption mainly includes indirect local taxes, as well as losses on the disposal of plants and other residual operating expenses. The euros 4.9 million decrease on 2005 is mainly due to:

- the registration tax for the acquisition of the TSO business activity paid in 2005 (down euros 2.8 million);
- taxes on interest on equity paid abroad in 2005 which are not deductible in Italy (down euros 3.7 million);
- contractual penalties for services and use of third party assets paid by the company (up euros 2.1 million).

8) CAPITALIZED INTERNAL WORK - euros -36.6 million

Capitalized expenses relate to personnel expenses (euros 27.5 million) and the consumption of materials and equipment in inventories (euros 9.1 million) for plants under construction. The euros 10.1 million increase is fully attributable to personnel expenses.

Financial income and expenses

9) NET FINANCIAL INCOME/(EXPENSES) - euros 16.1 million

This caption is detailed as follows:

In millions of euros	2006	2005	Change
FINANCIAL INCOME			
Interest income on former intercompany current account with Enel SpA	-	3.3	-3.3
Financial income from subsidiaries	40.1	39.3	0.8
Income on trading derivatives	8.8	-	8.8
Value changes of the hedged bond	-	3.7	-3.7
Other financial income	43.4	1.9	41.5
Exchange rate gains	-	4.4	-4.4
Total income	92.3	52.6	39.7
FINANCIAL EXPENSES			
Interest expenses on medium/long-term loans	-64.6	-55.3	-9.3
Financial expenses from subsidiaries	-0.8	-	-0.8
Expenses on trading derivatives	-	-2.0	2.0
Value changes of the hedged bond	-2.6	-	-2.6
Discounting of termination benefits and other employee-related provisions	-6.6	-5.9	-0.7
Other financial expenses	-	-0.1	0.1
Exchange rate losses	-1.6	-	-1.6
Total expenses	-76.2	-63.3	-12.9
TOTAL INCOME/(EXPENSES), NET	16.1	-10.7	26.8

Net financial income of the year amounts to euros 16.1 million, up euros 26.8 million on 2005. The change is due to the combined effect of a variety of factors. In particular:

- an increase in other financial income (euros 41.5 million) mainly related to the gain on the sale of 17.4% of Terna Participações shares. The sale was carried out by launching an IPO on the São Paulo Stock Exchange in Brazil (euros 38.4 million);
- the net positive effects of the fair value adjustment of the bond and related hedges, as well as additional derivative instruments in the company's portfolio (up euros 4.5 million);
- an increase in financial expenses due to medium/long-term indebtedness (up euros 9.3 million) mainly following the rise in interest rates with repercussions on the bond and the related hedges (up euros 11.0 million) and the EIB loans bearing interests at variable rates and the related hedges (down euros 1.6 million);
- exchange rate losses recognized in 2006 (euros 1.6 million), compared to the exchange rate gains recognized in 2005 (euros 4.4 million) due to the appreciation of the Brazilian real against the euro;

- higher financial expenses due to the discounting of employee benefits (euros 0.7 million);
- lower financial income (down euros 3.3 million) in relation to the intercompany current account, which was still open in 2005 with Enel SpA and closed on 15 September 2005.

10) INCOME TAXES - euros 211.1 million

Income taxes of the year amount to euros 211.1 million, with an impact on profits before taxes of 37.80% (net of tax adjustments relating to previous years). This figure is in line with the 37.57% of 2005, when income taxes amounted to euros 154.2 million.

Income taxes of the year are detailed as follows:

In millions of euros	2006	2005	Change
INCOME TAXES			
Current taxes:			
- IRES	194.7	136.6	58.1
- IRAP	39.6	28.6	11.0
Total current taxes	234.3	165.2	69.1
Temporary differences:			
- deferred tax income	-13.7	-9.5	-4.2
- deferred tax expenses	9.2	30.7	-21.5
Reversal of temporary differences:			
- deferred tax income	2.6	10.6	-8.0
- deferred tax expenses	-18.1	-37.2	19.1
Total deferred tax income	-20.0	-5.4	-14.6
Adjustments to income taxes of previous years	-3.2	-5.6	2.4
TOTAL	211.1	154.2	56.9

Current taxes

The increase in current taxes (up euros 69.1 million), mainly due to the significant growth in the profits for the year, was also a result of the following factors:

- recognition of the tax gain (IRES - article 110 of the Consolidated Income Tax Act) arising from the contribution of investments in the Brazilian operating companies TSN and Novatrans to the Brazilian subsidiary Terna Participações (euros 7.8 million). The transaction was completed in June 2006;
- recognition of the gain arising from the IPO of Terna Participações on Brazil's São Paulo stock exchange, corresponding to the portion in excess of the tax amount already released upon contribution of the shares (euro 1.3 million);
- increased non-deductible depreciation (euros 2.4 million);
- non-deductible accruals to the provisions for contingencies and the provision for bad debts (up euros 13.0 million);
- application of Decree Law no. 262/06, with effect from the year, which establishes the total non deductibility of all costs related to company cars (up approximately euros 1.1 million);
- taxes of euros 3.1 million on the fair value of derivative financial instruments not for hedging purposes and relevant for tax purposes (article 112 of the Consolidated Income Tax Act);
- change in the average IRAP rate of the year (4.72%) with respect to that calculated at 31 December 2005 (4.43%) (up euros 1.9 million).

Deferred tax income and expenses

Deferred tax income and expenses (-euros 20.0 million) decreased by net euros 14.6 million, mainly as a result of the following events:

- deferred tax income, net (euros 11.1 million) recognized in connection with temporary differences which arose during the year for accruals for personnel incentives (leaving incentives and bonuses) and the provision for bad debts in excess of the tax-deductible portion;
- the net utilization of deferred taxes (euros 5.4 million) mainly related to the effects of the introduction of Italian Law no. 266 of 23 December 2005, which introduced limitations on the tax deductibility of depreciation;
- the realignment of deferred tax expenses to the new average IRAP rate (up euros 3.5 million), as a result of the best estimate of the rate that will be in force when the deferred tax expenses is released.

Adjustments to income taxes of previous years were also recognized, generating income of euros 3.2 million.

For a better presentation of the differences between the theoretical and actual tax rates, the table below reconciles the profits before taxes with the taxable base for IRES purposes:

In millions of euros	Taxable base	Tax
Profits before taxes	566.8	-
Theoretical tax charge	-	187.0
Change in provisions	19.5	6.4
Incentives and employee benefits	7.7	2.5
Dividends - non-taxable portion	-40.0	-13.2
Tax recovery of excess and accelerated depreciation	51.5	17.0
Excess and accelerated depreciation	-18.9	-6.2
Other increases/decreases	3.3	1.1
TOTAL IRES (33%)	589.9	194.7

The table below shows the differences between the theoretical and actual IRAP tax rates:

In millions of euros	Taxable base	Tax
Operating profits	550.8	-
Theoretical tax charge	-	26.0
Personnel expenses	211.4	10.0
Provision for bad debts	12.1	0.6
Tax recovery of excess and accelerated depreciation	51.5	2.4
Excess and accelerated depreciation	-18.9	-0.9
Other increases/decreases	31.4	1.5
TOTAL IRAP (4.72%)	838.3	39.6

11) EARNINGS PER SHARE

Basic earnings per share amount to euros 0.178, in which the numerator and denominator amount to euros 355.8 million and euros 2,000 million, respectively.

Diluted earnings per share amount to euros 0.177, in which the numerator and denominator amount to euros 355.8 million and euros 2,010 million, respectively.

D) NOTES TO THE CONSOLIDATED BALANCE SHEET

Assets

12) PROPERTY, PLANT AND EQUIPMENT - euros 4,149.0 million

Property, plant and equipment amount to euros 4,149.0 million (euros 4,020.4 million at 31 December 2005). They may be broken down as follows:

In millions of euros	Land	Land related to buildings	Buildings	Plant and machinery	Industrial and commercial equipment	Other assets	Leasehold improvements	Assets under construction and payments on account	Total
Cost at 31.12.2005	20.6		566.1	6,758.9	42.0	30.7	0.0	375.6	7,793.9
Investments	2.2		18.4	105.0	2.3	13.6		177.0	318.5
Reclassifications	1.9		20.6	153.0		2.5		-178.0	0.0
Disposals	0.1		-0.3	-26.0	-0.1			-0.6	-26.9
Other changes			-0.9	-12.7					-13.6
Reclassifications			-0.8	2.5		-1.7			0.0
Cost at 31.12.2006	24.8		603.1	6,980.7	44.2	45.1		374.0	8,071.9
Accumulated depreciation and impairment losses at 31.12.2005	-		-213.2	-3,510.8	-29.3	-20.2	0.0	0.0	-3,773.5
Depreciation of the year			-13.6	-151.1	-2.3	-4.4			-171.4
Impairment losses									0.0
Disposals			0.2	21.7	0.1				22.0
Other changes				-					0.0
Reclassifications			0.2	-0.5		0.3			0.0
Accumulated depreciation and impairment losses at 31.12.2006	-		-226.4	-3,640.7	-31.5	-24.3	0.0	0.0	-3,922.9
Carrying amount									
AT 31 DECEMBER 2006	24.8		376.7	3,340.0	12.7	20.8		374.0	4,149.0
AT 31 DECEMBER 2005	20.6		352.9	3,248.1	12.7	10.5		375.6	4,020.4

The caption "plant and machinery" includes the electrical energy transmission grid and the transformation stations, the central systems for remote conduction and the national electrical energy control system.

A summary of changes in property, plant and equipment during the year is provided in the table below:

in million of euros

Investments:	
- Transmission lines	120.1
- Transformation stations	148.8
- Other	49.6
Total investments	318.5
Depreciation	-171.4
Disposals and other changes	-18.5
TOTAL	128.6

Investments of the year mainly include the completion of the Laino-Feroleto-Rizziconi (euros 3.8 million), Turbigo-Rho (euros 15.9 million) and Sardinia-Corsica (euros 2.9 million) long distance lines and the construction of the underwater long distance line SAPEI (euros 34.7 million).

Investments also include the development of the Matera-S.Sofia line (euros 8.2 million) and the Casellina-S.Barbara line (euros 5.9 million). Other investments include the purchase of company cars (euros 16.7 million) and the building in via della Marcigliana (euros 7.2 million).

In terms of assets under construction and payments on account, the main grid development and repowering projects, worth more than euros 5 million, are listed below:

in million of euros

Transmission lines	
KV 380 MATERA - S.SOFIA	80,133,093
SAPEI - DC underwater link	33,230,166
380 kV transformation stations	
FRATTA	8,133,254
CARPI FOSSOLI	6,627,750
CASELLINA	6,503,128
SORGENTE	6,370,000
B. PIGNICELLE	5,205,158
220 kV transformation stations	
MAGENTA	6,245,833

13) INTANGIBLE ASSETS - euros 159.2 million

Changes during the year in intangible assets are detailed below:

in million of euros	Concessions	Other assets	Assets under development and payments on account	Total
BALANCE AT 31.12.2005	134.5	11.3	5.7	151.5
Investments	0.0	16.1	10.4	26.5
Increases on capitalized internal work	0.0	0.5	-0.5	0.0
Amortization	-5.6	-13.2	0.0	-18.8
BALANCE AT 31.12.2006	128.9	14.7	15.6	159.2
BALANCE AT 31.12.2005				
Cost	135.4	53.6	15.6	204.6
Accumulated amortization	-6.5	-38.9	0.0	-45.4
Accumulated impairment losses				
BALANCE AT 31.12.2006	128.9	14.7	15.6	159.2

Intangible assets amount to euros 159.2 million (euros 151.5 million at 31 December 2005). The increase of the year (euros 7.7 million) is due to changes in investments (euros 26.5 million) and amortization (euros 18.8 million). The caption mainly includes the concession for electrical energy transmission and dispatching activities in Italy which was initially recognized in 2005, at fair value (euros 135.4 million) and subsequently measured at cost.

Other intangible assets mainly relate to the following:

- the development and innovation of application software to manage the energy invoicing process;
- the development and innovation of application software to protect the electrical energy system;
- software applications related to the development of the power exchange, particularly relating to the registration of operators, consumption units and the development of foreign procedures.

These software applications are amortized over their estimated residual useful lives, which are normally three years, given their rapid obsolescence.

14) DEFERRED TAX ASSETS - euros 54.6 million

Deferred tax assets relate to the following captions:

in million of euros	31.12.2005	IMPACT RECOGNIZED IN PROFITS OR LOSSES		31.12.2006
		Accruals	Utilization	
Provision for contingencies and charges	10.4	5.2	-0.8	14.8
Provision for bad debts	0.0	2.1	0.0	2.1
Termination benefits and other employee related provisions	30.5	7.4	-7.2	30.7
CFH and trading derivatives	9.6	0.0	-3.9	5.7
Other	1.3	0.0	0.0	1.3
DEFERRED TAX ASSETS	51.8	14.7	-11.9	54.6

The net increase (euros 2.8 million) on 2005 is mainly due to the combined effect of the following:

- the recognition of receivables of euros 5.2 million relating to the non-deductible accruals to the provisions for contingencies;
- the recognition of receivables of euros 2.1 million relating to the non-deductible portion of the accruals to the provision for bad debts;
- the utilization of receivables of euros 3.9 million for the year-end fair value adjustments of cash flow hedge financial instruments.

The change in this caption (euros 2.8 million) does not include the impact of the tax effects on profits or losses of some items, such as the adjustment of cash flow hedge derivatives (euros -3.8 million).

15) FINANCIAL ASSETS

The following table details financial assets recognized in Terna SpA's financial statements:

in million of euros	CARRYING AMOUNT		Change
	31.12.2006	31.12.2005	
FVH derivatives	11.3	106.1	-94.8
Trading derivatives	0.7	0.0	0.7
Investments in subsidiaries	660.0	288.4	371.6
Investments in associates	4.6	4.6	0.0
Non-current financial assets	676.6	399.1	277.5
Deferred assets on FVH derivative contracts	1.5	4.4	-2.9
Other non-current financial assets	1.1	0.0	1.1
Current financial assets	2.6	4.4	-1.8
TOTAL	679.2	403.5	275.7

The carrying amount shown in the table is equal to the fair value of the financial assets recognized in the financial statements.

Non-current financial assets amount to euros 676.6 million, up euros 277.5 million on 2005, mainly due to the following:

- increase in the carrying amount of the investment in the subsidiary RTL SpA following the capital injection by Terna SpA (24 November 2006) for euros 416.8 million, to cover the cost of acquiring AEM Trasmisione SpA and Edison Rete SpA;
- Terna SpA's contribution of the investments in TSN and Novatrans to the Brazilian subsidiary Terna Participações in early June. This transaction did not affect the total balance of investments in Brazilian subsidiaries;
- reduction of euros 44.3 million in the carrying amount of the Brazilian subsidiary Terna Participações following its IPO on the São Paulo stock exchange;
- euros 94.8 million decrease in fair value hedge derivatives due to the rise in the interest rate curve.

The following table shows Terna SpA's financial assets subject to interest rate risk, broken down by due date:

In millions of euros	Maturity	31.12.2005	31.12.2006	Average interest rate
FVH derivatives	2014-2024	106.1	11.3	1.30%
Trading derivatives	2007-2008	0	0.7	0.36%
TOTAL		106.1	12.0	

Trading derivatives have an impact on the income statement, while fair value hedge derivatives offset the impact of the change in the fair value of the bond. Fair value was calculated using the same method applied in 2005, that is by discounting estimated future cash flows to the market interest rate curve at the balance sheet date. The increase in the interest rate curve generated an increase in the fair value (up euros 11.9 million) of trading derivatives (a euros 0.7 million increase in non-current financial assets and a euros 11.2 million decrease in non-current financial liabilities) and a decrease (euros 94.8 million) in fair value hedge derivatives. The caption "Investments in associates" entirely relates to the 24.4% investment in Cesi SpA, which amounts to euros 4.6 million, as there is no change with respect to 31 December 2005. This company operates in the construction and management of laboratories and plants for tests, inspections, studies and experimental research relating to the general electro-technical field and its technical and scientific progress. The following table summarizes Terna SpA's direct investments in subsidiaries and associates at 31 December 2006, compared to the last set of approved financial statements.

Company	Registered offices	Business activity	Share capital	Currency	% of ownership
SUBSIDIARIES					
Terna Participações SA	Rio de Janeiro (Brazil)	Holding company of investments in other companies active in the transmission of electrical energy	1,309,403,148	real	66%
RTL Rete Trasmissione Locale	Rome	Construction and maintenance of electrical energy transmission grids	20,600,000	euro	100%
ASSOCIATES					
Cesi SpA	Milan	Experimental electro-technical research	8,550,000	euro	24.4%

Current financial assets amount to euros 2.6 million (euros 4.4 million at 31 December 2005) and mainly relate to the following:

- a 12-month intercompany financing agreement signed by Terna SpA and Terna Participações (on 6 June 2006) for a maximum of real 20 million (approximately euros 7.1 million at 31 December 2006). The agreement is renewable by Terna SpA for an additional 12 months. Interest accrues on the amount utilized at an annual rate equal to the daily average of the CDI plus a spread of 1.5%. At 31 December 2006, real 1.3 million (euros 0.5 million) had been utilized. The financing was repaid in advance on 20 February 2007, when Terna SpA collected the residual debt of approximately euros 0.5 million.
- deferred assets on FVH derivative contracts, which are entirely related to interest accrued and not yet received at the balance sheet date in connection with the derivative contracts (swaps) agreed to hedge the bond issued.

16) OTHER ASSETS

In millions of euros	31.12.2006	31.12.2005	Change
Receivables due from others:			
- loans and advances to employees	4.6	4.2	0.4
- assets on deposit with third parties	0.2	0.2	0.0
- tax advance on termination benefits	0.5	1.5	-1.0
Other non-current assets	5.3	5.9	-0.6
Receivables from subsidiaries	0.0	27.2	-27.2
Receivables due from others:			
- employees	0.5	0.6	-0.1
- other	16.8	22.6	-5.8
Other current assets	17.3	50.4	-33.1

Non-current assets, detailed above, have not undergone any changes with respect to the previous year.

Other current assets amount to euros 17.3 million (euros 50.4 million at 31 December 2005) and mainly relate to the following:

- receivables from the Greek tax authorities for indirect taxes (VAT of euros 9.1 million) in relation to the activities carried out by Terna's branch in Greece;
- assets in relation to portions of costs for insurance premiums already paid but pertaining to the subsequent year (euros 1.6 million);

- other deferred costs (euros 2.2 million) mainly attributable to charges on contracts to use assets, which Terna took over following the transfer of plants from Enel Distribuzione;
- sundry advances to employees and third parties (euros 0.7 million).

17) INVENTORIES - euros 7.7 million

Inventories under current assets include materials and devices used in the operating, maintenance and construction of plants of euros 7.7 million (euros 7.2 million at 31 December 2005). The euros 0.5 million increase is mainly due to the ordinary maintenance requirements of plants.

18) TRADE RECEIVABLES - euros 1,163.7 million

Trade receivables are composed as follows:

In millions of euros	31.12.2006	31.12.2005	Change
Trade receivables			
- subsidiaries	1.7	0.4	1.3
- third parties	265.2	225.7	39.5
Energy-related receivables	896.8	759.6	137.2
TRADE RECEIVABLES	1,163.7	985.7	178.0

Trade receivables amount to euros 1,163.7 million, up euros 178.0 million on 2005. The increase is due to electrical energy transmission and dispatching activities carried out by Terna in 2006 (in 2005 these activities had an impact for only two months following the acquisition of the transmission and dispatching business activity from GSE SpA in November 2005).

Energy-related receivables are measured net of impairment losses relating to items considered uncollectible and recorded as an adjustment in the provision for bad debts (euros 13.1 million).

Trade receivables - euros 266.9 million

These mainly relate to the grid transmission consideration (euros 218.7 million) and related fees paid to the company for use of the National Transmission Grid by distributors (under article 17 of AEEG Resolution no. 5/04 and subsequent modifications) and producers (under article 19 of AEEG Resolution no. 5/04 and subsequent modifications) of electrical energy. In particular, under Resolution no. 5/04, the receivable mainly relates to the fee pertaining to the last two months of 2006, which was collected in full at the end

of February 2007 (euros 185.0 million). The residual portion (euros 33.7 million) relates to the residual amount of the additional remuneration of 2005 paid under AEEG Resolution no. 162/06. It will be invoiced and collected by 31 July 2007.

Other trade receivables include receivables due from Italian customers (euros 39.5 million), Enel Group companies (euros 5.4 million) and receivables for contract work in progress (euros 1.8 million) relating to long-term work that the company is carrying out for third-party customers:

In millions of euros	Payments on account	Contract value	Balance at 31.12.2006	Payments on account	Contract value	Balance at 31.12.2005
Other	-6.1	7.9	1.8	-4.4	6.0	1.6
TOTAL	-6.1	7.9	1.8	-4.4	6.0	1.6

Energy-related receivables - euros 896.8 million

Energy items mainly include receivables in relation to energy in transit items arising on the dispatching of electrical energy and which do not create profits margins for the company. This caption also includes receivables for considerations payable by market operators for dispatching activities (DIS consideration as per AEEG Resolution no. 237/04) and metering activities (MIS consideration as per AEEG Resolution no. 05/04). This caption also includes deferred charges of euros 62.6 million relating to the signing of ETSO-CBT (European Transmission System Operators - Cross Board Trade) agreements governing the offsetting of energy in transit costs on foreign electricity grids. Under Resolution no. 15/2005, the AEEG ensured the coverage of the above charges and established that repayment terms will be set out in a specific provision.

19) CASH AND CASH EQUIVALENTS - euros 36.1 million

At 31 December 2006, Terna SpA's cash and cash equivalents amounted to euros 36.1, including bank current account deposits of euros 15.2 million (bearing interest at an average rate of 3.58%), euros 20.8 million in the intercompany current account held with the subsidiary RTM1 (bearing interest at an average rate of 3.39%) and euros 0.1 million in cash on hand for operating areas.

Liabilities

20) EQUITY - euros 1,901.7 million

Share capital - euros 440.0 million

The share capital of Terna SpA is comprised of 2,000,000,000 ordinary shares with a nominal value of euros 0.22 each.

Legal reserve - euros 88 million

The legal reserve is equal to 20% of the company's share capital.

Other reserves - euros 725.5 million

Other reserves underwent a net increase of euros 8.6 million, mainly as a result of the following:
fair value adjustment of derivatives hedging EIB loans - cash flow hedge derivatives, (up euros 11.6 million),
net of the related tax effect (euros -3.8 million);
the recognition of the cost of stock options described below (up euros 0. 8 million).

Retained earnings - euros 398.4 million

Retained earnings mainly relate to the reserve as per the Vietti Law (euros 421.3 million), which was set up at 31 December 2004 and IFRS FTA reserves (euros -53.9 million). Changes of the year mainly relate to the allocation of the residual 2005 profits for the year (euros 5.6 million).

2006 interim dividend

After receiving the report of the auditors as per article 2433 bis of the Italian Civil Code, the company's Board of Directors, on 6 September 2006, approved the distribution of an interim dividend of euros 106 million, equal to 0.053 per share which was paid beginning from 23 November 2006.

The following table shows individual equity captions at the balance sheet date, indicating their origin, availability and possibility of distribution:

In millions of euros

Description	Amount	Possibility of use	Available portion
Share capital	440.0	-	-
Legal reserve	88.0	B	-
Other reserves:			
- equity-related	396.1	A,B,C	396.1
- income-related	329.4	A,B	329.4
Retained earnings	398.4	A,B,C	398.4
interim dividend	-106.0	-	-
Profits for 2006	355.8	-	-
Total	1,901.7		
		TOTAL	1,123.9
		Unavailable portion	710.4
		Residual available portion	413.5

Key: **A** - to increase share capital **B** - to cover losses **C** - to be distributed to shareholders

The unavailable portion is mainly related to income-related reserves and retained earnings not yet subject to taxation.

Stock option plans

On 21 December 2005, based on the proposals put forth by the Remuneration committee, the Board of Directors resolved to adopt a 2006 stock option plan for Terna managers who hold the most important roles in terms of achieving the company's strategic targets.

This plan is aimed at giving Terna - in line with international best practice and that of the leading publicly listed Italian companies - a management incentive and loyalty tool, capable of giving key resources a sense of corporate belonging, while ensuring they are constantly focused on creating value, so as to bring shareholders' and management's interests together.

The 2006 stock option plan may be analyzed as follows:

Regulation governing the 2006 stock option plan (Resolution dated 21 December 2005)

The plan provides for the distribution of a maximum of 10,000,000 options to approximately 20 Terna managers, who hold the most important roles in terms of achieving the company's strategic targets, including the CEO, as a senior manager of the company.

Under the approved regulation governing the stock option plan:

1. the strike price of each share shall be determined as the arithmetic mean of the reference prices of Terna ordinary shares as identified by the computer system of Borsa Italiana SpA in the period ranging between the date of the offer and the same day on the previous calendar month;
2. the exercise of the options and consequently, the right to subscribe newly-issued Terna ordinary shares depends on two performance parameters. In particular:
 - (a) Terna EBITDA for the grant year (2006), must be greater than that shown in the budget approved by the Board of Directors;
 - (b) the 2006 performance of each beneficiary must be positively assessed by the CEO, forecasting a 50% reduction in the options that the individual beneficiary can exercise, should this second condition not be met;
3. if the conditions underlying the exercise are met, individual beneficiaries can exercise their options by 31 March 2010 and up to the following maximum quantities:
 - up to 30% of exercisable options, beginning from the date disclosed in the notice communicating the fact that the conditions underlying the exercise have been met;
 - up to 60% of exercisable options, beginning from the first day of the first calendar year subsequent to the year in which the conditions underlying the exercise are met;
 - up to 100% of exercisable options, beginning from the first day of the second calendar year subsequent to the year in which the conditions underlying the exercise are met. Options can be exercised only when the stock exchange is open during the last 10 days of each month.

The 2006 stock option plan entailed the granting, on 21 December 2005, of 9,992,000 options with a strike price of euros 2.072, to 17 managers of the company. The Board of Directors will verify that the conditions for exercise are met when it approves the financial statements at 31 December 2006.

The options granted under this plan at 31 December 2006 are all outstanding and none may be exercised at that date.

	Plan 2006
Outstanding at 1 January	9,992,000
Granted during the year	-
Unopted during the year	9,992,000
Exercised during the year	-
Matured during the year	-
Outstanding at 31 December 2006	9,992,000
Exercisable at 31 December 2006	-

The table below shows the residual life of options at 31 December 2006 and their fair value:

	Options granted (at 21 December 2005)	End of vesting period	Fair value at grant date (in euros)
Plan 2006	2,997,600	2007	0.126
	2,997,600	2008	0.121
	3,996,800	2009	0.115
TOTAL	9,992,000		

* factor of probability (100%)

The Cox-Rubinstein pricing method is used, which considers the value of the Terna share at the grant date, the volatility of the share, the interest rate curve at the grant date and throughout the duration of the plan.

The pricing parameters applied are the following:

- Closing price (underlying or spot price) of the share at the grant date (source: Bloomberg) of euros 2.058;
- Strike price of euros 2.072;
- Interest rate curve for the calculation of the discount factor at the grant date (source: Reuters);
- Historic volatility of the share recorded at the grant date (source: Bloomberg) of 14.860%.

The following table is provided in accordance with disclosure requirements for stock options granted to members of the Board of Directors, General Managers and Key Managers:

Name and Surname	Position	Number of options
Flavio Cattaneo	CEO	2,115,000

Other information on the stock option plan in place

Other beneficiaries of the stock option plan	7,877,000
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In this respect, as indicated above, all the options relate to the 2006 plan, were held at the beginning of the year and are, at 31 December 2006, still outstanding. None may be exercised at that date.

21) LOANS

The following table details loans and financial liabilities recognized in Terna SpA's financial statements at 31 December 2006.

In millions of euros	CARRYING AMOUNT		
	31.12.2006	31.12.2005	Change
Bond	1,406.6	1,498.4	-91.8
Bank loans	540.9	370.5	170.4
Long-term loans	1,947.5	1,868.9	78.6
CFH derivatives	6.2	17.8	-11.6
Trading derivatives	0.0	11.2	-11.2
Non-current financial liabilities	6.2	29.0	-22.8
Short-term loans	50.0	55.0	-5.0
intercompany current account with subsidiaries	21.0	4.8	16.2
Current portion of long-term loans	29.5	29.5	0.0
Short-term loans and current portion of medium/longterm loans	100.5	89.3	11.2
TOTAL	2,054.2	1,987.2	67.0

The carrying amount of the bond has been measured by adjusting the amortized cost to reflect the change in the fair value of the risk hedged, between the date of inception of the hedge and the balance sheet date.

Official Luxembourg stock exchange quotations for Terna bonds are as follows:

- bond maturing in 2024; price at 31/12/2006 103.56(*) and at 31/12/2005 109.68;
- bond maturing in 2014; price at 31/12/2006 99.77(*) and at 31/12/2005 105.43.

The carrying amount shown in the table is equal to the fair value of the financial liabilities recognized in the financial statements.

(*) Source: Bloomberg

Long-term loans

The following table shows the carrying amount of medium/long-term indebtedness and the repayment plan at 31 December 2006, broken down by loan type, including amounts falling due within one year.

In millions of euros	Maturity	31.12.2005	31.12.2006	Due within one year	Due after one year	2008	2009	2010	2011	After
Bonds	2014-2024	1,498.4	1,406.6	0.0	1,406.6	0.0	0.0	0.0	0.0	1,406.6
Total fixed rate		1,498.4	1,406.6	0.0	1,406.6	0.0	0.0	0.0	0.0	1,406.6
EIB no. 20271	2014	61.4	54.6	6.8	47.8	6.8	6.8	6.8	6.8	20.6
EIB no. 21159	2016	238.6	215.8	22.7	193.1	22.7	22.7	22.7	22.7	102.3
EIB no. 22947	2020	100.0	100.0	0.0	100.0	0.0	4.6	9.1	9.1	77.3
EIB no. 22947	2018	0.0	200.0	0.0	200.0	0.0	10.5	21.1	21.1	147.4
Total variable rate		400.0	570.4	29.5	540.9	29.5	44.6	59.7	59.7	347.5
TOTAL		1,898.4	1,977.0	29.5	1,947.5	29.5	44.6	59.7	59.7	1,754.0

Bonds are recognized at their fair value at 31 December 2006, calculated as described above. The repayment of nominal euros 1,400.00 million provides for the settlement of euros 600.00 million at 28 October 2014 and euros 800.00 million at 28 October 2024.

All other financial indebtedness items are stated at nominal value with the related repayment plan.

Terna SpA's total loans at 31 December 2006 amount to euros 1,977.0 million, including medium/long-term loans of euros 1,947.5 million.

The following table illustrates medium/long-term indebtedness, broken down by currency and average interest rate, including amounts due within one year.

In millions of euros	Maturity	Original currency	31.12.2006	Due within one year	Due after one year	Average interest rate at 31.12.2006
Bonds	2014-2024	euro	1,406.6	0.0	1,406.6	4.62%
Fixed rate			1,406.6	0.0	1,406.6	
EIB no. 20271	2014	euro	54.6	6.8	47.8	2.93%
EIB no. 21159	2016	euro	215.8	22.7	193.1	3.03%
EIB no. 22947	2020	euro	100.0	0.0	100.0	3.07%
EIB no. 22947	2018	euro	200.0	0.0	200.0	3.70%
Variable rate			570.4	29.5	540.9	
TOTAL			1,977.0	29.5	1,947.5	

Considering the implicit rate of hedges, the average interest rate on the bond is currently 3.6%. With respect to the two EIB loans, which are hedged against interest rate risk, considering the effect of cash flow hedge derivatives whose cost has been classified as current liabilities, the EIB no. 20271 loan has an average rate of 4.7%, while the EIB no. 21159 loan has an average rate of 4.4%.

The hedges in place to protect the company against the risk of fluctuations in interest rates ensure that the volatility of the cost of financial indebtedness remains limited.

The following table shows changes in medium and long-term indebtedness during the year:

In millions of euros

Type of debt	Notional debt at 31.12.05	Carrying amount at 31.12.05	Repayments and capitalizations	New issues	Exchange rate differences	Delta Fair Value 31.12.05 31.12.06	Notional debt at 31.12.06	Carrying amount at 31.12.06
Listed fixed rate bonds	1400.0	1498.4	0.0	0.0	0.0	(91.8)	1400.0	1406.6
Total bonds	1400.0	1498.4	0.0	0.0	0.0	(91.8)	1400.0	1406.6
Variable rate bank loans	400.0	400.0	(29.6)	200.0	0.0	0.0	570.4	570.4
Total bank loans	400.0	400.0	(29.6)	200.0	0.0	0.0	570.4	570.4
TOTAL FINANCIAL INDEBTEDNESS	1800.0	1898.4	(29.6)	200.0	0.0	(91.8)	1970.4	1977.0

Medium and long-term indebtedness shows a euros 78.6 million increase on 31 December 2005, due to the drop in the fair value of bonds (euros 91.8 million), the net increase in EIB loans (euros 170.4 million) (decrease of euros 29.6 million following the repayment of portions and increase of euros 200.0 million for new issues).

At 31 December 2006, Terna SpA has available credit lines of euros 1,569 million, including hot money of euros 819 million and the five-year revolving credit line of euros 750 million. The latter was renegotiated on 10 April 2006, and the amount, maturity and terms were redefined. The total amount of the credit line was increased from euros 500 million to euros 750 million through the extension of portions of the banking syndicate (Banca Intesa SpA, Banca Nazionale del Lavoro SpA, Banco Bilbao Vizcaya Argentaria SA, Capitalia Gruppo Bancario, Mediobanca - Banca di Credito Finanziario SpA, Monte dei Paschi di Siena SpA, Sanpaolo IMI SpA and Unicredit Banca Mobiliare SpA. Mediobanca - Banca di Credito Finanziario SpA and Banco Bilbao Vizcaya Argentaria SA are arrangers).

The maturity was postponed from 2009 to 2011, and Terna may request a further extension to 2013. The terms were also revised and, in particular, the importance of the rating was eliminated. Moreover, the spread on both the availed and unavailed portions of the credit were reduced from 17.5 to 15 base points and from 5.25 base points (30% of the margin of use) to 4 base points, respectively.

Furthermore, on 12 July 2006 the “Euro Medium Term Note Programme” (EMTN) was signed, for a total of euros 2 billion. The programme will enable Terna to benefit from the potential financial opportunities of international capital markets through the issue of bonds with various maturities in main world currencies.

Net financial indebtedness is detailed below:

In millions of euros	Carrying amount 31.12.2006
A) Cash and cash equivalents	15.3
B) Other cash and cash equivalents (details)	0.0
C) Cash and cash equivalents (A) + (B)	15.3
D) Short-term loan to Terna Part	0.5
E) Current financial receivables	0.5
F) Current bank debt	50.0
G) Current portion of long-term debt	29.5
H) Net intercompany current account balance with the RTL Group	0.2
I) Current financial indebtedness (F) + (G) + (H)	79.7
J) Net current financial indebtedness (I) - (E) - (D)	63.9
K) Non-current bank debt	540.9
L) Bonds	1406.6
M) Derivative financial instruments	-5.8
N) Non-current net financial indebtedness (K) + (L) + (M)	1,941.7
O) Net financial indebtedness (J) + (N)	2,005.7

The contractual clauses of loans in place at 31 December 2006 include negative pledges and default events in line with market standards (and, accordingly immaterial), while there are no financial covenants on existing debt.

Non-current financial liabilities

The table below provides the maturity and average interest rate of non-current financial liabilities:

In millions of euros	Maturity	31.12.06	31.12.05	Average interest rate
CFH derivatives	2014-2016	6.2	17.8	1.85%
Trading derivatives	2007-2008	-	11.2	0.36%
TOTAL		6.2	29.0	

Non-current financial liabilities include the fair value of fair cash flow hedge derivatives at 31 December 2006. Fair value is measured by discounting estimated future cash flows on the basis of the market interest rate curve at the reporting date. The fair value of cash flow hedge derivatives is recognized in the balance sheet under financial liabilities, with a balancing entry in a specific equity reserve. Accordingly, changes in the fair value of cash flow hedge derivatives have no impact on profits or losses. The rise in the interest rate curve generated a euros 11.6 million increase for cash flow hedge derivatives and euros 11.9 million change in trading derivatives, i.e. those derivatives that do not satisfy the requirements to be recognized hedging instruments and have an impact on the income statement. The latter increase was an increase in non-current financial assets of euros 0.7 million and a decrease in non-current financial liabilities of euros 11.2 million.

Short-term loans

To meet cash requirements, in December, two short-term credit lines were used for a total of euros 50 million. These credit lines were recognized when negotiated at an average interest rate of 3.81%.

On the basis of a treasury service agreement, Terna SpA funds and uses cash on behalf of its subsidiaries. The total of the intercompany current accounts is a debit balance totalling euros 21 million, detailed as follows:

In millions of euros	31.12.06	31.12.05	Difference
Current account			
RTL	18.8	4.8	14.0
RTM2	2.2	-	2.2
TOTAL	21.0	4.8	16.2

Current financial liabilities

Current financial liabilities arising on financial expenses accrued but not settled in relation to financial items are substantially unchanged with respect to 31 December 2005. The following table details deferred liabilities on the basis of the financial liabilities to which they relate:

In millions of euros	31.12.2006	31.12.2005	Change
Deferred liabilities on:			
Derivative contracts			
- hedging	0.2	0.6	-0.4
- trading	0.0	0.9	-0.9
Total	0.2	1.5	-1.3
Bond			
- ten-year	4.5	4.5	0.0
- twenty-year	7.0	7.0	0.0
Total	11.5	11.5	0.0
Loans	2.3	1.4	0.9
TOTAL	14.1	14.4	-0.3

22) TERMINATION BENEFITS AND OTHER EMPLOYEE-RELATED PROVISIONS

euros 161.8 million

Terna offers its employees benefits during their employment with the Company (e.g., loyalty bonus), upon termination of employment (e.g., termination benefits, additional month's pay and indemnity for lack of notice) and after termination of employment (e.g., electricity discount and the ASEM health plan).

Employee benefits (loyalty bonus) are due to company employees hired under the national labour contract (including managers) upon the achievement of specific seniority requirements (25 and 35 years of service).

Termination benefits are due to all employees, managers hired or appointed before 28 February 1999 (indemnity for lack of notice), and employees (blue collars, white collars and junior managers) hired before 24 July 2001 under the national labour contract (additional month's pay).

Post-employment benefits consist of the following:

- discount on electrical energy consumed for domestic use. This benefit is offered to all company employees hired before 30 June 1996 under the national electrical energy sector labour contract. It is referred to as the electricity discount;
- health plan in addition to national healthcare, as provided for by the national industrial labour contract for managers (ASEM health plan).

The composition of and changes in termination benefits and other employee-related provisions at 31 December 2006 are detailed below:

In millions of euros	31.12.2005	Accruals	Interest cost	Utilization and other changes	31.12.2006
Employee benefits					
Loyalty bonus	3.9	-	0.2	-0.1	4.0
Total	3.9	0.0	0.2	-0.1	4.0
Termination benefits					
Termination benefits	74.6	9.0	2.9	-5.2	81.3
Additional month's pay	9.2	0.5	0.4	-3.1	7.0
Indemnity for lack of notice and other similar benefits	2.3	-	0.1	1.3	3.7
Total	86.1	9.5	3.4	-7.0	92.0
Post-employment benefits					
Electricity discount	63.0	1.1	2.5	-13.7	52.9
ASEM	15.2	0.3	0.6	-3.2	12.9
Total	78.2	1.4	3.1	-16.9	65.8
TOTAL	168.2	10.9	6.7	-24.0	161.8

This caption amounts to euros 161.8 million at 31 December 2006 (euros 168.2 million at 31 December 2005) and shows a net decrease of euros 6.4 million compared to the previous year. This change is mainly due to the combined effect of the net accruals of termination benefits (euros 6.7 million), net utilization, transfers and other changes in the electricity discount and ASEM made by the company (euros -12.4 million).

In millions of euros	Termin. ben.	Indemnity for lack of notice	Additional month's pay	Loyalty bonus	ASEM	Electricity discount	Indemnity Electricity discount	Total
31.12.2005	74.6	2.1	9.2	3.9	15.2	63	0.2	168.2
Cost	9.0	-0.1	0.5	0.0	0.3	1.1	0.0	10.9
Interest	2.9	0.1	0.4	0.2	0.6	2.5	0.0	6.7
(Gains)/Losses	5.3	1.5	-2.0	1.4	-3.1	-11.1	0.0	-8.0
Disbursements and transfers	-10.5	-0.1	-1.1	-1.5	-0.1	-2.6	0.0	-15.9
31.12.2006	81.3	3.5	7.0	4.0	12.9	52.9	0.2	161.8

The main assumptions made in the actuarial estimate of employee benefit obligations are the following:

	2006	2005
discount rate	4.25%	4.0%
rate of increase in personnel expenses	2.0% - 4.0%	2.0% - 4.0%
rate of increase in healthcare costs	3.0%	3.0%

23) PROVISIONS FOR CONTINGENCIES AND CHARGES - euros 54.3 million

The caption at 31 December 2006 and changes therein may be analyzed as follows:

In millions of euros	Provision for disputes and litigation	Provision for contingencies and other charges	Provision for leaving incentives	Total
BALANCE AT 31.12.2005	13.8	12.3	9.6	35.7
Accruals	0.4	19.9	4.1	24.4
Utilization	-1.0	-3.0	-1.8	-5.8
BALANCE AT 31.12.2006	13.2	29.2	11.9	54.3

Provision for litigation - euros 13.2 million

This provision is substantially in line with 2005. It is accrued mainly to cover year-end liabilities which could arise on lawsuits and out-of-court litigation relating to company activities. The amount accrued takes into account the opinions of the both internal and independent lawyers. Litigation for which a positive outcome

is expected and those entailing a remote, potential charge are not provided for, nor are those for which no charges can be calculated. The latter are described under "off-balance sheet items".

Provision for contingencies and charges - other - euros 29.2 million

This caption shows a net increase of euros 16.9 million on the previous year, due to accruals of euros 19.9 million and utilizations of euros 0.3 million, including:

- euros 1.6 million for the long-term incentive plan for managers not benefiting from the stock option plan;
- euros 5.6 million for "Urban and environmental redevelopment projects" to offset the environmental impact of the construction of long distance lines;
- euros 9.8 million, reflecting the estimated cost to be incurred by the company for additional INPS contributions;

Provision for leaving incentives - euros 11.9 million

This provision reflects the estimated non-recurring charges related to the agreed early termination of the working relationship of employees who are eligible for pension.

24) TAX LIABILITIES, INCLUDING DEFERRED - euros 453.5 million

Changes in this caption are detailed as follows:

In millions of euros	31.12.2005	IMPACT RECOGNIZED IN PROFITS OR LOSSES		Other changes	31.12.2006
		Accruals	Utilization		
Land related to buildings	3.8		-0.1		3.7
Employee benefits	0.1		-0.1	-1.7	-1.7
FVH derivatives and FV bond	1.3				1.3
Amortization and depreciation	456.9	5.7	-17.9		444.7
Difference in the fair value of former TSO properties	2				2
IRAP rate adjustment	0	3.5			3.5
TOTAL	464.1	9.2	-18.1	-1.7	453.5

Deferred tax liabilities decreased by euros 10.6 million on 31 December 2005, mainly due to the combined effect of the following events:

- utilization (euros 17.9 million) to absorb amortization/depreciation in excess of the deductible portion.

- Accruals made by the company (euros 5.7 million) mainly related to amortization/depreciation in addition to the rates of the year;
- adjustment (euros 3.5 million) of the IRAP rate (from 4.43% in 2005 to 4.72%) applied to provisions for deferred taxation, to better reflect the rates that will be applicable when the related temporary differences reverse.

25) OTHER NON-CURRENT LIABILITIES - euros 170.8 million

This caption amounts to euros 170.8 million at 31 December 2006 and includes deferrals for grants related to plants (euros 156.4 million at 31 December 2005), as well as grid transport consideration to cover future costs of the National Transmission Grid safety plan (euros 14.4 million). The decrease on the previous year (down euros 5.4 million) is mainly due to the release of portions of grants in connection with the depreciation of the year applicable to plants.

26) CURRENT LIABILITIES

Current liabilities at 31 December 2006 are detailed as follows:

In millions of euros	31.12.2006	31.12.2005	Change
Short-term loans (*)	71.0	59.8	11.2
Current portion of long-term loans (*)	29.5	29.5	-0.0
Trade payables	1,282.9	936.2	346.7
Tax liabilities	72.3	14.4	57.9
Current financial liabilities (*)	14.1	14.5	-0.4
Other current liabilities	106.8	97.8	9.0
TOTAL	1,576.6	1,152.2	424.4

(*) Reference should be made to the comments in note 21) LOANS.

Trade payables - euros 1,282.9 million

Trade payables at 31 December 2006 are detailed as follows:

In millions of euros	31.12.2006	31.12.2005	Change
Suppliers			
Suppliers:			
- non-energy related payables	219.4	184.8	34.6
- energy-related payables	1,046.9	747.2	299.7
Associates - Cesi	4.4	2.7	1.7
Subsidiaries	12.0	0.9	11.1
Payables for contract work in progress			
Payables for contract work in progress	0.2	0.6	-0.4
TOTAL	1,282.9	936.2	346.7

SUPPLIERS

Non-energy related payables

Amounts due to suppliers relate to invoices received and to be received for tenders, services and the purchase of materials and equipment.

The increase on 2005 (euros 34.6 million) is due to greater purchases and services in the last few months of the year as part of ordinary investing activities and operations.

The caption also includes amounts due for services provided to Enel Group companies (euros 28.7 million), which mainly include the following balances:

the euros 4.1 million due to Enel Distribuzione for invoices to be received for the electricity discount (discount on energy consumed for domestic use, which is given to all Company employees hired before 30 June 1996 under the national electricity sector labour contract);

the euros 24.0 million due to Enel Servizi for personnel administration, IT services, canteen services and security.

Energy-related payables

This caption includes the effects of amounts due for energy in transit on the balance sheet, mainly in connection with the purchase of energy and the transport consideration due to the owners of other portions of the National Transmission Grid. The increase (euros 299.7 million) on 2005 is mainly due to the operations of the TSO business activity for the last two months of 2005 only, and deferred payables relating to capacity payments (euros 84 million), UESS - basic units (euros 29.8 million), interconnection (euros 18.6 million), CCT returns (euros 59.1 million) whose allocation and/or coverage is yet to be defined by AEEG.

Associates

This caption amounts to euros 12 million and relates to payables for invoices received and to be received, mainly in relation to the grid transmission consideration due to the RTL Group for the portions of the National Transmission Grid that it owns. These include the following amounts, in particular:

- euros 1.2 million to RTL for the grid transmission consideration for September/December 2006;
- euros 7.3 million to RTM1 to remunerate the portion of the National Transmission Grid owned by RTM1 in the last two months of 2006;
- euros 3.5 million to RTM2 to remunerate the portion of the National Transmission Grid owned by RTM2 in the last three months of 2006.

The euros 11.1 million increase on the previous year is mainly due to the recognition of payables to RTM1 and RTM2, acquired from the subsidiary RTL in November 2006.

Associates

This caption amounts to euros 4.4 million and relates to payables to Cesi SpA for services provided to Terna in the construction and management of laboratories and plants for tests, inspections, studies and experimental research relating to the general electro-technical field and its technical and scientific progress. This caption totalled euros 2.7 million at 31 December 2005.

Commitments with suppliers for the 2007-2012 period amount to euros 1,116.8 million and relate to the as yet unpurchased portions of contractual purchase commitments pending at year end, which do not fall under normal operations.

PAYABLES FOR CONTRACT WORK IN PROGRESS

This caption amounts to euros 0.2 million at 31 December 2006, in line with 31 December 2005 and is composed as follows:

In millions of euros	Payments on account	Contract value	Balance at 31.12.2006	Payments on account	Contract value	Balance at 31.12.2005
Other	(2.1)	1.9	(0.2)	(5.3)	4.7	(0.6)
TOTAL	(2.1)	1.9	(0.2)	(5.3)	4.7	(0.6)

Tax liabilities - euros 72.3 million

This caption includes the company's taxes of the year (euros 194.7 million for IRES and euros 39.6 million for IRAP), net of payments on account in June and November 2006, totalling euros 162 million.

Other current liabilities - euros 106.8 million

Other current liabilities are detailed below:

In millions of euros	31.12.2006	Due within one year	Due after one year	31.12.2005	Change
Payments on account	19.7	0.7	19.0	25.2	-5.5
Other tax liabilities	43.8	43.8	-	7.7	36.1
Amounts payable to social security institutions	12.0	12.0	-	11.5	0.5
Amounts payable to employees	25.1	25.1	-	21.7	3.4
Others:					
- third parties	5.9	3.6	2.3	31.7	-25.8
- subsidiaries	0.3	0.3	-	0.1	0.2
TOTAL	106.8	85.5	21.3	97.9	8.9

PAYMENTS ON ACCOUNT

This caption includes grants related to plants collected by the company for non-current assets still under construction at 31 December 2006.

The net decrease of euros 5.5 million on 2005 (euros 25.2 million) is mainly due to the effect of the new contributions received from third parties for connections to the National Transmission Grid (euros 15.0 million) and the decrease (euros 20.5 million) in the contributions which directly reduce the carrying amount of the related assets, which became operational during the year.

OTHER TAX LIABILITIES

Other tax liabilities, which amount to euros 43.8 million, include euros 35.5 million, mainly for the settlement of VAT in December, substitute tax withholdings (euros 5.5 million) and registration tax on the agreement for the acquisition of the TSO business activity (euros 2.8 million).

The significant increase (euros 36.1 million) is mainly due to the decreased payable to the tax authorities in 2005, when the company had a VAT credit in relation to the previous year.

AMOUNTS PAYABLE TO SOCIAL SECURITY INSTITUTIONS

This caption amounts to euros 12.0 million, substantially in line with the previous year. It relates to the amounts payable to INPS for December 2006 and settled in January 2007. The caption also includes the contributions of the year relating to employees' incentives, to be paid in the following year, and the portion of the contributions arising from the renewal of employees' labour contract which was signed in July 2006.

AMOUNTS PAYABLE TO EMPLOYEES

Amounts payable to employees amount to euros 25.1 million (euros 21.7 million at 31 December 2005) and mainly relate to termination benefits due to employees whose employment was terminated before 31 December 2006 and amounts due for employees' leaving incentives to be paid in 2007. The euros 3.4 million increase is mainly due to increased payables (up euros 2.6 million) in 2006 for incentives on the company's results.

OTHER

This caption amounts to euros 6.2 million (euros 31.8 million at 31 December 2005) and mainly relates to the following:

- euros 2.3 million for guarantee deposits made in connection with the contractual obligations undertaken by electricity market operators with respect to dispatching contracts;
- euros 1.3 million for the amount due to ACEA SpA, partly being the portion of the incentive to unify the National Transmission Grid following the sale of the grid to the company (AEEG Resolution no. 73/06);
- euros 2.1 million for deferred liabilities of a sundry nature;
- euros 0.3 million in relation to the residual payable to the subsidiary Terna Participações for expenses (taxes and banking fees) on the IPO in the OTC market,

the euros 25.6 million decrease on 31 December 2005 is mainly due to the reclassification of energy items (euros 23.5 million), which arose in 2005 in conjunction with the acquisition of the TSO business activity, to "Trade payables".

E) COMMITMENTS AND CONTINGENCIES ARISING FROM OFF-BALANCE SHEET ITEMS

Environmental litigation

Environmental litigation relates to the installation and operating of electrical systems and, in particular, the effects of electric and magnetic fields.

The company was summoned in various civil and administrative cases in which requests were made for the transfer or change in operations of allegedly damaging electrical lines, even if installed in full compliance with current legislation to this regard. Only a very small number of cases include claims for compensation for damage to health due to electromagnetic fields.

The Prime Minister's Decree of 8 July 2003, which completed outline Law no. 36 of 22 February 2001, established the amounts of the three parameters (exposure limits, warning values and quality standards), provided for by law, with which electrical systems must comply. This decree had a favourable impact on the pending litigation, as until then, the scope of the outline law had been limited to general principles only. In terms of the decisions taken to this regard, in only a few rare cases were judgments passed against the company. Moreover, these were appealed and the appeals are still pending. However, no claims of compensation for damage to health have been upheld.

Electric and magnetic field legislation

The outline law, passed on 22 February 2001, gives the government responsibility for establishing the reference parameters (exposure limits, warning values and quality standards) with which plants must comply under specific measures.

To this end, the outline law regarding reclamation provides for a recovery mechanism for reclamation costs, calculated by the Electrical Energy and Gas Regulator pursuant to Law no. 481/95, as these are expenses incurred in the public's interest.

On 29 August 2003, the Prime Minister's Decree of 8 July 2003 for the "Establishment of exposure limits, warning values and quality standards for the protection of the population from electric and magnetic fields at the grid frequency (50 Hz) used by long distance power lines", was published in the Official Journal of the Italian Republic. It established the amounts of the three parameters provided for by the outline law.

In terms of regional regulations, certain regions have proposed laws concerning this issue, with more

restrictive limits than those provided for by the Prime Minister's Decree of 1992, and the more recent decree of 8 July 2003.

However, under judgement no. 307 of the Constitutional Court, passed down on 7 October 2003, certain regional laws regarding electromagnetic fields are anti-constitutional (including the Campania Region's law no. 13 of 24 November 2001), on the basis of the principle that the limits established by the government legislation cannot be waived, not even by regional legislation, as the protection of health must be ensured consistently throughout Italy.

GSE (formerly GRTN) business activity litigation

Under the provisions of article 1 of the Prime Minister's Decree of 11 May 2004 and the transfer agreement signed by Terna and GSE on 28 February 2005, the litigation following events that occurred up to the date of the transfer of, and in relation to, the GSE business activity relating to electrical energy transmission and dispatching activities ("business activity") was not transferred. Accordingly, the former GRTN (now GSE SpA) retains all liability, charges or liabilities to be incurred as a result or in connection with the litigation. As it holds the concession for transmission and dispatching activities since 1 November 2005, Terna was summoned in certain cases appealing AEEG's and/or MAP's measures relating to the above issue. Only in those cases in which the plaintiffs claim not only defects in the measures, but also Terna's alleged violation of the rules established by such Authorities, is the company called to appear in court.

Other litigation

In addition, cases relating to urban planning and environmental issues are pending, following the construction and operating of certain transmission lines. Any unfavourable outcome to these cases could have adverse effects for the company, which cannot be foreseen to date. Accordingly, no accruals have been made in this respect.

The outcome of a limited number of cases cannot be forecast as undoubtedly positive for the company, and the possible consequences could consist of compensation for damage, as well as incurring, *inter alia*, charges to change lines and suspend their use temporarily. In any case, any unfavourable outcome would not jeopardise line operations.

The above litigation has been examined, also considering the opinion of independent legal experts, and any negative outcome is considered remote.

INPS Memorandum no. 63 of 6 May 2005 provided that, with retroactive effect from 1999, government industrial companies and public bodies carrying out industrial, privatized activities, owed contributions to CIG, CIGS and DS, as well as amounts payable for redundancy, entailing charges of approximately euros 24.8 million. Given the complexity of this issue, Terna, along with other companies operating in the electrical energy sector, initially took legal recourse before an administrative law judge, claiming the measure be suspended and declared null and void. The judge claimed it was not that court's jurisdiction, since the issue concerned solely subjective rights. To date, Terna has taken its claims before the ordinary judicial authorities to claim that it has no obligation to pay the contributions. The hearing was set for 24 April 2007. However, INPS considered it necessary to request an opinion from the Council of State, and suspended payment of these contributions until it obtained such opinion.

On 8 February 2006, the Council of State found that the contributions should not be applied retroactively, and that the Memorandum should be duly integrated and corrected.

F) BUSINESS COMBINATIONS

There were no business combinations in 2006 other than the changes in controlling investments discussed above.

G) RELATED PARTY TRANSACTIONS

Related parties are identified in accordance with the provisions of IAS 24.

A party is related to the company if:

- (a) it directly or indirectly, through one or more intermediaries:
 - (I) controls the company, is controlled by the company, or is jointly controlled thereby (including parents, subsidiaries and associates);
 - (II) it holds an investment in the company that gives it significant influence over that company;
 - (III) it jointly controls the company;
- (b) the party is an associate of the company;
- (c) the party is a joint venture in which the company is an investor ;
- (d) the party is a member of senior management with strategic duties of the company or its parent;
- (e) the party is a close relative of one of the parties described in letters (a) or (d);
- (f) the party is controlled, jointly controlled or under the significant influence of one of the parties described in letters (d) or (e), or those parties directly or indirectly hold a significant portion of voting shares;

(g) the party is a pension fund for the employees of the company, or any of its related parties.

A related party transaction occurs when there is a transfer of resources, services or obligations between related parties, regardless of whether a consideration is agreed.

Related party transactions carried out by the company during the year included those with its subsidiaries, the associate Cesi SpA and the employee pension funds FONDENEL and FOPEN.

Transactions carried out by Terna with the subsidiaries of RTL SpA relate to the following:

- a lease payment due from the company, as manager of the National Transmission Grid, to use a portion of the grid owned by the subsidiaries;
- the management and coordination of all transactions relating to the administration of financial resources and cash requirements, as well as treasury services and all other related transactions (i.e., treasury agreements);
- services for ordinary operating and maintenance activities on the high-voltage lines owned by the subsidiaries to keep the plants efficient;
- an assistance and consultancy agreement for administrative, financial, legal/corporate and tax issues, as well as strategies and business coordination, specifically with RTL (i.e., a management fee agreement).

In particular, agreements with Cesi SpA in which Terna is the customer mainly relate to services and technical consultancy, studies and research, design and trials carried out on behalf of Terna. Other agreements mainly relate to the lease of laboratories and other similar structures for specific use.

Transactions with the Brazilian subsidiaries are mainly financial and relate to the dividends paid to the company during the year. In addition, transactions with Terna Participações include the financing agreement signed with Terna in June and repaid on 20 February 2007.

FONDENEL and FOPEN are pension funds in which the company's employees participate for complementary pensions. The related transactions with an impact on the company's balance sheet and income statement involve contributions incurred by the company, which are calculated and paid on a monthly basis.

The following table provides total costs and revenues of the year and receivables and payables at year end in millions of euros.

COMPANY	INCOME STATEMENT BALANCES			BALANCE SHEET BALANCES		
	Revenues	Expenses of the year	Investment expenses	Receivables	Payables	Guarantees
RTL Group:						
- RTL SpA	2.5	6.5*	-	0.4	20.0	
- RTM1 SpA	0.5	3.1*	-	21.3	7.3	
- RTM2 SpA	-	1.1*	-	0.8	5.7	
Brazilian companies:						
- Terna Participações SA	9.7	-	-	0.5	0.3	
- Novatrans Energia SA	10.4	-	-	-	-	
- Trasmisora Nordeste Sudeste SA	19.1	-	-	-	-	
Cesi SpA	0.1	0.9	7.6	-	4.4	2.0
Fondenel	-	0.4	-	-	-	
Fopen	-	1.3	-	-	0.7	
TOTAL	42.3	13.3	7.6	23.0	38.4	2.0

* Including a total of euros 10.5 million in relation to items in transit.

Guarantees relate to sureties received on contracts.

H) SIGNIFICANT NON-RECURRING TRANSACTIONS AND EVENTS AND ATYPICAL OR UNUSUAL TRANSACTIONS

With the exception of those discussed above, no significant, non-recurring, atypical or unusual transactions were carried out during the year.

I) NOTES TO THE CASH FLOW STATEMENT

The cash flows generated by operating activities during the year amounted to approximately euros 756.2 million and include operating activities before the changes in net working capital (euros 777.3 million) and cash flows used by the change in working capital (approximately euros 21.0 million).

Investing activities in property, plant and equipment and intangible assets also used net financial resources of approximately euros 327.5 million, while investments in companies used euros 415.9 million. In particular, these outflows related to the acquisition of AEM Trasmisone SpA and Edison Rete SpA through the subsidiary RTL (euros 416.8 million), net of the proceeds from the sale of a portion of the

investment in the Brazilian subsidiary Terna Participações, through its IPO on the São Paulo stock exchange (euros 82.7 million). Cash outflows for self-financing were mainly due to the distribution of dividends in 2005 (euros 160 million) and the interim dividend for 2006 (euros 106 million), while medium/long-term financial indebtedness, net of the related fair value hedges, increased by approximately euros 173.4 million.

Cash flows generated by these transactions amounted to approximately euros 4.2 million.

L) SUBSEQUENT EVENTS

2007-2011 business plan

On 31 January 2007, Terna presented financial analysts with its 2007-2011 business plan, approved by the company's Board of Directors.

The Terna Group's 2007-2011 business plan focuses on three main guidelines:

- Development of the National Transmission Grid (RTN): the investment plan provides for total expenditure of euros 2.7 billion from 2007 to 2011, with a 35% increase on the previous plan. Development investments account for 80% of total investments, up from euros 1.4 billion to euros 2.2 billion;
- Cost cutting with an increase in profits margins: in particular, by rationalizing costs for regulated in Italy. The plan provides for a reduction of approximately euros 60 million in total Terna Group costs in the years covered on a like-for-like basis;
- Guaranteed high security of the electrical system and reliability of the National Transmission Grid with average service interruption times of less than 1 minute/year and grid availability of over 99%.

Credit rating confirmation

On 31 January 2007, Standard & Poor's Ratings Services confirmed its ratings for Terna SpA, following the Italian utility company's presentation of its 2007-2011 business plan: long-term rating of AA- and short-term rating of 'A-1+ with a stable outlook.

New dispatching and conduction organization

The new organizational structure for the Dispatching and Conduction Department was implemented on 1 March 2007, to complement the work performed on processes following the acquisition of the GSE SpA (formerly GRTN) business activity. This new structure enables process-based management, while ensuring that operating and strategic objectives are aligned, preventing the scattering of similar activities within the same process to more than one unit. In addition, a portion of the resources formerly under the Systems and Technology Department (which is now the Technology and Management Systems Department), has come under the Technologies and Process Systems Function reporting to the Dispatching and Conduction Department. Similarly, work groups have begun identifying further measures to take to optimize in detail the processes related to real time management.

Fibre optics

On 4 April 2007, an agreement was signed with the Wind Telecomunicazioni Group to acquire the exclusive right to use optical fibre pairs owned by the Wind Group for 20 years. The pairs run for a total length of approximately 11,000 km throughout all of Italy.

The agreement amounts to euros 43.5 million.

The data transmission infrastructure is a crucial element of the security and efficiency of control, conduction and protection processes for the high voltage grid, as it makes it possible to improve grid supervision and carry out work on Terna plants, while allowing the development of advanced solutions to protect the electricity system.

This transaction will enable Terna to further boost the security of the system and is included in the investments provided for by the 2007-2011 business plan.

Merger of RTM1 and RTM2 into RTL

On 18 April 2007, the shareholders of Rete di Trasmissione Locale Società per Azioni (RTL), "Rete Trasmissione Milano 1 Società per Azioni" (RTM1) and "Rete Trasmissione Milano 2 Società per Azioni" (RTM2) met and approved the plan for the merger of RTM1 and RTM2 into RTL, on the basis of the companies' financial statements as of and for the year ended 31 December 2006, with the cancellation of all shares of RTM1 and RTM2, in accordance with the methods set out in the plan and, accordingly, without RTL increasing its share capital or provided for a share exchange ratio or cash consideration.

The merger will take effect from the date of registration of the merger deed with the company registrar, or a subsequent date indicated in the merger deed.

Pursuant to point 6), article 2501-*ter* of the Italian Civil Code, referred to by article 2504 *bis* of the Italian Civil Code and paragraph 9, article 172 of Presidential Decree no. 917 of 22 December 1986, the transactions carried out by companies to be merged will be recognized in the financial statements of the merging company and the merger will take effect for accounting and tax purposes from midnight on the first day of the year in which the merger takes effect.

In particular, the purpose of the transaction is to improve the Terna Group companies' operations, by expanding synergies through a Group reorganization in order to streamline the investment chain and pursue increased management efficiency, while reducing administrative costs. To this end, all companies in the same sector will be merged together.

Acquisition of AEM Trasporto Energia Srl Torino

On 20 April 2007, through RTL, the Terna Group signed an agreement with Iride Energia to acquire 100% of AEM Trasporto Energia Srl ("AEM TE") and the 220-kV electrical substation in Moncalieri (Turin), which is part of the National Transmission Grid ("RTN").

The consideration totalled euros 49.4 million, including euros 38.8 million to acquire the 100% investment in AEM TE, euros 2.8 million for the company's net financial position at 31 December 2006 and euros 10.6 million to acquire the Moncalieri (Turin) substation. The acquisition agreement provides for an adjustment to the consideration in relation to the change in AEM TE's equity between 31 December 2006 and the date the transaction is concluded.

AEM TE owns approximately 220 km of triads and four electrical substations in Piedmont, which are part of the National Transmission Grid (Martinetto, Rosone, Sud Ovest and Villa).

At 31 December 2006, AEM TE reported revenues of euros 7.6 million, EBITDA of euros 4.3 million and a profits for the year of euros 1.7 million. Net invested capital amounted to approximately euros 25.7 million, including property, plant and equipment totalling roughly euros 27.1 million. Equity amounted to around euros 28.6 million.

The transaction is subject to authorization from the Anti-Trust Authority before it can be concluded.

Control of Terna SpA held by Cassa Depositi e Prestiti

On 19 April 2007, Cassa Depositi e Prestiti SpA, which owns 29.99% of Terna SpA, notified the company that it had verified that it controlled Terna SpA. This assessment was based on the following elements:

- the composition and breakdown of the shareholding structure;
- events at particularly significant shareholders' meetings;
- the composition of the Board of Directors.

M) TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

Introduction

Following Legislative Decree no. 38 of 28 February 2005, exercising the power granted by EEC regulation no. 1606/2002, from 2006, companies with shares traded on regulated markets in the member states of the European Union are required to prepare their separate financial statements in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board and endorsed by the European Commission ("IFRS").

Accordingly, Terna SpA has adopted IFRS from 2006. Its date of transition is 1 January 2005.

The last set of separate financial statements prepared in accordance with Italian GAAP is those as of and for the year ended 31 December 2005.

In this document, figures showing the effects of transition to IFRS in the reconciliation schedules required by IFRS 1, previously approved and published along with the Terna Group's consolidated half year report at 30 June 2006, have been reclassified and integrated. However, there were no changes to the effects of

transition on equity at 31 December 2005 or the income statement for 2005.

The most significant accounting policies and measurement criteria applied in the preparation of the reconciliation schedules are those described in the notes to the financial statements as of and for the year ended 31 December 2006.

IFRS-compliant balance sheets as of 1 January 2005 and 31 December 2005 **IFRS-compliant income statement for the year ended 31 December 2005**

The balance sheets as of 1 January 2005 and 31 December 2005 and the income statement for the year ended 31 December 2005 are provided below, showing:

- Italian GAAP figures reclassified under IFRS;
- IFRS adjustments.

The functional currency used for the schedules is the Euro, and all figures are shown in euros.

RECONCILIATION OF EQUITY AT 1 JANUARY 2005

In millions of euros	Note	Italian GAAP	Effects of IFRS_IAS	IFRS_IAS
Non-current assets				
Property, plant and equipment	1	3,848,337,763	9,741,655	3,858,079,418
Deferred tax assets	2	14,837,169	36,813,758	51,650,927
Financial assets and other assets	3	311,772,738	41,971,419	353,744,157
Total non-current assets		4,174,947,670	88,526,832	4,263,474,502
Current assets				
Inventories		10,039,942		10,039,942
Trade receivables	4	141,742,596	543,049	142,285,645
Current financial assets		4,559,594		4,559,594
Cash and cash equivalents		144,008,296		144,008,296
Other current assets		42,260,393		42,260,393
Total current assets		342,610,821	543,049	343,153,870
Total assets		4,517,558,491	89,069,881	4,606,628,372
Loans	5	1,711,143,061	23,636,488	1,734,779,549
Termination benefits and other employee-related provisions	6	61,141,826	77,170,152	138,311,978
Provisions for contingencies and charges		40,090,796		40,090,796
Deferred tax liabilities	7	463,968,279	4,653,790	468,622,069
Non-current financial liabilities	8		31,466,262	31,466,262
Non-current liabilities		158,206,431		158,206,431
Total non-current liabilities		2,434,550,393	136,926,692	2,571,477,085
Current portion of long-term loans	9		18,184,650	18,184,650
Trade payables	10	177,369,586	543,049	177,912,635
Tax liabilities		12,087,213		12,087,213
Current financial liabilities		12,940,435		12,940,435
Other liabilities		42,649,296		42,649,296
Total current liabilities		245,046,530	18,727,699	263,774,229
Total liabilities		2,679,596,923	155,654,391	2,835,251,314
Share capital		440,000,000		440,000,000
Other reserves		813,174,696		813,174,696
Retained earnings	17	584,786,872	-66,584,510	518,202,362
Total equity		1,837,961,568	-66,584,510	1,771,377,058
TOTAL LIABILITIES AND EQUITY		4,517,558,491	89,069,881	4,606,628,372

RECONCILIATION OF EQUITY AT 31 DECEMBER 2005

In millions of euros	Note	Italian GAAP	Effects of IFRS_FTA	IFRS
Non-current assets				
Property, plant and equipment	1	4,004,990,509	15,367,500	4,020,358,009
Intangible assets		151,489,122		151,489,122
Deferred tax assets	2	12,105,321	39,646,624	51,751,945
Financial assets and other assets	3	296,149,846	108,914,609	405,064,455
Total non-current assets		4,464,734,798	163,928,733	4,628,663,531
Current assets				
Inventories		7,175,172		7,175,172
Trade receivables	4	985,033,523	635,134	985,668,657
Current financial assets		4,420,462		4,420,462
Cash and cash equivalents		15,791,228		15,791,228
Other current assets		50,410,630		50,410,630
Total current assets		1,062,831,015	635,134	1,063,466,149
Total assets		5,527,565,813	164,563,867	5,692,129,680
Non-current liabilities				
Loans	5	1,793,392,734	75,520,107	1,868,912,841
Termination benefits and other employee-related provisions	6	77,446,834	90,697,694	168,144,528
Provisions for contingencies and charges		35,675,117		35,675,117
Deferred tax liabilities	7	456,849,516	7,245,377	464,094,893
Non-current financial liabilities	8		29,047,521	29,047,521
Non-current liabilities		176,191,033		176,191,033
Total non-current liabilities		2,539,555,234	202,510,699	2,742,065,933
Current liabilities				
Current portion of long-term loans	9		29,540,000	29,540,000
Trade payables	10	935,521,378	635,134	936,156,512
Tax liabilities		14,387,553		14,387,553
Current financial liabilities		74,313,226		74,313,226
Other liabilities		97,782,420		97,782,420
Total current liabilities		1,122,004,577	30,175,134	1,152,179,711
Total liabilities		3,661,559,811	232,685,833	3,894,245,644
Share capital		440,000,000		440,000,000
Other reserves		816,683,476	-11,777,462	804,906,014
Retained earnings		441,278,092	-53,915,683	387,362,409
Profits for the year, net of interim dividends		168,044,434	-2,428,821	165,615,613
Total equity	17	1,866,006,002	-68,121,966	1,797,884,036
TOTAL LIABILITIES AND EQUITY		5,527,565,813	164,563,867	5,692,129,680

Reconciliation of profits for 2005

in euros	Italian GAAP	Effects of IFRS_FTA	IFRS
Revenues	887,800,824		887,800,824
Other revenues	22,335,615	142,177	22,477,792
Total revenues	910,136,439	142,177	910,278,616
Raw materials	23,883,919,8	0,0	23,883,920
Services	106,665,629,5	0,0	106,665,630
Personnel expenses	193,217,619,9	5,412,942,3	198,630,562
Amortization, depreciation and impairment losses	157,490,500,0	-387,695,9	157,102,804
Other operating expenses	22,195,841,5	-2,283,505,0	19,912,335
Capitalized expenses	-26,460,510,3	0,0	-26,460,510
Total expenses	476,993,000	2,741,741	479,734,741
Operating profits	433,143,439	-2,599,564	430,543,875
Financial income	52,521,450		52,521,450
Financial expenses	62,420,823	841,302	63,262,125
PROFITS BEFORE TAXES	423,244,066	-3,440,866	419,803,200
Income taxes	155,199,631	-1,012,044	154,187,587
PROFITS FOR THE YEAR	268,044,435	-2,428,821	265,615,613

Notes to the main IFRS adjustments made to the balance sheet captions as of 1 January 2005 and 31 December 2005

The main adjustments to the individual balance sheet figures as of 1 January 2005 and 31 December 2005 are discussed below.

BALANCE SHEET - ASSETS

1) PROPERTY, PLANT AND EQUIPMENT

euros 9.7 million at 1 January 2005 and euros 15.4 million at 31 December 2005

These adjustments relate to the reinstatement of the carrying amount of land relating to electrical stations at their historic cost, through the reversal of the related accumulated depreciation. These adjustments are based on the assumption that land has an indefinite useful life and, accordingly, is not subject to depreciation. In 2005, the adjustment is also due to the fair value adjustment of TSO business activity properties acquired from GRTN, for a total of euros 5.2 million.

2) DEFERRED TAX ASSETS

euros 36.8 million at 1 January 2005 and euros 39.6 million at 31 December 2005

These amounts reflect the balancing entry in balance sheet assets of the tax effect on adjustments mainly in relation to post employment benefits (euros 26.5 million at 1 January 2005 and euros 30.1 million at 31 December 2005), cash flow hedges (euros 6.2 million at 1 January 2005 and euros 5.8 million at 31 December 2005) and trading derivatives (euros 4.1 million at 1 January 2005 and euros 3.7 million at 31 December 2005).

3) FINANCIAL ASSETS AND OTHER ASSETS

euros 42.0 million at 1 January 2005 and euros 108.9 million at 31 December 2005

These relate to the recognition of derivatives in portfolio for fair value hedges on the Terna bonds in the balance sheet at fair value.

4) TRADE RECEIVABLES

euros 0.5 million at 1 January 2005 and euros 0.6 million at 31 December 2005

These reflect the restatement of the net receivable for contract work in progress for third parties, in the periods considered, under contract with Terna.

These amounts have balancing entries in trade payables.

BALANCE SHEET - LIABILITIES

5) LOANS

euros 41.8 million at 1 January 2005 and euros 105.0 million at 31 December 2005

This adjustment reflects the fair value adjustment of the hedged portion of Terna bonds. The net balance of the adjustment also includes the reclassification of the current portion of loans to current liabilities (euros -18.2 million at 1 January 2005 and euros -29.5 million at 31 December 2005).

6) TERMINATION BENEFITS AND OTHER EMPLOYEE-RELATED PROVISIONS

euros 77.2 million at 1 January 2005 and euros 90.7 million at 31 December 2005

These adjustments are summarized as follows:

In millions of euros	01.01.2005	31.12.2005
Termination benefits	-2,920,427	-1,215,825
Provision for the electricity discount	53,213,000	63,004,381
Other provisions	26,877,579	28,909,138
TOTAL	77,170,152	90,697,694

These mainly relate to the application of actuarial calculations to termination benefits and the recognition of the actuarially-based present value of obligations for post-employment defined-benefit plans.

7) DEFERRED TAX LIABILITIES

euros 4.6 million at 1 January 2005 and euros 7.2 million at 31 December 2005

These reflect the balancing entry in liabilities of the tax effect on adjustments made mainly for termination benefits and the reversal of accumulated depreciation of land.

8) NON-CURRENT FINANCIAL LIABILITIES

euros 31.5 million at 1 January 2005 and euros 29.0 million at 31 December 2005

These relate to the recognition of financial derivatives in portfolio at their fair value in the balance sheet at 1 January 2005 (CFH on EIB loans: euros 18.9 million; trading derivatives: euros 12.6 million) and 31 December 2005 (CFH on EIB loans: euros 17.8 million; trading derivatives: euros 11.2 million).

9) CURRENT PORTION OF LONG-TERM LOANS

euros 18.2 million at 1 January 2005 and euros 29.5 million at 31 December 2005

These reflect the reclassification of the current portion of long-term loans.

10) TRADE PAYABLES

euros 0.5 million at 1 January 2005 and euros 0.6 million at 31 December 2005

These reflect the restatement of the net payable for contract work in progress for third parties. These amounts have balancing entries in trade payables.

2005 INCOME STATEMENT ADJUSTMENTS

11) OTHER REVENUES - euros 0.1 million

This adjustment is due to the transfer of the TSO business activity from GRTN to Terna, and the excess fair value of the assets and liabilities acquired by the company with respect to the acquisition price paid for the business activity.

12) PERSONNEL EXPENSES - euros 5.4 million

This relates to the adjustment of provisions to the present value (actuarial) of obligations for post employment defined benefit plans. The adjustment of the period is due to higher costs recognized.

13) AMORTIZATION, DEPRECIATION AND IMPAIRMENT LOSSES - euros -0.4 million

This adjustment is mainly due to the reversal of the depreciation of the period in relation to land.

14) OTHER OPERATING EXPENSES - euros -2.3 million

This mainly relates to the reversal of costs of the electricity discount granted to retired former employees, recalculated using actuarial techniques and recognized under personnel expenses.

15) NET FINANCIAL EXPENSES - euros 0.8 million

The adjustment mainly includes:

- the financial component of the discounting of employee benefits (euros 5.9 million);
- the net effect on profits or losses of financial expenses (euros 62.0 million) and income (euros 67.1 million) on derivative financial instruments (hedging and trading) in portfolio at 31 December 2005.

16) INCOME TAXES - euros -1.0 million

This amount reflects the tax effects of adjustments on income statement captions, as detailed below:

TAX EFFECT OF IFRS ADJUSTMENTS

In millions of euros	2005
Termination benefits and other employee related provisions	-2,817,960
Separation of land from buildings	144,327
Derivatives	1,661,589
TOTAL TAX EFFECT	-1,012,044

17) RECONCILIATION OF EQUITY

The following reconciliation of equity at 1 January 2005 and 31 December 2005 and the profits for 2005, along with notes to the adjustments made to balances determined under Italian GAAP is provided to integrate the above reconciliation schedules of the balance sheets and income statement.

In millions of euros	Note	Equity at 01.01.2005	Equity at 31.12.2005	2005 income statement
ITALIAN GAAP		1,837,961,568	1,866,006,002	268,044,434
property, plant and equipment and related depreciation	a	9,741,655	15,367,500	528,388
employee benefits	b	-77,170,152	-90,697,694	-8,841,861
stock option plans	c	-	-	-162,510
derivative financial instruments	d	-31,315,981	-25,193,019	5,035,118
tax effect of IFRS adjustments	e	32,159,968	32,401,247	1,012,044
Total		-66,584,510	-68,121,966	-2,428,821
IFRS		1,771,377,058	1,797,884,036	265,615,613

a) Property, plant and equipment and related depreciation

IFRS provide that the caption "Land" be classified separately from other assets and not depreciated. Land relating to buildings, which was previously depreciated together with the asset built upon it, has been separated from those assets and the related depreciation has been eliminated, with a positive effect on equity at 1 January 2005 and 31 December 2005, totalling approximately euro 9.7 million and euro 15.4 million, respectively.

b) Employee benefits

IFRS identify post-employment benefits as a type of employee benefits. These are the benefits due to employees after termination of employment. In defined benefit plans, actuarial risk (the risk that benefits will be less than expected) and investment risk (the risk that the invested assets will be insufficient to meet expected benefits) fall on the company instead of the employee. Accordingly, the present value of the expected liability and related costs and income, including financial expenses and actuarial gains and losses is recognized. Terna's defined benefit plans, which include termination benefits, additional month's pay, indemnity for lack of notice, loyalty bonus and the electricity discount, have been remeasured and recognized as follows:

- electricity discount liability;
- loyalty bonus liability.

In compliance with the measurement methods for:

- termination benefits;
- provision for the additional month's pay and indemnity for lack of notice.

The above adjustments have had a negative effect on equity at 1 January 2005 and 31 December 2005 of approximately euros 77.2 million and euros 90.7 million, respectively. They have also had a negative impact of euros 8.8 million on the 2005 income statement.

c) Stock option plans

Unlike Italian GAAP, IFRS require that the company recognize share-based payments to employees over the vesting period, on the basis of the fair value at the grant date. Recognition of fair value should be a balancing entry to a specific equity reserve. Accordingly, the total effect on equity is nil. The effect on profits and losses (personnel expenses) for 2005 amounts to euros 0.2 million for plans set up by the company.

d) Derivative financial instruments

The company agrees derivative contracts to hedge the risk of fluctuations in interest and exchange rates, for both specific transactions and overall exposure. IFRS provide for specific rules for the recognition of these derivatives, which vary from those set forth by Italian GAAP.

In particular, the main impact of derivatives that hedge fluctuations in projected future cash flows related to an asset, liability or future transaction (cash flow hedges, "CFH"), is the following:

- the recognition of the fair value of the derivative asset/liability in the balance sheet;
- the recognition of the effective portion of the hedge in the reserve for cash flows hedges;
- the recognition of the ineffective portion of the hedge in profits or losses.

The main impact of derivatives that hedge fluctuations in the fair value of the hedged item, consisting of an asset or liability recognized in the balance sheet (fair value hedge on interest rates), is the following:

- the recognition of the derivative asset/liability in the balance sheet at its fair value;
- the recognition of the difference in the fair value of the hedged risk as an adjustment to the hedged item.

Lastly, derivatives that do not qualify for hedge accounting under IFRS are measured at fair value and the related effects are taken directly to profits or losses.

This accounting treatment has had a negative effect on equity at 1 January 2005 and 31 December 2005 of euros 31.3 million and euros 25.2 million, respectively.

e) Tax effect of IFRS adjustments

This is due to the tax effects of adjustments to income statement balance sheet captions, with a positive impact on equity at 1 January 2005 and 31 December 2005 of euros 32.2 million and euros 32.4 million, respectively.