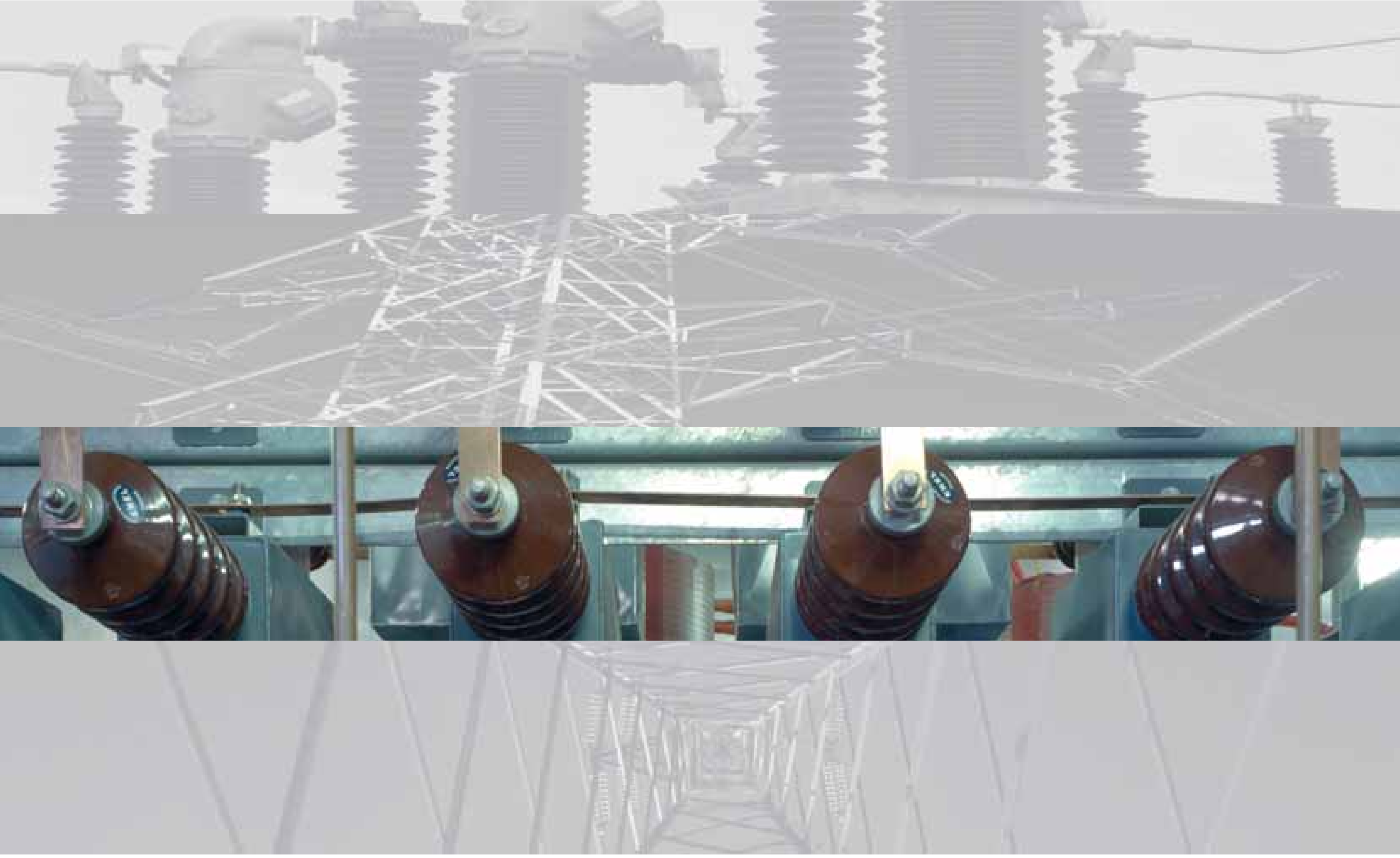

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

A) ACCOUNTING POLICIES AND MEASUREMENT CRITERIA

Introduction

Terna SpA has registered offices in Via Arno, 64 Rome, Italy. Its consolidated financial statements as of and for the year ended 31 December 2006 include its separate financial statements and those of its subsidiaries (the "Group"), as well as the group's investment in associates. The subsidiaries included in the consolidation scope are listed below.

These consolidated financial statements were approved for publication by the Directors on 21 March 2007. The Board of Directors also authorized the Chairman and CEO to make any formal changes to the consolidated financial statements and any integrations and adjustments to the sections relating to subsequent events that should be necessary up to the date of approval by the shareholders (23 and 24 May 2007).

International Financial Reporting Standards

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and the interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC), endorsed by the European Commission ("IFRS") at that date.
These consolidated financial statements have been prepared also considering the provisions of Legislative Decree no. 38 of 28 February 2005, the provisions of the Italian Civil Code and Consob Resolutions no. 15519 and no. 15520 of 27 July 2006, as well as Consob Communication no. DEM/6064293 of 28 July 2006.

Presentation criteria

The consolidated financial statements are comprised of the balance sheet, income statement, cash flow statement, statement of changes in consolidated equity, statement of recognized income and expenses 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 group's normal operating cycle. Current liabilities are those

expected to be settled in the group's normal operating cycle or within one year from the balance sheet date. The consolidated income statement is classified on the basis of the nature of costs, while the cash flow statement has been prepared using the indirect method.

These consolidated financial statements are presented in euros, and all figures are shown in millions of euros, unless otherwise indicated.

The consolidated 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 consolidated financial statements 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. Actual results may differ from these estimates. 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 consolidated 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.

Provision for bad debts

Trade receivables are initially recognized net of any impairment losses relating to sums considered non recoverable, which are taken to the specific provision for bad debts. Impairment losses are measured on the basis of the present value of estimated future cash flows, discounted at the original effective interest rate.

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.

Subsidiaries and the consolidation scope

The consolidation scope includes the parent Terna SpA and the companies over which the parent has the power to directly or indirectly govern financial and operating policies as to obtain benefits from their activities. In assessing whether or not the parent has control, potential voting rights that are presently exercisable or convertible are also considered.

The financial statements of subsidiaries are included in the consolidated financial statements on a line-by line basis from the date when the parent gains control until the date when such control ceases.

Below is a list of the companies included in the consolidation scope:

Company	Registered offices	Business activity	Share capital	Currency	% of ownership	Consolidation method
Companies controlled directly by Terna SpA						
Terna Participações SA	Rio de Janeiro (Brazil)	Holding of investments in other companies that operate in the electrical energy transmission sector	1,309,403,148	real	66%	Line-by-line
RTL Rete Trasmissione Locale	Rome	Construction and maintenance of electrical energy transmission grids	20,600,000	euro	100%	Line-by-line
Companies controlled indirectly through RTL SpA						
Rete Trasmissione Milano 1	Rome	Construction and maintenance of electrical energy transmission grids	106,778,200	euro	100%	Line-by-line
Rete Trasmissione Milano 2	Rome	Construction and maintenance of electrical energy transmission grids	76,596,900	euro	99.99%	Line-by-line
Companies controlled indirectly through Terna Participações SA						
TSN Transmissora Sudeste Nordeste SA (Brazil)	Rio de Janeiro (Brazil)	Construction and maintenance of electrical energy transmission grids	250,000,000	real	66%	Line-by-line
Novatrans Energia SA	Rio de Janeiro (Brazil)	Construction and maintenance of electrical energy transmission grids	373,135,465	real	66%	Line-by-line

The change in the consolidation scope was due to the acquisition of investments in Rete Trasmissione Milano 1 SpA (“RTM1”) and Rete Trasmissione Milano 2 SpA (“RTM2”) by the subsidiary RTL on 24 November 2006. Furthermore, the percentage of ownership in the Brazilian companies decreased (from 100% at 31 December 2005 to 66%) following the listing of the Brazilian subsidiary Terna Participações on the São Paulo stock exchange in the second half of 2006.

Associates

Investments in associates are those over which the Terna Group has significant influence but which are neither subsidiaries nor joint interests. In assessing whether or not the parent has significant influence, potential voting rights that are presently exercisable or convertible are also considered.
These investments are initially recognized at acquisition cost and subsequently measured using the equity method. Profits and losses attributable to the shareholders of the parent are recognized from the date when it begins to exercise significant influence until that influence ceases.
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.

Consolidation policies

All financial statements of investees used to prepare the consolidated financial statements are as of and for the year ended 31 December 2006. They have been adjusted, where necessary, to align them with the parent's accounting policies.
In the preparation of the consolidated financial statements, intercompany balances, transactions, revenues and costs are fully eliminated, net of the related tax effect, where material ("consolidation on a line-by-line basis"). Unrealized gains and losses with associates are eliminated in proportion to the group's share therein. In both cases, unrealized losses are eliminated, unless they represent impairment.

Translation of foreign currency captions

The financial statements of each consolidated company are prepared using the functional currency with reference to the economic context in which each company operates.
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.

Translation of financial statements in foreign currency

For the purposes of the consolidated financial statements, profits and losses, assets and liabilities are expressed in euros, which is the parent Terna SpA's functional currency.

For the purposes of preparing the consolidated financial statements, the financial statements of investees with a functional currency other than the euro, including goodwill and consolidation adjustments, are converted into euros at the exchange rate ruling at the balance sheet date. Income statement figures included in these financial statements are converted at the average exchange rate of the year. Any resulting exchange rate differences are taken directly to equity, and are classified separately in a specific equity reserve. This reserve is then released to profits or losses when the investment is sold.

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 group, 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 group 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 2004 (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% - 4.00%
Power lines	2.50% - 4.50%
Transformation stations:	
- Electrical machinery	2.00% - 3.00%
- Electrical devices and equipment	2.80 - 4.50%
- Automated and control systems	5.00 - 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.

Property, plant and equipment acquired under finance lease, through which the group has received substantially all the risks and rewards of ownership, are recognized as Group 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. If the company is not reasonably certain that it will acquire ownership at the end of the lease, the asset is depreciated over the shorter of the term of the lease and the asset's useful life.

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 in full to profits or losses over the term of the lease.

Terna

The concession granted to the parent, 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.

Brazil

Similarly to that described above with respect to Terna's concession, the Brazilian companies hold free concessions to use the portion of the electrical energy transmission grid they own. The term of the concession is thirty years from the grant date (2003) and the Brazilian companies have no obligation to return the plants (lines and stations) that make up the portion of the transmission grid they own upon expiry of the concession. Upon expiry, the plants, rights and privileges of the concession will be transferred to the Federal Government, upon payment of an indemnity commensurate with the undepreciated portions of investments in the related assets made to ensure guaranteed service continuity.

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

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.
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 parent 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 (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.

Goodwill

Goodwill arising from the acquisition of subsidiaries is allocated to each of the identified cash-generating units ("CGU"). The identified CGUS are the companies that hold concessions for electrical energy transmission and dispatching activities. Goodwill is not amortized after initial recognition. Rather, it is adjusted to reflect impairment losses, measured as described below. Goodwill relating to investments in associates is included in the carrying amount of those companies. Where negative goodwill arises, it is taken to profits or losses at the time of the acquisition.

In the adoption of IFRS endorsed by the European Commission, the group decided to restate only those business combinations that occurred after the transition date (1 January 2004). Goodwill arising on acquisitions before that date corresponds to the amount recognized using the previous accounting policies.

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 equal to the greater of fair value less costs to sell 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

Any financial assets that the company has the positive intention and ability to hold to maturity are recognized at cost at the "settlement date", which is the fair value of the initial consideration given in exchange, 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. 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 are initially recognized at the settlement date and measured at fair value, 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), changes in the fair value are initially taken to equity and subsequently to profits or losses, in line with the effects of the hedged transaction.

Changes in the fair value of derivatives that do not meet hedge accounting requirements are recognized in 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[9], indemnity for lack of notice[10], 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 parent 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.

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 for 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 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.

[9] Additional month's pay
[10] Indemnity for lack of notice

Provisions for contingencies and charges

Accruals to the provisions for contingencies and charges are recognized when, at the reporting date, the group 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. If the liability relates to property, plant and equipment, the provision is recognized as a balancing entry to the asset to which it relates. The expenses is recognized in the income statement through depreciation of the item of property, plant and equipment to which it relates.

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 expensed in full when the conditions for recognition are satisfied.

Revenues

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

- revenues from the sale of goods is recognized when the significant risks and rewards of ownership of the goods have been transferred to the buyer;
- revenues from the rendering of services is recognized with reference to the stage of completion of the transaction. If revenues cannot be reliably measured, it is 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-Group 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. This presentation method, which reflects the substance of transactions by offsetting revenues with the related costs arising from the "same transaction" is described in all its parts in a specific paragraph of the notes.

Financial income and expenses

Financial income and expenses are recognized on an accruals basis in line with the interest accrued on the net 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 of 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 group's consolidated 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 group 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 consolidated 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 Group 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 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 interest 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 estimated cash flows of the contracts is offset by a corresponding change in the fair value and/or estimated cash flows of the underlying position.

The main source of interest rate risk with regard to the investments in Brazil is the subsidised indexed interest rate on the loan granted by Banca BNDES. This indebtedness has not be hedged since the subsidised rate granted by BNDES (TJLP) is not volatile and is considered advantageous with respect to short-term Italian interest rates (CDI) and similar rates on similar maturity loans.

The Brazilian companies have taken out loans in US dollars, and the related exchange rate risk has not been hedged, considering both the burden of long-term hedges and the natural hedging that occurs, as the companies' revenues is indexed to the US dollar, given that it closely follows trends in the US dollar/Brazilian real exchange rate.

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 group's needs.

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.

In Brazil, a similar change in interest rates would not have material effects, given the nature of Brazilian debt, which is indexed to an interest rate (TJLP) that is subsidised by the Brazilian Government. Accordingly, it is not vulnerable to market volatility.

Credit risk

The Terna Group provides its services exclusively to counterparties considered solvent by the market, i.e., they have high credit ratings. Moreover, the group 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 group 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 group 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 Group's primary and secondary segments were determined considering the organizational structure and internal reporting system. In particular, since the risks and rewards of the group'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 transmission activities are reported geographically, since they are performed in Italy and Brazil. 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 sectors are measured at current market conditions.

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

2005

In millions of euros	Regulated activities: Transmission ITALY	Transmission BRAZIL	Dispatching Italy	Metering Italy	Unregulated activities	Total
Revenues	837.5	170.4	17.7	1.5	60.3	1,087.4
Segment revenues	**465.1**	**116.0**	**-2.3**	**1.5**	**26.6**	**606.9**
Unallocated expenses						59.8
Operating profits						**547.1**
Financial income/(expenses)						-82.0
Share of profits/(losses) of equity accounted investees	1.8					1.8
Income taxes						169.0
Profits for the year						**297.9**
OTHER INFORMATION						
Segment assets	4,024.0	884.2	1,090.4	2.2	289.7	6,290.6
Segment liabilities	2,797.6	499.7	837.9	-	253.2	4,388.4
Investments	260.3	9.4	3.2	-	-	272.9
Amortization, depreciation and impairment losses	151.3	17.7	6.2	-	-	175.2
Other non-monetary expenses	1.1	-	-	-	-	1.1

2006

In millions of euros	Regulated activities: Transmission ITALY	Transmission BRAZIL	Dispatching Italy	Metering Italy	Unregulated activities	Total
Revenues	954.6	187.6	105.0	9.3	51.3	1,307.8
Segment profits	**636.3**	**133.3**	**1.4**	**8.0**	**18.8**	**797.8**
Unallocated expenses						110.3
Operating profits						**687.5**
Financial income/(expenses)						-68.6
Share of profits/(losses) of equity-accounted investees	0.0					0.0
Income taxes						249.1
Profits for the year						**369.8**
OTHER INFORMATION						
Segment assets	4,456.8	937.6	1,345.0	10.4	239.5	6,989.3
Segment liabilities	2,763.8	473.2	1,309.4	2.0	282.0	4,830.4
Investments	324.7	7.0	20.7	0.1	-	352.5
Amortization, depreciation and impairment losses	171.2	18.9	34.1	0.4	-	224.6
Other non-monetary expenses	0.8		-	-	-	0.8

C) NOTES TO THE CONSOLIDATED INCOME STATEMENT

Revenues

1) REVENUES FROM GOODS AND SERVICES - euros 1,279.5 million

The table below details revenues of the year:

In millions of euros	2006	2005	Change
Grid transmission consideration	1,143.9	957.8	186.1
Adjustments for prior year grid transmission consideration	47.6	34.8	12.8
Other energy revenues	41.9	6.9	35.0
Other revenues from goods and services	46.1	59.1	-13.0
TOTAL	**1,279.5**	**1,058.6**	**220.9**

Grid transmission consideration

Most of this caption (euros 876.0 million) relates to the consideration received by the parent for use of the National Transmission Grid. It also includes grid transmission considerations (AEEG Resolution no. 15/2005) paid to Terna with the acquisition of the TSO business activity (euros 71 million); while revenues earned by the Brazilian companies, of euros 186.5 million, relates to the fixed fee established by the concession for transmission lines issued by the local energy authority (ANEEL); this caption also includes revenues of the subsidiaries of RTL Group (euros 10.5 million) relating to the related portion of the National Transmission Grid. The net increase (euros 186.1 million) is due to the following factors in particular:

- 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);
- the euros 16.7 million increase in the revenues of the Brazilian subsidiaries which is entirely related to the appreciation of the local currency (approximately euros 18.5 million);
- the contribution of revenues of the subsidiaries of the RTL Group in relation to its portion of the National Transmission Grid (euros 9.2 million).

Adjustments for prior year grid transmission consideration

AEEG's Resolution no. 162/06 of 27 July 2006 established that the transmission service tariff proceeds for 2005, based on the tariffs in place in that period, did not adequately remunerate the transmission operators.

The tariff deficit recorded amounted to a total of euros 51.7 million, which GSE SpA will pay rightful transmission operators, by using a portion of the transmission capacity considerations realized in 2004 and 2005. In particular, the greater revenues relating to Group companies includes approximately euros 47.3 million for the parent and euros 0.3 million for its subsidiary RTL SpA.

This caption also includes 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 parent 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 (energy in transit activities for the group; these have a nil balance) relating entirely to the parent and 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	Changes
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
revenues from grid transmission 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 46.1 million (2005: euros 59.1 million) and mainly relates to revenues from a variety of specialized high and very high voltage services, which the parent provides to third party customers. In particular, the amount reflects revenues from:

- maintenance for high-voltage lines (euros 20.1 million), in particular the maintenance contract for the high voltage lines owned by Enel Distribuzione SpA (euros 16.1 million, down euros 4.4 million on 2005);
- the operating, maintenance and development of the optical fibre owned by Wind Group on Terna SpA plants (safety cables) (euros 7.1 million);
- a variety of specialized services in the high voltage field for several customers (euros 17.5 million);
- requests to connect to the National Transmission Grid as per AEEG Resolution no. 281/05 (euros 1.4 million).

2) OTHER REVENUES - euros 28.3 million

Other revenues and income

Other revenues mainly relates to the parent, and is detailed below:

In millions of euros	2006	2005	Changes
Third party contributions for high-voltage connections	12.1	10.2	1.9
Other revenues	6.2	6.7	-0.5
Rental income	6.8	1.7	5.1
Prior year income	3.2	4.6	-1.4
TOTAL	**28.3**	**23.2**	**5.1**

This caption generally reflects rental income (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 parent's grids - euros 4.7 million), insurance compensation for damage to plants, gains on the sale of plant parts to third parties and, in particular, portions of third party contributions for connections to the National Transmission Grid released during the year. The prior year income for adjustments from GSE SpA on the grid transmission consideration of previous years and the release of the provision for contingencies already accrued for grid transmission consideration (euros 34.8 million) recognized in 2005, were reclassified to “revenues from goods and services”.

Income for higher taxes recognized in 2005 under “prior year income” (euros 5.6 million) is reclassified under “income taxes” as a direct decrease of such caption.

Operating Expenses

3) RAW MATERIALS AND CONSUMABLES - euros 18.7 million

In millions of euros	2006	2005	Changes
Inventory procurement	10.7	10.7	0.0
Supply of materials and equipment	5.7	9.6	-3.9
Other supplies	2.3	5.1	-2.8
TOTAL	**18.7**	**25.4**	**-6.7**

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

4) SERVICES - euros 145.3 million

In millions of euros	2006	2005	Changes
Tenders on plants	24.7	25.6	-0.9
Sundry services	64.8	41.8	23.0
Insurance	5.1	5.4	-0.3
Remote transmission and telephone	19.0	22.0	-3.0
IT services	13.0	10.5	2.5
Use of third party assets	18.7	13.5	5.2
TOTAL	**145.3**	**118.8**	**26.5**

This caption increased by euros 26.5 million on 2005 mainly because the parent Terna was fully operative as TSO integrated operator for the entire year. Figures for 2005 only relate to costs for the last two months of the year. With respect to the parent, services total euros 123.7 million.

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. It also relates to remote transmission and telephone services, IT services, leases, rentals and general services.

The following table shows the fees paid to the parent's Directors and statutory auditors. The table shows their term of office and fees are calculated 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
Machì Salvatore	Director	jan-06/dec-06	Approval of the 2007 financial statements	55,000.00		55,000.00
Macrì 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	jul-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/jul-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 242.0 million

In millions of euros	2006	2005	Changes
SHORT-TERM EMPLOYEE BENEFITS			
wages and salaries	157.2	128.4	28.8
social security contributions	51.0	33.3	17.7
other	3.8	2.9	0.9
Directors	1.2	1.1	0.1
POST-EMPLOYMENT BENEFITS			
Defined benefit plans			
electricity discount	2.6	8.8	-6.2
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	10.0	8.8	1.2
TOTAL	**242.0**	**201.7**	**40.3**

This caption includes the cost of wages and salaries, social security contributions and other costs incurred by the parent 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 40.3 million, mainly due to the costs following the acquisition of the TSO business activity and the addition of its human resources (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 parent 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' labor 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	Number at 31.12.2006	Number at 31.12.2005
Managers	73	75	75
Junior managers	420	439	403
White collars	1,890	1,937	1,866
Blue collars	1,074	1,104	1,098
TOTAL	**3,457**	**3,555**	**3,442**

The net change with respect to 31 December 2005 is an increase of 113 employees. The increase is mainly due to the acquisition of RTM1 and RTM2.

6) AMORTIZATION, DEPRECIATION AND IMPAIRMENT LOSSES - euros 224.6 million

These relate to accruals during the year calculated on the basis of amortization and depreciation rates that reflect the useful lives of the plants of the group companies. This caption increased by euros 37.4 million on 2005, mainly due to the parent, 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). The Brazilian subsidiaries also recorded an increase in amortization and depreciation (euros 1.2 million), entirely due to the effects of the different exchange rates ruling from one year to the next, while the amortization and depreciation of the subsidiaries of the RTL Group amounting to euros 3.4 million.

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

7) OTHER OPERATING EXPENSES - euros 26.5 million

In millions of euros	2006	2005	Changes
Local taxes and duties	13.5	35.0	-21.5
Prior year expenses	2.9	4.3	-1.4
Losses on the sale/disposal of plants	3.1	3.4	-0.3
Other operating expenses	7.0	3.0	4.0
TOTAL	**26.5**	**45.7**	**-19.2**

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

- lower local taxes and duties, (down euros 15.6 million) reported by the Brazilian subsidiaries in the year;
- 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 parent (up euros 2.1 million);
- grants and membership fees paid by the parent (up euros 0.8 million).

8) CAPITALIZED INTERNAL WORK - euros -36.8 million

Capitalized expenses relate to personnel expenses (euros 27.7 million) and the consumption of materials and equipment in inventories (euros 9.1 million) for plants under construction. They relate entirely to the parent. The euros 10.4 million increase is fully attributable to personnel expenses, which also offset the reduction in the capitalization of consumed materials.

Financial income expenses

9) NET FINANCIAL EXPENSES - euros 68.6 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
Other financial income	44.9	11.6	33.3
Value changes of the hedged bond	-	3.7	-3.7
Income on trading derivatives	8.8	-	8.8
Exchange rate gains	7.0	16.8	-9.8
Total income	**60.7**	**35.4**	**25.3**
FINANCIAL EXPENSES			
Interest expenses on medium/long-term loans	-118.4	-109.5	-8.9
Value changes of the hedged bond	-2.6	-	-2.6
Expenses on trading derivatives	-	-2.0	2.0
Discounting of termination benefits and other employee-related provisions	-6.6	-5.9	-0.7
Exchange rate losses	-1.7	-	-1.7
Total expenses	**-129.3**	**-117.4**	**-11.9**
TOTAL EXPENSES, NET	**-68.6**	**-82.0**	**13.4**

Net financial expenses of the year amounts to euros 68.6 million, down euros 13.4 million on 2005. The change is due to the combined effect of a variety of factors. In particular:

- an increase in financial expenses due to medium/long-term indebtedness (up euros 8.9 million) mainly following the rise in interest rates with repercussions on bonds and the related hedges (up euros 11.0 million) and the EIB loans bearing interest at variable rates and the related hedges (down euros 1.6 million). A decrease in financial expenses for the Brazilian subsidiaries, including the effects of the real/euros exchange rate (down euros 0.4 million);
- an increase in other financial income (euros 33.3 million) mainly related to the gain on 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 31.4 million);
- lower exchange rate gains recognized by the parent (down euros 11.5 million) and lower exchange rate losses due to the appreciation of the Brazilian real against the euro and the US dollar with respect to 2005.
- the net positive effects of the fair value adjustment of bonds and related hedges, as well as additional derivative instruments in the parent's portfolio (up euros 4.5 million);
- the financial effect of the discounting of employee benefits, which includes charges substantially in line with 2005 (up euros 0.7 million);
- lower financial income (down euros 3.3 million) of the parent in relation to the intercompany current account, which was still open in 2005 with Enel SpA and closed on 15 September 2005.

10) SHARE OF PROFITS/(LOSSES) OF EQUITY-ACCOUNTED INVESTEES - euros -0.0 million

In 2005, this caption included the fair value adjustment of the investment in the associate Cesi SpA, measured using the equity method. In 2006, no changes occurred in this respect.

11) INCOME TAXES - euros 249.1 million

Income taxes of the year amount to euros 249.1 million, with an impact on profits before taxes of 40.23% (net of tax adjustments relating to previous years). In 2005, income taxes amounted to euros 163.4 million, with an impact on profits before taxes of 35.41%.

Income taxes of the year are detailed as follows:

In millions of euros	2006	2005	Changes
INCOME TAXES			
Current taxes:			
- IRES	195.2	136.2	59.0
- IRAP	40.9	28.6	12.3
- Brazilian companies	32.2	11.4	20.8
Temporary differences:			
- deferred tax income	-15.7	-14.2	-1.5
- deferred tax expenses	9.9	32.3	-22.4
Reversal of temporary differences:			
- deferred tax income	8.2	11.9	-3.7
- deferred tax expenses	-21.7	-37.2	15.5
Adjustments to income taxes of previous years	0.1	-5.6	5.7
TOTAL	**249.1**	**163.4**	**85.7**

The euros 85.7 million increase with respect to the previous year is mainly due to higher current taxes in Italy (up euros 71.3 million) and in Brazil (up euros 20.8 million), following the strong results of the year.

Deferred tax income and expenses (-euros 19.3 million) decreased by a net euros 12.1 million, mainly as a result of the following events:

- deferred tax income, net (euros 7.5 million) recognized in connection with temporary differences which arose during the year for accruals for personnel incentives (leaving incentives and bonuses) and to the provision for bad debts in excess of the tax-deductible portion;
- the net utilization of deferred taxes (down euros 11.8 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 caption also includes income (down euros 5.7 million on 2005) in relation to the parent's higher current taxes of previous years (euros -3.2 million), offset by adjustments for greater taxes (euros 3.3 million) in relation to previous years recognized by Brazilian subsidiaries for the recalculation of contributions to the

PIS (Social integration scheme) and the Cofins (Social insurance loan) on the Brazilian grid concession fees (RAP) with the former fees, which were higher, as established by the Brazilian tax authorities, with retroactive effect, as per Legislative Instructions no. 658 issued by the SRF (Secretaria da Receita Federal) on 4 July 2006.

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

In millions of euros	2006	2005
Theoretical tax charge 33%	**204.2**	**154.1**
IRAP	40.9	28.6
Brazil	2.4	-16.9
Permanent differences	1.5	3.2
Actual tax charge	**249.0**	**169.0**
ACTUAL RATE	**40.2%**	**36.2%**

At year end, the total deferred tax charge relating to items recognized directly in equity amounts to euros 2.0 million and relates to the deferred tax effect on the fair value adjustment of derivatives hedging cash flow hedges.

12) EARNINGS PER SHARE

Basic earnings per share amount to euros 0.185, in which the numerator and denominator amount to euros 369.8 million and euros 2,000 million, respectively.

Diluted earnings per share amount to euros 0.184, in which the numerator and denominator amount to euros 369.8 million and euros 2,010 million, respectively.

D) NOTES TO THE CONSOLIDATED BALANCE SHEET

Assets

13) PROPERTY, PLANT AND EQUIPMENT - euros 5,159.0 million

Property, plant and equipment amount to euros 5,159.0 million (euros 4,646.3 million at 31 December 2005). They may be broken down as follows:

In millions of euros	Land	Buildings	Plant and machinery	Industrial and commercial equipment	Other assets	Assets under construction and payments on account	Total
Cost at 01.01.2006	**20.7**	**614.5**	**7,392.4**	**42.0**	**31.3**	**376.9**	**8,477.8**
Investments	2.3	18.7	108.5	2.3	14.6	179.6	326.0
Reclassifications	1.9	20.9	153.2		2.5	-178.5	0.0
Acquisition of Munirah		0.1	36.9			0.3	37.3
RTM1		0.4	359.4	0.5	0.3	0.6	361.2
RTM2	0.3		112.3	0.1			112.7
Exchange rate differences		-0.4	-18.4		0.2	-1.0	-19.6
Disposals	0.1	-0.3	-26.0	-0.1	-0.1	-0.6	-27.0
Other changes		-0.9	-12.6				-13.5
Reclassifications		-34.7	36.4		-1.7		0.0
Cost at 31.12.2006	**25.3**	**618.3**	**8,142.1**	**44.8**	**47.1**	**377.3**	**9,254.9**
Accumulated depreciation and impairment losses at 01.01.2006		**-216.0**	**-3,565.9**	**-29.3**	**-20.3**		**-3,831.5**
Depreciation of the year		-14.1	-172.6	-2.3	-4.7		-193.7
Impairment losses							0.0
Acquisition of Munirah			-0.4				-0.4
RTM1		-0.1	-69.0	-0.1	-0.3		-69.5
RTM2			-24.6				-24.6
Exchange rate differences			1.7				1.7
Disposals		0.2	21.6	0.1			21.9
Other changes			0.2				0.2
Reclassifications		1.8	-2.2		0.4		0.0
Accumulated depreciation and impairment losses at 31.12.2006	**0.0**	**-228.2**	**-3,811.2**	**-31.6**	**-24.9**		**-4,095.9**
Carrying amount							
AT 31 DECEMBER 2006	**25.3**	**390.1**	**4,330.9**	**13.2**	**22.2**	**377.3**	**5,159.0**
AT 31 DECEMBER 2005	**20.7**	**398.5**	**3,826.5**	**12.7**	**11.0**	**376.9**	**4,646.3**

The caption “plant and machinery” includes the electrical energy transmission grid and the transformation stations in Italy and Brazil, the central systems for remote conduction and the national electrical energy control system.

The Brazilian plant includes the Northeast-Southeast transmission line, which has a nominal voltage of 500 kV and is about 1,062 km long, beginning at the Serra da Mesa substation, in the state of Goias, and ending at the Sapeaçu substation, in the state of Bahia; and the North-South II transmission line, which has a nominal voltage of 500 kV and is about 1,280 km long, beginning at the Imperatriz substation, in the state of Maranhão, and ending at the Samambaia substation, in the Federal District.

By acquiring Munirah (March 2006), TSN acquired an additional 107 Km of 500 kV transmission lines and the substation of Camaçari (II) (Bahia), therefore completing the North-Northeast transmission circuit.

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

In millions of euros	
Investments:	
- Transmission lines	120.4
- Transformation stations	148.9
- Other	49.7
- Brazil	7
Total investments	**326.0**
Depreciation	-193.7
Disposals and other changes	-18.4
Changes in consolidation scope:	
- RTM1	291.7
- RTM2	88.1
- Munirah	36.9
Exchange rate differences	-17.9
TOTAL	**512.7**

In addition to ordinary changes of the year relating to investments (euros 326.0 million), contributions for plants which became operative during the year (euros 13.6 million), sales (euros 5.1 million) and depreciation (euros 193.7 million), the caption also includes the acquisition of non-current assets following the acquisition of RTM1 (euros 291.7 million) and RTM2 (euros 88.1 million) in Italy (for greater information, reference should be made to the section "business combinations") and Munirah (euros 36.9) in Brazil.

Investments of the year relating to the National Transmission Grid (euros 318.7 million) 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 Rome, via della Marcigliana (euros 7.2 million).

Investments in Brazil (euros 7.0 million) mainly relate to the termination of the EPC contract (euros 1.3 million), the acquisition of ancillary services for all NVT stations (euros 1.2 million), the purchase of a back up reactor for the Serra de Mesa station (euros 0.6 million) and the restructuring of the new headquarters in Rio de Janeiro (euros 0.6 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 millions 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

14) GOODWILL - euros 139.9 million

Goodwill amounts to euros 139.9 million (euros 154.7 million at 31 December 2005). The balance and the changes by cash-generating unit are shown in the table below:

In millions of euros	TSN	NVT	RTL	RTM1	RTM2	MUNIRAH	Total
BALANCE AT 31 DEC. 2005	**106.1**	**48.1**	**0.5**	**0.0**	**0.0**	**0.0**	**154.7**
Change in consolidation scope				11.9	25.9	2.6	40.4
Terna Participações Listing	-36.1	-16.3					-52.4
Exchange rate differences	-1.7	-0.8					-2.5
Other changes			-0.3				-0.3
BALANCE AT 31 DEC. 2006	**68.3**	**31.0**	**0.2**	**11.9**	**25.9**	**2.6**	**139.9**

At 31 December 2006, goodwill (euros 139.9 million) relates to the difference paid by the group with respect to equity of subsidiaries at the acquisition date which was adjusted, for foreign subsidiaries, to reflect the effects of the year-end exchange rate. The increase in the balance at 31 December 2006 on the previous year end relates to the following:

- the acquisition of the subsidiaries RTM1 (euros 11.9 million) and RTM2 (euros 25.9 million) on 24 November 2006; for greater information reference should be made to the section “business combinations”;
- the partial realization of goodwill of Brazilian subsidiaries arising from the 34% reduction in the parent’s investment in the subsidiary Terna Participações following the listing of the company on Brazil’s São Paulo stock exchange in the second half of 2006 (euros -52.4 million);
- the adjustment of remaining goodwill (66%) to the above-mentioned listing relating to foreign subsidiaries

to reflect the effects of the year-end exchange rate (euros -2.5 million);

- the acquisition of the Brazil-based Munirah (euros 2.6 million).

Impairment testing

The recoverable amount of goodwill on the three Brazilian cash-generating units (CGUs) (Trasmissora Sudeste-Nordeste/TSN, Novatrans/NVT and Terna Participações) was estimated based on the list price of Terna Participações shares at 31 December 2006 (real 24.1), less estimated selling costs comprising local commissions and taxes of 4.1%. Based on the above, the recoverable amount of goodwill exceeds the above-mentioned carrying amount of the CGUs.

15) INTANGIBLE ASSETS - euros 159.2 million

Changes during the year in intangible assets are detailed below:

In millions of euros	Concessions	Other assets	Assets under development and payments on account	Total
BALANCE AT 31 DEC. 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 DEC. 2006	**128.9**	**14.7**	**15.6**	**159.2**
BALANCE AT 31 DEC. 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 DEC. 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 of the year relating to 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 external procedures.

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

16) DEFERRED TAX ASSETS - euros 62.1 million

Deferred tax assets relate to the following captions:

In millions of euros	31.12.2005	Change in consolidation scope and other changes	IMPACT RECOGNIZED IN PROFITS OR LOSSES		31.12.2006
			Accruals	Utilization	
Provision for contingencies and charges	10.3	1.4	5.4	-0.8	16.3
Provision for bad debts			2.1		2.1
Termination benefits and other employee-related provisions	30.5		7.4	-7.2	30.7
CFH and trading derivatives	9.6			-3.9	5.7
Tax loss	5.0			-5.0	0.0
Other	1.9	4.2	1.7	-0.5	7.3
DEFERRED TAX ASSETS	**57.3**	**5.6**	**16.6**	**-17.4**	**62.1**

The net increase (euros 0.8 million) on 2005 is mainly due to the combined effect of the following:

- the recognition of receivables of euros 5.4 million relating to the non-deductible accruals to the provisions for contingencies and charges;
- 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 utilization of receivables following the full recovery of the tax losses incurred by Novatrans and RTL (euros -5.0 million);
- the increase in receivables following the acquisition of RTM1 and RTM2 (euros 6.9 million).

The change in this caption (euros 4.8 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).

17) EQUITY-ACCOUNTED INVESTEES - euros 6.4 million

Investments in equity-accounted investees amount to euros 6.4 million and relate to Cesi SpA, in which the group holds 24.4%.

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 carrying amount of this investment is unchanged with respect to 2005.

As permitted by current legislation, Cesi opted not to apply IFRS to the preparation of its financial statements at 31 December 2006. Consequently, these financial statements were prepared in accordance with Italian GAAP.

The main figures of Cesi, restated in accordance with the presentation and measurement criteria applied by Terna Group are as follows:

	ASSETS		LIABILITIES				
In millions of euros	Current	Non-current	Current	Non-current	Equity	Revenues	Profits for the year
Cesi	71.3	56.9	36.1	65.3	26.8	69.3	0.7

18) FINANCIAL ASSETS

Financial assets recognized in the consolidated financial statements are detailed in the table below:

	CARRYING AMOUNT		
In millions of euros	31.12.2006	31.12.2005	Change
FVH derivatives	11.3	106.1	-94.8
Trading derivatives	0.7	0.0	0.7
Non-current financial assets	**12.0**	**106.1**	**-94.1**
Deferred assets on FVH derivative contracts	1.5	4.4	-2.9
Other non-current financial assets	0.7	0.0	0.7
Current financial assets	**2.2**	**4.4**	**-2.2**
TOTAL	**14.2**	**110.5**	**-96.3**

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

“Non-current financial assets” amount to euros 12.0 million. The euros 94.1 million decrease is due to the rise in interest rate curve which triggered a reduction in the carrying amount of FVH derivatives (euros 94.8

million) and an increase in trading derivatives (euros 11.9 million).

The following table shows the group 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**	

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 bonds. 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.

"Current financial assets" amount to euros 2.2 million (euros 4.4 million at 31 December 2005) and mainly relate to the following:

- "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 bonds issued, amount to euros 1.5 million;
- "Other financial assets - current", which are entirely related to interest accrued and not yet received at the balance sheet date in connection with the current account balances, amount to euros 0.7 million.

19) INVENTORIES - euros 25.6 million

Inventories under current assets include materials and devices used in the operating, maintenance and construction of plants of euros 25.6 million (euros 21.2 million at 31 December 2005). The euros 4.4 million increase is mainly due to the ordinary maintenance requirements of plants.

20) TRADE RECEIVABLES - euros 1,182.1 million

Trade receivables are composed as follows:

In millions of euros	31.12.2006	31.12.2005	Change
Non-energy related receivables	285.3	266.5	18.8
Energy-related receivables	896.8	759.7	137.1
TRADE RECEIVABLES	**1,182.1**	**1,026.2**	**155.9**

Trade receivables amount to euros 1,182.1 million, up euros 155.9 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 (formerly GRTN) 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).

Non-energy related receivables - euros 285.3 million.

These amount to euros 285.3 million and 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. This caption also includes the share of fees pertaining to the operation of the Brazilian lines, both invoiced and to be invoiced (euros 14.5 million).

Receivables of foreign subsidiaries decreased substantially on 31 December 2005 (down euros 18.7 million), mainly as a result of the effects of the adjustment of the concession fees (RAP) for the period from 1 July 2006 to 30 June 2007 (ANEEL standardization Resolution no. 385 of 27 June 2006) and the retroactive application (again with respect to the RAP) of the former PIS/CONFINS rates to concession agreements signed before 31 October 2003 (under SRF regulatory Recommendation no. 658 of 4 July 2006, issued by the Brazilian Ministry of Finance). The latter measure entailed an adjustment to receivables following the higher grid transmission consideration calculated for PIS/CONFINS (period from January 2004 to the first half of 2006) and the corresponding recognition of tax receivables.

Other trade receivables include receivables due from Italian customers (euros 41.3 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.

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 parent. 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 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.

21) 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	1.3	1.3	0.0
- tax advance on termination benefits	0.5	1.5	-1.0
Other non-current assets	**6.4**	**7.0**	**-0.6**
Tax assets	8.0	11.7	-3.7
Receivables due from others:			
- advances to employees	0.2	0.2	0.0
- other	25.8	21.0	4.8
Other current assets	**34.0**	**32.9**	**1.1**

Non-current assets, detailed above, have not undergone any changes with respect to the previous year. Other current assets amount to euros 34.0 million (euros 32.9 million at 31 December 2005) and mainly relate to the following:

- tax assets of euros 8.0 million, primarily in relation to the following items:
  - tax receivables of foreign subsidiaries (euros 5.6 million) due to the retroactive adjustment of the former PIS/COFINS rates (under SRF regulatory Recommendation no. 658 of 4 July 2006 issued by the Brazilian Ministry of Finance);
- receivables due from others of euros 26.0 million, mainly in relation 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;
  - deferred tax assets of euros 3.9 million relating, in particular, to charges on use of third-party assets contracts which the parent subsequently entered into following the sale of plants by Enel Distribuzione (euros 1.5 million) and insurance premium (euros 1.6 million);
  - sundry receivables of euros 6.6 million;
  - sundry advances to employees (euros 0.2 million) and third parties (euros 2.2 million).

22) CASH AND CASH EQUIVALENTS - euros 200.4 million

At 31 December 2006, the parent's cash and cash equivalents amounted to euros 15.3 million, including bank current account deposits of euros 15.2 million (bearing interest at an average rate of 3.58%) and euros 0.1 million in cash on hand for operating areas.
At 31 December 2006, the cash and cash equivalents of the Brazilian subsidiaries amounted to euros 185.1 million (real 179.7 million and US$ 5.4 million) and include current account deposits of euros 149.1 million and term deposits of euros 36.0 million to guarantee loans granted.
The significant increase in the cash and cash equivalents of the Brazilian subsidiaries is due to the listing (IPO) of Terna Participaçoes shares on the São Paulo Stock Exchange in October.

Liabilities

23) EQUITY ATTRIBUTABLE TO THE SHAREHOLDERS OF THE PARENT euros 2,008.9 million

Share capital - euros 440.0 million

The share capital of Terna SpA is comprized 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 parent's share capital.

Other reserves - euros 744.9 million

Other reserves underwent a net increase of euros 21.8 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 net accrual of the portion (euros 13.2 million) of the incentive received from the Brazilian Ministry of National Integration relating to 2006 to equity reserves by the subsidiaries TSN and Novatrans;
the recognition of the cost of stock options described below (up euros 0.8 million).

Retained earnings - euros 475.7 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. The increase of the year (euros 22.5 million) mainly relates to the following events:

- allocation of the excess (euros 37.9 million) consolidated profits for the year ended 31 December 2005, with respect to the distribution of the balance of the related dividend during the first half of 2006 (euros 160.0 million).
- decrease in translation reserve following:
  - the reduction in translation differences arising on the consolidation of the foreign subsidiaries, mainly as a result of the appreciation of the Brazilian real against the euro compared with 2005. In this respect, the adjustment of goodwill at the year-end exchange rate entailed a euros 2.5 million decrease in that caption;
  - the partial goodwill of Brazilian subsidiaries arising from the 34% reduction in the investment in the subsidiary Terna Participações following the listing of the company on the Nivel 2 segment of Brazil's São Paulo stock exchange (Bolsa de Valores de São Paulo - BOVESPA), in the second half of 2006 (euros -13.2 million);

2006 interim dividend

After receiving the report of the auditors as per Article 2433 bis of the Italian Civil Code, the parent'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	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	395.2	A, B	329.4
Retained earnings	429.3	A, B, C	398.4
interim dividend	-106.0	-	-
Profits for 2006	366.3	-	-
Total	**2,008.9**		
		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.

The Board of Directors proposed that the shareholders, in their meeting which will be called on 23 May 2007 (first call) and 24 May 2007 (second call), approve a total dividend for 2006 of euros 0.14 per share and to pay, gross of withholdings as provided for by the law, the remaining euros 0.087 per share with respect to the above mentioned interim dividend. Consequently, the proposed dividend for 2006 amounts to euros 280 million, up 20 million or 7.7% on 2005.

The dividend is subject to the approval of shareholders called in their annual meeting. Therefore, it was not included under balance sheet liabilities. The balance of the proposed 2006 dividend will be payable to all shareholders on 21 June 2007.

Equity attributable to minority interests - euros 150.0 million

Equity attributable to minority interests relates to the Brazilian subsidiaries. In particular, the following is attributable to minority interests:

the purchased (OTC market) and subscribed (primary market) share capital and the relevant portion of equity reserves and the share of profits/(losses) of the Brazilian subsidiaries until the listing date (euros 148.7 million);

the profits, translation reserve and the reserve relating to the incentive received from the Brazilian Ministry of National Integration to the extent of the portion accrued in the period subsequent to the listing (euros 1.3 million).

Terna SpA stock option plans

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

These plans are aimed at giving the Terna Group - 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.

2006 stock option plans 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 managers of the Terna Group, who hold the most important roles in terms of achieving the group'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 Group EBITDA for the grant year (2006), must be greater than that shown in the group 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:
   a. 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;
   b. 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;
   c. up to 100% of exercisable options, beginning from the first day of the second calendar year subsequent to the year in which the notice communicating the fact that the conditions underlying the exercise have been 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 verified that the conditions for exercise had been met when it approved the draft 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.

	2006 plan
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)
2006 plan	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%.

Stock options - Terna Participações SA

On 14 December 2006, the Board of Directors of Terna Participações SA, following the approval of shareholders in their extraordinary meeting of 5 October 2006, decided to adopt the first stock option plan for the three managers of Terna Participações SA; in particular, the 2007 Brazil stock option plan may be analyzed as follows:

Regulation governing the stock option plan (Resolution dated 14 December 2006)

The plan provides for the distribution of a maximum of 163,472 options to three managers of Terna Participações, who hold the important roles in terms of achieving strategic targets, including the CEO.

Under the approved regulation governing the stock option plan:

1. the strike price of each share certificate (unit) is real 21.00;

2. the exercise of the options and consequently, the right to subscribe certificates of the newly-issued Terna Participações shares depends on meeting two performance parameters. In particular:

   a. Terna Participações EBITDA for 2006 and the first half of 2007, must be greater than that shown in the budget approved by the Board of Directors;

3. if the conditions underlying the exercise are met, individual beneficiaries can exercise their options by 31 December 2011 and up to the following maximum quantities:
   a. 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;
   b. up to 60% of exercisable options, beginning from 31 December of the year in which the notice communicating the fact that the conditions underlying the exercise have been met is issued;
   c. up to 100% of exercisable options, beginning from 31 December of the first calendar year subsequent to the year in which the notice communicating the fact that the conditions underlying the exercise have been met.

The Board of Directors will verify that the conditions for exercise are met when it approves the interim financial statements at 30 June 2007.

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

	2007 Plan
Outstanding at 1 January	-
Granted during the year	163,472
Unopted during the year	163,472
Exercised during the year	-
Matured during the year	-
Outstanding at 31 December 2006	163,472
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 14 December 2006)	End of vesting period	Fair value * at grant date (in real)
2007 Plan	49,041	first half 2007	3.17
	49,041	second half 2007	3.17
	65,390	2008	3.17
TOTAL	**163,472**		

* factor of probability 80%

The binomial pricing method is used, which considers the value of the Terna Participações 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 real 24.10;
- Strike price of real 21.00;
- 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 of 13.62%.

24) LOANS

The following table details loans and financial liabilities recognized in the Terna Group's consolidated financial statements at 31 December 2006. In particular, for each category, the carrying amount and the fair value of all financial liabilities recognized in the Terna Group's consolidated financial statements are compared.

In millions of euros	Carrying amount 31.12.06	Carrying amount 31.12.05	Change	Fair Value 31.12.06	Fair Value 31.12.05	Change
Bonds	1,406.6	1,498.4	-91.8	1,406.6	1,498.4	-91.8
Bank loans:						
- Italy	540.9	370.5	170.4	540.9	370.5	170.4
- Brazil	420.4	440.2	-19.8	420.4	436.5	-16.1
Total bank loans	**961.3**	**810.7**	**150.6**	**961.3**	**810.7**	**150.6**
Long-term loans	**2,367.9**	**2,309.1**	**58.8**	**2,367.9**	**2,305.4**	**62.5**
CFH derivatives	6.2	17.8	-11.6	6.2	17.8	-11.6
Trading derivatives	0.0	11.2	-11.2	0.0	11.2	-11.2
Non-current financial liabilities	**6.2**	**29.0**	**-22.8**	**6.2**	**29.0**	**-22.8**
Short-term loans	50.0	55.0	-5.0	50.0	55.0	-5.0
Current portion of long-term loans	71.1	58.3	12.8	71.1	58.3	12.8
Short-term loans and current portion of medium/long-term loans	**121.1**	**113.3**	**7.8**	**121.1**	**113.3**	**7.8**
TOTAL	**2,495.2**	**2,451.4**	**43.8**	**2,495.2**	**2,447.7**	**47.5**

The carrying amount of the bonds 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.

(*) 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	1498.4	1406.6	0.0	1406.6	0.0	0.0	0.0	0.0	1406.6
IDB	2016	48.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total fixed rate		**1547.2**	**1406.6**	**0.0**	**1406.6**	**0.0**	**0.0**	**0.0**	**0.0**	**1406.6**
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	215.9	22.7	193.2	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	2008	0.0	200.0	0.0	200.0	0.0	10.5	21.1	21.1	147.4
BNDES-UNIBANCO	2016-2018	420.2	461.9	41.5	420.4	38.4	37.8	40.9	44.4	258.9
Total variable rate		**820.2**	**1032.4**	**71.1**	**961.3**	**67.9**	**82.4**	**100.6**	**104.0**	**606.4**
TOTAL		**2367.4**	**2439.0**	**71.1**	**2367.9**	**67.9**	**82.4**	**100.6**	**104.0**	**2013.0**

Bonds are recognized at their fair value at 31 December 2006, calculated as described above. The repayment of a 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.

The Terna Group's total loans at 31 December 2006 amount to euros 2,439.0 million, including medium/longterm loans of euros 2,367.9 million. The changes during the year include the new payables acquired on 31 March 2006 following TSN's acquisition and merger of Brazil-based Munirah Transmissora de Energia SA, which had been recognized in Munirah's financial statements. They total euros 23.0 million, broken down as follows:

- euros 21.3 million granted by BNDES on 22 April 2005 to fund the Munirah line investment project, including principal of euros 3.7 million in Brazilian real, but updated daily for changes in the real against a basket of foreign currencies (88.08% US dollar, 11.50% Japanese yen, 0.24% euro and 0.18% other currencies). Interest on this debt in Brazilian real is calculated at the TJLP rate plus a spread of 3.0%. If the TJLP exceeds 6%, interest due for that excess amount is capitalized and repaid in accordance with the repayment plan for residual debt. Interest on debt indexed to the basket of foreign currencies accrues at a variable rate based on the average cost incurred by BNDES to acquire foreign currency, plus a 3%

spread. Interest is paid at the end of each month for both loans. The principal is repayable in 144 monthly instalments from 15 April 2006;

- euros 1.7 million granted by Banco Santander on 31 March 2006, but repaid on 2 May 2006.

On 15 December 2006, Novatrans took out a new loan granted by BNP Paribas, Banco Santander and Citibank denominated in local currency and indexed to the short-term interbank rate (CDI), plus a 0.90% spread. Interest is paid and the principal is repaid in instalments at the end of the each month. This payable was used to early repay the existing payable denominated in US dollars taken out with Interamerican Development Bank (IDB).

On 13 April 2006, TSN took out a new loan with the following characteristics:

- real 50.0 million, equal to euros 19.4 million (at the exchange rate of 2.58256 ruling on 13 April 2006) granted by UNIBANCO and maturing on 13 April 2008. Interest accrues at the short-term interbank rate (CDI), plus a 0.85% spread, while principal is repaid in 24 instalments at the end of each month.

Lastly, on 17 April 2006, BNDES disbursed TSN the last instalment of a loan, amounting to euros 0.5 million.

These loans are not hedged by derivatives. Accordingly, the entire amount is exposed to risks of fluctuations in interest rates.

Guarantees given amount to approximately euros 211 million and relate to the subsidiaries TSN and Novatrans shares held by Terna Group, which have been pledged to the lending banks (BNDES Itaú, ABN, Citibank, BNP e Santander) for investments in Brazil. However, Terna Participações retains the right to vote and receive dividends.

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 31.12.06
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	215.9	22.7	193.2	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%
BNDES-UNIBANCO	2016-2018	real	461.9	41.5	420.4	11.19%
Variable rate			**1,032.4**	**71.1**	**961.3**	
TOTAL			**2,439.0**	**71.1**	**2,367.9**	

Considering the implicit rate of hedges, the average interest rate on the bonds is 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 group 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	Difference in fair value from 31.12.05 to 31.12.06	Notional debt at 31.12.06	Carrying amount at 31.12.06
Listed fixed rate bonds	1,400.0	1,498.4	0.0	0.0	0.0	(91.8)	1,400.0	1,406.6
Total bonds	**1,400.0**	**1,498.4**	**0.0**	**0.0**	**0.0**	**(91.8)**	**1,400.0**	**1,406.6**
Bank loans of subsidiaries	469.0	469.0	(78.0)	82.9	(12.0)		461.9	461.9
Bank loans of the parent	400.0	400.0	(29.5)	200.0	0.0	0.0	570.5	570.5
Total bank loans	**869.0**	**869.0**	**(107.5)**	**282.9**	**(12.0)**	**0.0**	**1,032.4**	**1,032.4**
TOTAL FINANCIAL INDEBTEDNESS	**2,269.0**	**2,367.4**	**(107.5)**	**282.9**	**(12.0)**	**(91.8)**	**2,432.4**	**2,439.0**

Medium and long-term indebtedness shows a euros 71.6 million increase on 31 December 2005, due to the drop in the fair value of bonds (euros 91.8 million), the repayment of EIB loans (euros 170.5 million; euros 29.5 million as a decrease in the repayment subsidiaries' loans and euros 200.00 million as an increase for new issues), the repayment of subsidiaries' loans (euros 78.0 million), the decrease due to exchange rate differences (euros 12.0 million) and the increase following the issue of new debt or the consolidation of new debt (euros 82.9 million).

At 31 December 2006, the parent 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, Unicredit Banca Mobiliare SpA Mediobanca - Banca di Credito Finanziario SpA and Banco Bilbao Vizcaya Argentaria SA are lead arrangers of this transaction). 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 on hand - Italy	15.3
B) Cash on hand - Brazil	185.1
C) Securities held for trading	0.0
D) Cash and cash equivalents (A) + (B) + (C)	**200.4**
E) Current financial receivables	**0.0**
F) Current bank debt	50.0
G) Current portion of long-term debt	71.1
H) Other current financial payables	0.0
I) Current financial indebtedness (F) + (G) + (H)	**121.1**
J) Net current financial indebtedness (I) - (E) - (D)	**-79.3**
K) Non-current bank debt	961.3
L) Bonds	1,406.6
M) Derivative financial instruments in portfolio	-5.8
N) Non-current financial indebtedness (K) + (L) + (M)	**2,362.1**
O) Net financial indebtedness (J) + (N)	**2,282.8**

There are no financial payables or receivable due from/to related parties.

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	31.12.2006	31.12.2005	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 (increase in non-current financial assets of euros 0.7 million and 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%.

Current financial liabilities

Current financial liabilities arising on financial expense 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**
Bonds			
- ten-year	4.5	4.5	0.0
- twenty-year	7.0	7.0	0.0
Total	**11.5**	**11.5**	**0.0**
Loans	**4.3**	**3.8**	**0.5**
TOTAL	**16.0**	**16.8**	**-0.8**

25) TERMINATION BENEFITS AND OTHER EMPLOYEE-RELATED PROVISIONS euros 166.1 million

The Terna Group offers its employees benefits during their employment with the group (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 Group 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 Group 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	0.0	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	-1.1	85.4
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	0.0	0.1	1.5	3.9
Total	**86.1**	**9.5**	**3.4**	**-2.7**	**96.3**
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**	**-19.7**	**166.1**

This caption amounts to euros 166.1 million at 31 December 2006 (euros 168.2 million at 31 December 2005) and shows a net decrease of euros 2.1 million compared to the previous year, mainly due to the combined effect of the net accruals of termination benefits (euros 10.8 million), net utilization, transfers and other changes in the electricity discount and ASEM made by the group (euros -12.4 million).

In millions of euros	Termin. ben.	Indemnity for lack of notice	Additional month's pay	Loyalty bonus	ASEM	Electricity discount	Elec. discount substitute indemnity	Total
31.12.2005	**74.6**	**2.1**	**9.2**	**3.9**	**15.2**	**63**	**0.2**	**168.2**
Cost	9	-0.1	0.5	0	0.3	1.1	0	10.9
Interest	2.9	0.1	0.4	0.2	0.6	2.5	0	6.7
(Gains)/Losses	5.3	1.5	-2	1.4	-3.1	-11.1	0	-8
Disbursements and transfers	-10.5	-0.1	-1.1	-1.5	-0.1	-2.6	0	-15.9
Change in consolidation scope	4.0	0.2	0	0	0	0	0	4.2
31.12.2006	**85.3**	**3.7**	**7**	**4**	**12.9**	**52.9**	**0.2**	**166.1**

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%

26) PROVISIONS FOR CONTINGENCIES AND CHARGES - euros 59.1 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 DEC. 2005	**14.3**	**13.5**	**9.6**	**37.4**
Accruals	0.4	20.5	4.1	25
Utilization	-1	-3.2	-1.8	-6.0
Change in consolidation scope	-	2.7	-	2.7
BALANCE AT 31 DEC. 2006	**13.7**	**33.5**	**11.9**	**59.1**

Provision for litigation - euros 13.7 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 Group activities. The amount accrued takes into account the opinions of both the internal and independent lawyers. Litigation for which a positive outcome is expected and those entailing a remote, potential charge are not provided for, and nor are those for which no charge can be calculated; The latter are described under “off-balance sheet items”.

Provision for contingencies and charges - other - euros 33.5 million

With respect to 2005, the provision shows a net increase of euros 20.0 million due to the net effect of accruals (euros 20.5 million), utilization (euros 3.2 million) of the year and the contribution of the companies acquired (euros 2.7 million), including, in particular:

- 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 parent 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.

27) TAX LIABILITIES, INCLUDING DEFERRED - euros 454.5 million

Changes in this caption are detailed as follows:

In millions of euros	31.12.2005	IMPACT RECOGNIZED IN PROFITS OR LOSSES Accruals	 Utilization	Other changes	31.12.2006
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
Change in consolidation scope	-			1.0	1.0
IRAP rate adjustment	-	3.5			3.5
Financial expenses	3.6		-3.6		-
TOTAL	**467.7**	**9.2**	**-21.7**	**-0.7**	**454.5**

Deferred tax liabilities decreased by euros 13.2 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.
- utilization (euros 3.6 million) of the taxes accrued on financial expenses following the repayment of the EDB loan by Novatrans;

- accruals made by the parent (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.

28) OTHER NON-CURRENT LIABILITIES - euros 170.8 million

This caption, which is substantially in line with the balance at 31 December 2005 (euros 176.2 million), includes deferrals of grants related to plants (euros 156.4 million) and deferred portions of the parent's grid transmission consideration to cover future costs of the National Transmission Grid safety plan (euros 14.4 million). The decrease on 2005 (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.

29) 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 (*)	50.0	55.0	-5.0
Current portion of long-term loans (*)	71.1	58.3	12.8
Trade payables	1,280.6	951.4	329.2
Tax liabilities	75.3	14.4	60.9
Current financial liabilities (*)	16.0	16.8	-0.8
Other current liabilities	112.8	104.9	7.9
TOTAL	**1,605.8**	**1,200.8**	**405.0**

(*) Reference should be made to the comments in note 24) LOANS.

Trade payables - euros 1,280.6 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	228.4	200.9	27.5
- energy-related payables	1,046.9	747.2	299.7
Associates - Cesi	4.4	2.7	1.7
Payables for contract work in progress			
Payables for contract work in progress	0.9	0.6	0.3
TOTAL	**1,280.6**	**951.4**	**329.2**

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 27.5 million) is due to greater purchases and services in the last few months of the year as part of ordinary investing activities and operations, and the payables of the subsidiaries RTM1 and RTM2 (euros 5 million) which were not included in the consolidation scope of the Terna Group in 2005. The caption also includes amounts due for services provided to Enel Group companies (euros 28.7 million), which mainly comprise the following amounts:

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 Group employees hired before 30 June 1996 under the national electricity sector labour contract);

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 transmission 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, which amounts to euros 4.4 million, refers to amounts due to Cesi for services provided to the parent in relation to 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 euros 1.7 million increase on 31 December 2005 is due to the greater services rendered in the last few months of the year.

Commitments with suppliers for the 2007-2012 period amount to euros 1,140.5 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 0.9 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	(2.8)	1.9	(0.9)	(5.3)	4.7	(0.6)
TOTAL	**(2.8)**	**1.9**	**(0.9)**	**(5.3)**	**4.7**	**(0.6)**

Tax liabilities - euros 75.3 million

The caption includes the group payable for taxes of the year. In particular, it relates to:

- the parent (euros 72.3 million, of which euros 62.5 million relate to IRES and euros 9.8 million to IRAP);
- the RTL Group (euros 3.0 million), in particular RTM1 (euros 2.0 million) and RTM2 (euros 1.0 million); conversely, RTL offset the income tax payable of the year against the tax credits arising from the 2005 IRES and IRAP advances.

Other current liabilities - euros 112.8 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	48.4	48.4	-	14.4	34.0
Amounts payable to social security institutions	12.6	12.6	-	11.7	0.9
Amounts payable to employees	26.0	26.0	-	21.9	4.1
Other	6.1	3.8	2.3	31.7	-25.6
TOTAL	**112.8**	**91.5**	**21.3**	**104.9**	**7.9**

PAYMENTS ON ACCOUNT

This caption, which amounts to euros 19.7 million, includes grants related to plants collected by the parent 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 48.4 million, include euros 43.8 million in relation to the parent, mainly for the settlement of VAT in December (euros 35.5 million), substitute tax withholdings (euros 5.5 million) and registry tax on the agreement for the acquisition of the TSO business activity (euros 2.8 million).

The residual euros 4.6 million relates to the following:

the RTL Group, for the VAT payable (euros 1.1 million) and the withholdings on employees' remuneration (euros 0.2 million);

the Brazilian subsidiaries, for local taxes and withholdings (euros 3.3 million).

The significant increase (euros 34.0 million) is mainly due to the parent which, in 2005, had a lower balance of sums payable to taxation authorities. Indeed, in the last VAT settlement, it was in a credit position.

AMOUNTS PAYABLE TO SOCIAL SECURITY INSTITUTIONS

Amounts payable to social security institutions amount to euros 12.6 million (euros 11.7 million at 31 December 2005) and mainly relate to the parent's 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 26.0 million (euros 21.9 million at 31 December 2005) and mainly relate to termination benefits due from the parent to employees whose employment was terminated before 31 December 2006 (euros 8.2 million), amounts due for employees' leaving incentives to be paid in 2007 (euros 9.9 million) and vacation and holidays accrued but not taken, to be paid in January (euros 6.4 million for the parent and euros 0.8 million for subsidiaries).

OTHER

Other payables of euros 6.1 million (euros 31.7 million at 31 December 2005) mainly relate to the parent and may be analyzed as follows:

- 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, being mainly the portion of the incentive to unify the National Transmission Grid following the sale of the grid to the parent (AEEG Resolution no. 73/06);
- euros 2.1 million for deferred liabilities of a sundry nature;

the euros 25.6 million decrease on 31 December 2005 is mainly due to the reclassification of the parent's 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 parent 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 the 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 parent. 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 relevant 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 Electricity 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

With respect to the litigation over events that occurred up to the date of transfer in relation to the GSE business activity responsible for energy transmission and dispatching activities ("business activity"), 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 was not transferred. Accordingly, GSE retains all liability, charges or liabilities to be incurred as a result or in connection with the litigation. Moreover, the parent has referred to these provisions in litigation in which it is involved and has requested the former GRTN (now GSE SpA) to hold it harmless from any charges.

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 parent 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 group, 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 parent, 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, privatised 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

Acquisition of Terna Participações

On 13 March 2006, the parent Terna SpA acquired the entire share capital of Brazil-based Donnery Holdings SA (real 100) for approximately real 25 thousand (roughly euros 10 thousand). The company was originally set up in São Paulo on 23 January 2006. The new shareholders then decided to change the company's name to Terna Participações SA. The purpose of Terna Participações SA is to hold investments in other Brazilian and foreign companies operating in the electrical energy transmission sector.

Acquisition and merger of Munirah

On 31 March 2006, TSN finalized the acquisition of 100% of Munirah Transmissora de Energia SA ("Munirah") from Control Y Montajes Industriales CYMI SA and Fluxo Engenharia Ltda.

The acquisition, which was governed by a purchase and sale agreement signed on 15 December 2005, was finalized once ANEEL and the financing bank BNDES had given their approval.

Munirah holds concessions on 106 km of transmission lines and two bays in two substations (owned by TSN and Chesf) in Bahia, and makes up the extension of the 500-kV lines owned by TSN that close the North-Northeast circuit.

This transaction will enable Terna to consolidate its presence in Brazil by giving it control over a strategic line in terms of geographical position and proximity to TSN's assets.

At the same time of the acquisition, Munirah was merged into TSN, to streamline the investment structure and optimize administrative expenses.

The table below provides figures recognized at the acquisition date (31 March 2006), reflecting the assets and liabilities of the company, measured at fair value at that date, which corresponds to the IFRS balances recognized immediately after the business combination. The euros 3 million difference between the price paid to acquire Munirah, real 48 million (approximately euros 18 million), and the fair value of assets acquired and liabilities assumed and incurred, amounting to approximately euros 15 million, has been allocated to goodwill arising on the merger.

Brazilian real/million	
Property, plant and equipment	97.4
Intangible assets	0.1
Inventories	3.5
Trade and other receivables	2.0
Cash and cash equivalents	0.9
Financial liabilities	61.0
Tax liabilities	0.8
Trade and other payables	1.0
Net identifiable assets and liabilities	**41.1**
Goodwill	7.4
Consideration	**48.5**
Cash and cash equivalents	-0.9
NET CASH OUTFLOWS	**47.6**

Acquisition of Rete Trasmissione Milano 1

On 24 November 2006, RTL SpA acquired 100% of RTM1 - Rete Trasmissione Milano1 from Edison SpA. The consideration paid amounted to approximately euros 304 million, net of the incentives provided for by the Electricity and Gas Regulator (Resolution no. 73/06).

In accordance with the provisions of Law no. 290/2003 and the subsequent Prime Minister's Decree of 11 May 2004 concerning the unification process of the domestic transmission grid under Terna SpA, the latter provided RTL with the funding necessary to acquire this investment, through a capital injection equal to the investment's cost. In addition, it financed RTL through the intercompany current account for an amount equal to the costs directly related to the acquisition.

RTM1 owns 2,763 km of high-voltage electrical energy transmission lines and 29 electrical substations scattered throughout Northern Italy. It also manages two control centers.

The table below provides the amount recognized at the acquisition date, reflecting the company's assets and liabilities, measured at fair value at that date, and the IFRS balances recognized immediately after the business combination. The euros 11.9 million difference between the price paid to acquire RTM1, approximately euros 287 million, and the fair value of assets acquired and liabilities assumed and incurred, amounting to approximately euros 275 million, has been allocated to goodwill arising on the merger. This amount was allocated on the basis of the provisional values of a specific appraisal under completion by independent experts.

In millions of euros	IFRS CARRYING AMOUNTS BEFORE THE BUSINESS COMBINATION	FAIR VALUE
RTM1		
Property, plant and equipment	191.6	291.8
Inventories	1.2	1.2
Trade and other receivables	16.7	16.7
Cash and cash equivalents	0.1	0.1
Provisions for contingencies and charges	1.5	1.5
Termination benefits	3.3	3.3
Trade and other payables	29.7	29.7
Net identifiable assets and liabilities	**175.1**	**275.3**
Goodwill		11.9
Acquisition price		287.2
Consideration (including acquisition costs)		293.9
Incentive as per Resolution no. 73/06		-6.7
Acquisition price		287.2
Intercompany payable recognized		17.3
NET CASH OUTFLOWS		**304.5**

Acquisition of Rete Trasmissione Milano 2

On 24 November 2006, RTL SpA acquired 99.99% of RTM2 - Rete Trasmissione Milano2 from AEM SpA. The consideration paid amounted to approximately euros 121 million, net of the incentives provided for by the Electricity and Gas Regulator (Resolution no. 73/06).

In accordance with the provisions of Law no. 290/2003 and the subsequent Prime Minister's Decree of 11 May 2004 concerning the unification process of the domestic transmission grid under Terna SpA, the latter provided RTL with the funding necessary to acquire this investment, through a capital injection equal to the investment's cost. In addition, it financed RTL through the intercompany current account for an amount equal to the costs directly related to the acquisition.

RTM2 owns 1,095 km of high-voltage electrical energy transmission lines and 12 electrical substations scattered throughout Northern Italy. It also manages two control centers.

The table below provides the amount recognized at the acquisition date, reflecting the company's assets and liabilities, measured at fair value at that date. The euros 25.9 million difference between the price paid to acquire RTM2, approximately euros 121 million, and the fair value of assets acquired and liabilities assumed, amounting to approximately euros 95 million, has been allocated to goodwill arising on the merger. This amount was allocated on the basis of the provisional values of a specific appraisal under completion by independent experts.

In millions of euros	IFRS CARRYING AMOUNTS BEFORE THE BUSINESS COMBINATION	FAIR VALUE
RTM2		
Property, plant and equipment	78	88.2
Trade and other receivables	9.7	9.7
Cash and cash equivalents	3.6	3.6
Provisions for contingencies and charges	2.2	2.2
Termination benefits	0.8	0.8
Trade and other payables	3.7	3.7
Net identifiable assets and liabilities	**84.6**	**94.8**
Goodwill		25.9
Acquisition price		120.7
Consideration (including acquisition costs)		123.1
Incentive as per Resolution no. 73/06		-2.4
NET CASH OUTFLOWS		**120.7**

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 Terna Group during the year essentially included those with the associate Cesi SpA and the group's employee pension funds FONDENEL and FOPEN.

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.

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

	INCOME STATEMENT FIGURES			BALANCE SHEET FIGURES		
In millions of euros	Revenues	Costs	Investments	Receivables	Payables	Guarantees
Cesi SpA	0.1	0.9	7.6	-	4.5	2.0
Fondenel	-	0.4	-	-	-	-
Fopen	-	1.3	-	-	0.7	-
TOTAL	**0.1**	**2.6**	**7.6**	**-**	**5.2**	**2.0**

The guarantees relate to sureties received on contracts in which Terna is the customer.

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

With the exception of that discussed above, there were no atypical or unusual transactions during 2006.

I) NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

Cash flows generated by operating activities during the year amount to approximately euros 769.0 million, including roughly 940.3 million from operating activities before changes in net working capital and outflows of roughly euros171.3 million to fund the change in working capital.

Investing activities also used net financial resources of approximately euros 676.1 million. In particular, the acquisition of AEM Trasmissione SpA (RTM2) and Edison Rete SpA (RTM1) through the subsidiary RTL and the acquisition of Munirah through the subsidiary TSN generated an increase in property, plant and equipment of euros 416.7 million, with the recognition of goodwill totalling euros 40.4 million. On the other hand, the IPO of the Brazilian subsidiary Terna Participaçoes on the São Paulo stock exchange generated net proceeds of euros 115.3 million for the group, as a result of the combined effect of the following factors:

- Terna SpA's collection of euros 82.7 million, corresponding to the list price of Terna Part shares sold on the OTC market for euros 93.9 million, net of local taxes and fees incurred for the transaction (euros 11.2 million);
- the increase in the nominal value of shares held by Terna SpA (euros 32.7 million) following Terna Participações SA's total share capital increase (share premium) subscribed by other investors on the primary market.

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 approximately euros 178.4 million. Moreover, 34% of equity was attributed to minority interests following the subscription of that percentage of Terna Participações share capital by other investors.

Cash flows generated by these transactions amounted to approximately euros 123.8 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 domestic 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 activities 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 safety of the electrical system and reliability of the domestic 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 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 safety 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 the 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 domestic 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 domestic 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 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 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.