

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 20-F

- ☐ **REGISTRATION STATEMENT PURSUANT TO SECTION 12(b)**
OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
OR
☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Fiscal Year Ended: December 31, 1999

1-14970

(Commission file number)

ENEL-Società per Azioni

(Exact name of registrant as specified in its charter)

ENEL S.p.A.

(Translation of registrant's name into English)

Italy

(Jurisdiction of incorporation or organization)

Viale Regina Margherita 137

Rome, Italy

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class

Name of each exchange
on which registered

American Depositary Shares
Ordinary shares with a par value of 1,000
Italian Lire each

New York Stock Exchange
New York Stock Exchange*

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report.

12,126,150,379 ordinary shares

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒

No ☐

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 ☐

Item 18 ☒

*Not for trading, but only in connection with the registration of the American Depositary Shares.

TABLE OF CONTENTS

	<u>Page</u>
PRESENTATION OF FINANCIAL AND OTHER INFORMATION	iii
GLOSSARY OF SELECTED ELECTRICITY TERMS	v

PART I

<i>Item 1.</i>	<i>Description of Business</i>	<i>1</i>
	OVERVIEW	1
	STRATEGY	7
	THE ENEL GROUP	11
	Italian Electricity Demand.....	11
	Generation	12
	Purchased Power	21
	Transmission.....	22
	Distribution and Sales to Franchise Market.....	25
	Sales to Free Market.....	30
	Capital Investment Program.....	30
	Competition in the Electricity Markets.....	31
	Other Businesses	33
	Possible acquisitions	43
	Support Services	43
	Insurance	44
	OPERATING ENVIRONMENT	44
	The Republic of Italy	44
	REGULATORY MATTERS	46
	Electricity Regulation	46
	Telecommunications	65
	Environmental Matters	67
	EMPLOYEES	75
	RISK FACTORS	77
<i>Item 2.</i>	<i>Description of Property</i>	<i>85</i>
<i>Item 3.</i>	<i>Legal Proceedings.....</i>	<i>85</i>
<i>Item 4.</i>	<i>Control of Registrant.....</i>	<i>87</i>
<i>Item 5.</i>	<i>Nature of Trading Market.....</i>	<i>89</i>
<i>Item 6.</i>	<i>Exchange Controls and Other Limitations Affecting Security Holders</i>	<i>92</i>
<i>Item 7.</i>	<i>Taxation</i>	<i>95</i>
<i>Item 8.</i>	<i>Selected Financial Data</i>	<i>98</i>
<i>Item 9.</i>	<i>Management's Discussion and Analysis of Financial Condition and Results of Operations</i>	<i>103</i>
	Overview.....	103

Results of Operations	107
1999 Compared with 1998	107
1998 Compared with 1997	116
U.S. GAAP Reconciliation.....	120
Liquidity and Capital Resources	121
Capital Expenditures.....	122
Commitments.....	123
Year 2000 Compliance	123
European Single Currency	123
Item 9A. Quantitative and Qualitative Disclosures About Market Risk	124
Price risk management and market risk information.....	124
Foreign exchange risk.....	126
Interest rate risk	126
Commodity price risk.....	127
Item 10. Directors and Officers of the Registrant.....	127
Item 11. Compensation of Directors and Officers	130
Item 12. Options to Purchase Securities from Registrant or Subsidiaries.....	132
Item 13. Interest of Management in Certain Transactions	133
PART II	
Item 14. Description of Securities to be Registered.....	133
PART III	
Item 15. Defaults upon Senior Securities.....	133
Item 16. Changes in Securities and Changes in Security for Registered Securities.....	133
Item 17. Financial Statements.....	133
Item 18. Index to Financial Statements and Exhibits	133
SIGNATURES	

PRESENTATION OF FINANCIAL AND OTHER INFORMATION

The statements in this Annual Report on Form 20-F (the “Annual Report”) are based on financial information prepared in accordance with the accounting principals prescribed by Italian law and supplemented by the accounting principles issued by the *National Boards of Dottori Commercialisti and of Ragioneri* (National Board of Chartered Accountants) and, to the extent such requirements or principles are silent on particular issues and not at variance, by those standards laid down by the International Accounting Standards Committee (I.A.S.C.) (such requirements, as so interpreted and supplemented, “Italian GAAP”). Such principles are described in the Note “Summary of Significant Accounting Policies” to the Consolidated Financial Statements included in response to Item 18 of this Annual Report. These principles differ in certain respects from generally accepted accounting principles in the United States (“U.S. GAAP”). See Note 23 to the Consolidated Financial Statements. Unless indicated otherwise, any reference in this Annual Report to our Consolidated Financial Statements is to the Consolidated Financial Statements (including the notes to the Consolidated Financial Statements) included in response to Item 18 of this Annual Report.

We publish our Consolidated Financial Statements in Italian lire. In this Annual Report, unless we specify otherwise or the context otherwise requires:

- References to “dollars”, “\$” and “U.S. dollars” are to United States dollars;
- References to “lire”, “lira” or “Lit.” are to Italian lire; and
- References to “€” or “euro” are to the euro, the single currency established for participants in the third stage of the European Economic and Monetary Union, or EMU, commencing January 1, 1999. The Republic of Italy is a participant in the EMU. The euro replaced the Italian lira as the official currency of Italy on that date and until the implementation of the next stage of the EMU, which is expected to occur in 2002, the lira will continue to exist solely as a subdivision of the euro. The lira will cease to exist at the implementation of the next stage of the EMU.

For convenience only and except where we specify otherwise, we have translated certain lira figures into dollars at the rate of Lit. 1,922.81 = \$1.00. The rate of exchange between lire and dollars represents the lire equivalent (at the fixed rate of exchange established by the European Council of Ministers on December 31, 1998 between the lira and euro of Lit. 1,936.27 = €1.00) of \$1.0070 = €1.00, the noon buying rate in The City of New York for cable transfers in foreign currencies as announced by the Federal Reserve Bank of New York for customs purposes (the “noon buying rate”) on December 31, 1999. To obtain a current formulation of the value of Italian lira amounts in dollars, you must first convert lire into euro at the fixed lira/euro conversion rate of Lit. 1,936.27 = €1.00, and then convert the resulting euro amount into dollars at the prevailing rate of exchange. By including convenience currency translations in this Annual Report, we are not representing that the lira amounts actually represent the dollar amounts shown or could be converted into dollars at the rates indicated. On June 26, 2000, the noon buying rate for euro was \$0.9382 = €1.00 and the effective noon buying rate for lire was Lit. 2,063.87 = \$1.00. For information about the rate of exchange between the lira and dollar for periods from 1995 through June 26, 2000 and between the dollar and the euro since January 1, 2000, you should read “Selected Financial Data and Exchange Rates” in Item 8.

In this Annual Report, “Enel” and the “Company” refer to ENEL S.p.A. and the terms “Enel Group,” “Group,” “we,” “us” and “our” refer to ENEL S.p.A., together with its consolidated subsidiaries. All references to “Italy” or the “State” are to the Republic of Italy. All references to the “Treasury Ministry” or the “Treasury” are to the Ministry of the Treasury, Budget and Economic Planning of the Republic of Italy, all references to the “Industry Ministry” are to the Ministry of Industry, Commerce and Handicrafts of the Republic of Italy, all references to the “Environment Ministry” are to the Ministry of the Environment of the Republic of Italy and all references to the “Energy Authority” are to the Authority for Electric Energy and Gas of the Republic of Italy.

Except for the historical statements and discussions contained herein, statements contained in this Annual Report constitute “forward looking statements” within the meaning of Section 27A of the U.S. Securities Act of 1933 and Section 21E of the U.S. Securities Exchange Act of 1934. Forward looking statements may include words such as “expect”, “estimate”, “project”, “anticipate”, “should”, “intend” and similar expressions or variations on such expressions. Any filing of the Company with the U.S. Securities and Exchange Commission may include forward looking statements. In addition, other written or oral statements which constitute forward looking statements have been made and may in the future be made by or on behalf of the Company, including statements concerning its future operating and financial performance, the Company’s share of new and existing markets, general industry and economic trends and the Company’s performance relative thereto and the Company’s expectation as to requirements for capital expenditures and regulatory matters. Forward looking statements with regard to the Company’s businesses rely on a number of assumptions concerning future events and are subject to a number of risks, uncertainties, assumptions and other factors, many of which are outside the Company’s control, that could cause actual results to differ materially from such statements, including, among other things, the Company’s intention to develop a telecommunications business; anticipated trends in the Company’s business, including trends in demand for electricity; the Company’s ability to implement successfully its cost reduction program; changes in the Company’s regulatory environment, including the tariff structure, and implementation of applicable regulations; the Company’s intention to develop new businesses or expand non-core businesses; and future capital expenditure and investments. The Company disclaims any obligation to update or revise any forward looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward looking events discussed in this Annual Report might not occur.

GLOSSARY OF SELECTED ELECTRICITY TERMS

The following explanations are not technical definitions, but they should assist you in understanding some of the terms used in this document.

Average thermal efficiency.....	A measure of the efficiency of a thermal generating plant in converting sources of energy such as fuel oil into electricity. Average thermal efficiency is expressed as the amount of electricity actually produced in kWh as a percentage of the kWh equivalent of the energy source consumed.
CCGT (Combined Cycle Gas Turbine).....	A type of generating plant that produces electricity through both gas turbines and steam turbines. Conventional boilers or other generators recover and use the heat exiting from gas turbines.
Co-generation.....	The simultaneous generation of steam and electricity, typically where the need arises for industrial purposes.
Generating unit	An electric generator together with the turbine or other device which drives it.
Gigawatt (GW).....	1,000,000,000 watts (1,000 megawatts).
Gigawatt hour (GWh)	One gigawatt of power supplied or demanded for one hour.
Installed capacity	The maximum power which could be produced continuously throughout a prolonged period of operation. All equipment is assumed to be fully operational.
Kilovolt (kV).....	1,000 volts.
Kilovolt ampere (kVA).....	1,000 volts ampere.
Kilowatt (kW)	1,000 watts.
Kilowatt hour (kWh)	One kilowatt of power supplied or demanded for one hour.
Megawatt (MW)	1,000,000 watts (1,000 kilowatts).
Megawatt hour (MWh)	One megawatt of power supplied or demanded for one hour.
Megavolt ampere (MVA)	1,000,000 volts ampere.
NO _x	Oxides of nitrogen.
Orimulsion	Abbreviation of “Orinoco emulsion”, which is a fossil fuel from the Orinoco river basin in Venezuela consisting of very fine bitumen dispersed in water. Orimulsion emits the same amount of CO ₂ as fuel oil of equivalent energy value.
SO ₂	Sulfur dioxide.

Substation	Equipment which switches and/or changes or regulates the voltage of electricity in a transmission and distribution system.
Terawatt (TW)	1,000,000,000,000 watts (1,000 gigawatts).
Terawatthour (TWh)	One terawatt of power supplied or demanded for one hour.
Thermal unit.....	A generating unit which uses combustible fuel as the source of energy to drive an electric generator.
Volt	The basic unit of electric force analogous to water pressure in pounds per square inch.
Voltampere	The basic unit of apparent electrical power.
Watt	The basic unit of active electrical power.

PART I

Item 1. *Description of Business*

OVERVIEW

Enel S.p.A. and its consolidated subsidiaries is the principal electricity company in Italy, with the leading position in the generation, transmission, distribution and supply of electricity. We generated approximately 71% of the 253 Terawatt hours (“TWh”)* of electricity produced in Italy in 1999. Our distribution network supplied approximately 92% of the 241 TWh of electricity sold in Italy in 1999 to final customers. Measured by the amount of electricity sold, the Enel Group is the third largest electric utility in the 29 member states of the Organization for Economic Co-operation and Development and the largest publicly listed electric utility in Europe. Based on revenues, we were one of the largest industrial company in Italy in 1999, with operating revenues of Lit. 40,584 billion, or approximately \$ 21.1 billion. Our net income for the same period was Lit. 4,541 billion, or approximately \$ 2.4 billion.

The following table shows selected operating data for our electricity operations for each of the past five years. Net production equals gross production of electricity less consumption by units generating electricity and mechanical and electrical losses in production.

	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
Gross installed capacity (Megawatts (“MW”)).....	55,917	57,072	58,223	58,906	59,418
Net production (TWh)	180.3	179.9	177.2	179.5	178.8
Electricity sold to final customers and to municipal distributors (TWh).....	211.6	213.8	219.3	226.2	230.5
Customers at year end (millions).....	28.5	28.7	29.0	29.3	29.7
Customers served per employee.....	296	306	332	349	384
Electricity sold per employee (MW hours (“MWh”))....	2,198	2,277	2,507	2,691	3,027

Through Enel Produzione S.p.A. (“Enel Produzione”) and our other generating companies, we produce a majority of all electricity generated in Italy. We have 749 generating plants, consisting of thermal, hydroelectric, geothermal and other renewable resources plants. At December 31, 1999, our generating facilities represented approximately 78% of the total gross installed capacity in Italy. In 1999, 76.6% of our production was thermal, 21.1% hydroelectric and the remaining 2.3% came from geothermal and other renewable resources. We no longer operate any nuclear plants. As explained in more detail below, recent Italian legislation designed to liberalize the Italian electricity market will require us to dispose of a portion of our generating capacity by 2003.

Through T.E.R.N.A. S.p.A. (“TERNA”), we continue to own almost all the transmission assets of Italy’s national electricity grid and we are the sole owner of Italy’s network of high voltage 380 kiloVolt (“kV”) lines. However, as a part of the reorganization of the Italian electricity sector, we transferred control over all electric energy transmission activities, including electricity dispatching and management of the national transmission network grid, to Gestore della Rete di Trasmissione Nazionale S.p.A. (“Gestore della Rete”), a company now wholly-owned by the Treasury following our transfer of all of its shares to the Treasury free of charge on April 1, 2000. The transmission system that we own and that the *Gestore della Rete* operates carries almost all the electricity transmitted to distribution networks for sale

* For explanations of a number of the technical terms used herein, please refer to the “Glossary of Selected Electricity Terms” on pages v and vi.

in Italy. At December 31, 1999, that transmission system consisted of a total of 37,102 kilometers of lines and 248 primary transformer stations.

Through Enel Distribuzione S.p.A. ("Enel Distribuzione") and Enel Trade S.p.A. ("Enel Trade"), we are the largest electricity distributor in Italy. We serve 92% of the residential customers in Italy. Of our sales to final customers in 1999, approximately 49% were to industrial customers, 24% to customers in the commercial and other services sector, 25% to residential customers and 2% to the agricultural sector. At December 31, 1999, our distribution network consisted of a total of 1,051,075 kilometers of lines, mostly medium and low voltage, and 405,371 primary and secondary transformer substations, with a total transformer capacity of 148,720 Megavolt amperes ("MVA"). As described in more detail below, recent Italian legislation also requires us to dispose of our distribution networks in certain municipalities.

Our most significant business outside of our core electricity operations is our 51% interest in WIND, a joint venture in the telecommunications industry with Deutsche Telekom and France Telecom. WIND launched commercial fixed-line telephony services for corporate customers in December 1998 and fixed and mobile telephony line services to residential customers on March 1, 1999. WIND was the first Italian provider of integrated fixed-line voice telephony and mobile telephony services. WIND is also starting to provide data transmission and Internet services. As of December 31, 1999, WIND had more than 2.1 million active corporate and consumer telephone lines. As of May 31, 2000, the number of lines had increased to approximately 3.7 million, and WIND's Internet service had approximately 300,000 registered users.

We are diversifying into other businesses that include water distribution, gas, communications and Internet and e-commerce services, as well as developing our information technology resources and real estate holdings.

The following chart sets forth our principal business units and the companies through which some of these businesses are conducted.

Enel S.p.A.

Electric power production	Enel Produzione	Enelpower	Engineering and development of Generation and transmission Systems
Electric power production from renewable geothermal and alternative sources	Erga	Elettroambiente	Electric power production from waste disposal
Electric power production	Eurogen	Enel.Hydro (formerly Ismes)	Design, construction and Management of water Distribution networks
Electric power production	Elettrogen	Sei	General services and real estate management
Electric power production	Interpower	Dalmazia Trieste	Real estate management
Transmission of electric power	Terna	Conphoebus	Photovoltaic plants and real estate technologies
Electric power distribution and sale	Enel Distribuzione	Enel.it	Information technology and Infrastructure related to transmission services
Sale of electric power to Eligible Customers	Enel Trade	Enel.re	Captive reinsurance company
Public lighting	So.I.e.	Enel.factor	Captive factoring company
Electrical equipment maintenance	Enel.si (formerly Se.m.e)	Sfera	Personnel training and development
Fuel trading and logistics	Enel.FTL	CESI	Services and research for the electricity sector
Natural gas distribution	Colombo Gas	WIND	Telecommunications
		Itnet	Internet provider

The Electricity Market under the New Regulatory Framework

The Italian electricity market is subject to extensive European Union and Italian governmental regulation. In 1999, the Italian government adopted Legislative Decree No. 79/99, commonly known as the Bersani Decree, which is significantly changing the regulation of the electricity market.

Legislative Decree No. 79/99 – the Bersani Decree

As a result of the Bersani Decree, the electricity sector has been significantly restructured to increase competition and achieve other public policy goals. The significant changes introduced by the Bersani Decree include:

- *Liberalization.* The generation, import and export of electricity, as well as the sale of electricity to certain customers, have been liberalized as of April 1, 1999.
- *Maximum Market Share Levels for Producers.* In order to ensure competition among producers, no single company or group may have more than a 50% market share of the electricity generation and import market at January 1, 2003. The Bersani Decree requires us to sell not less than 15,000 MW of our generating capacity by that date to reduce our market share. In August 1999, the Italian government approved our plan to dispose of plants representing 15,057 MW of net installed capacity, which is equivalent to approximately 16,000 MW of gross installed capacity, to comply with this requirement. We have established three new separate generating company subsidiaries to which we have transferred the productive capacity (and related assets) that we plan to dispose of. We will dispose of our interest in each of these three companies by the end of 2002. In June 2000, speaking before the Parliamentary Commission on Productive Activities, the Minister of Industry noted the importance of completing the sale as soon as possible, preferably by the first half of 2001.
- *Distinction between Classes of Customers.* Electricity customers have been classified as follows:
 - “Eligible Customers”, which are principally high volume users such as large manufacturing and industrial companies or consortia that meet specified thresholds of annual electricity consumption. Under the Bersani Decree, Eligible Customers are free to purchase electricity either from power producers or from wholesale suppliers. Sales to Eligible Customers are made on the basis of contracts between the customer and the producer or wholesale supplier and are intended to be competitive. The criteria for determining which customers are Eligible Customers reflects the Italian electricity regulator’s intention that 35% of the electricity supply market be opened for competition in 2000. The new regulatory regime gradually broadens the criteria for Eligible Customers with the intention that consumption by Eligible Customers will represent 40% of the market from 2002. Eligible Customers may elect not to participate in the free market for a period of time not to exceed four years.
 - “Non-eligible Customers”, which are customers that do not meet the criteria to be Eligible Customers, such as residential and small and medium-sized business customers, and as a result are not eligible to participate in the competitive market. Non-eligible Customers must purchase electricity from the distributor that serves the area in which they are located. Sales to Non-eligible Customers and to Eligible Customers that choose not to participate in the free market are regulated by the Energy Authority, an Italian governmental entity.

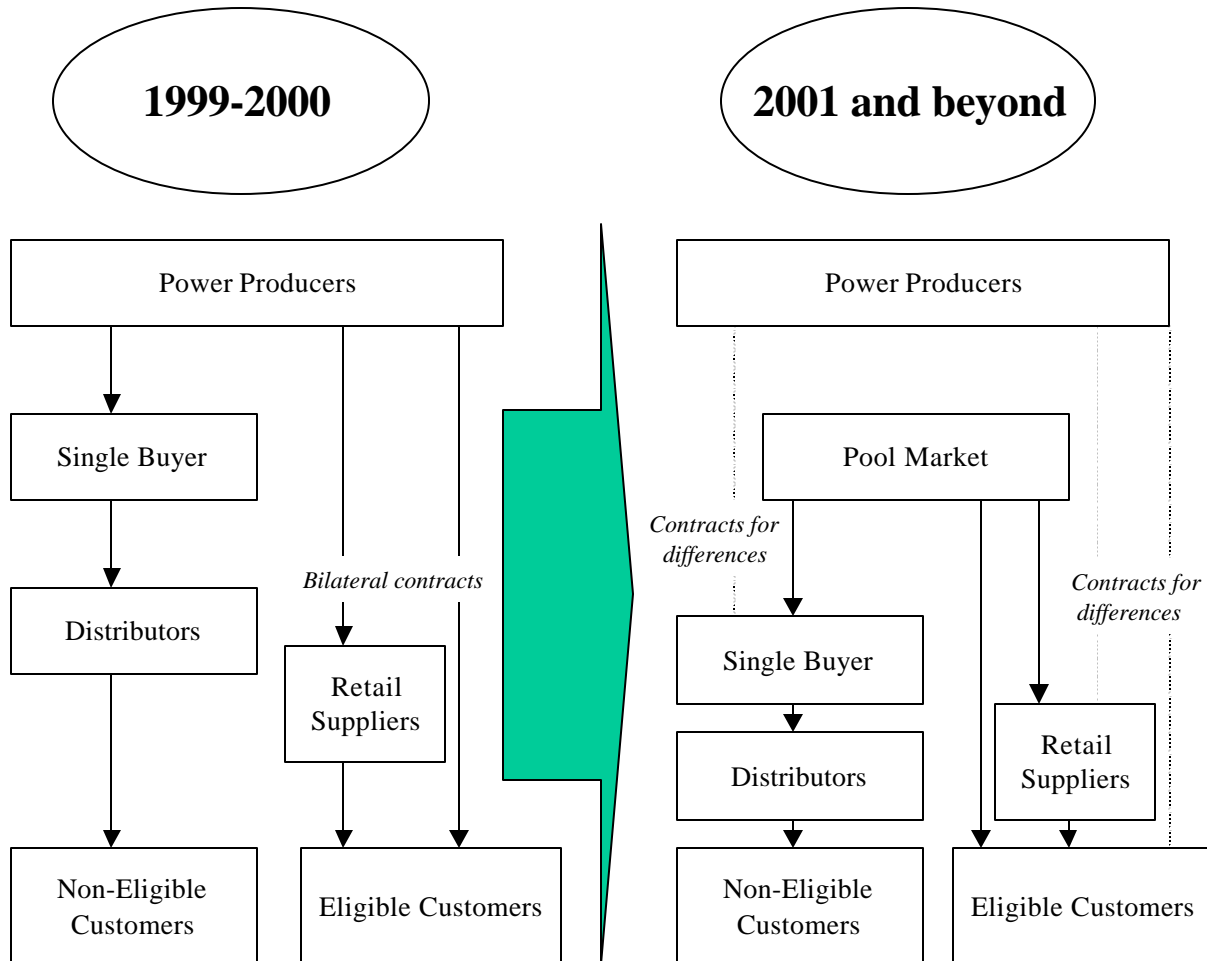
- *Creation of a “Single Buyer”.* A State-owned entity referred to as the Single Buyer is expected to begin operation in the second half of 2000. It will be responsible for purchasing all of the electricity to be supplied to the regulated market.
- *Introduction of a Pool Market with Competitive Bidding.* A pool market for the spot trading of electricity among generating companies, importers, wholesalers, distributors, other Eligible Customers and the Single Buyer is scheduled to be created by the beginning of 2001. The intention of the Bersani Decree is that prices in the pool market will be determined through competitive bidding.
- *Creation of a System Operator for the National Transmission Network.* We have transferred our electricity dispatching and national transmission network grid management operations to the *Gestore della Rete*, a separate State-owned entity that is now responsible for those functions. Through TERNA, we continue to own our transmission network, which we now operate based on guidelines from the *Gestore della Rete*.
- *New Distribution License Regime and Consolidation of Distribution Networks.* Only one license for the distribution of electricity is to be granted in a single municipality; distribution companies that now serve the same municipality are required to consolidate their local networks.
- *New Tariff Regime.* A new tariff regime took effect on January 1, 2000. The new regime significantly lowers the fixed tariff components for generation, transmission and distribution in 2000. Once the pool market becomes operational, the tariff component for generation will be periodically adjusted to reflect prices on that market. The tariff components for transmission and distribution will be subject to a system of price caps from 2001 to 2003. The transmission and distribution components of the tariffs will be reset in 2004 and subject to a new price cap after 2004.

You should read “—Regulatory Matters—Electricity Regulation” for a more detailed discussion of the new tariff regime and the changing Italian electricity sector.

The restructuring of the Italian electricity market will occur in two phases. The following charts show the expected evolution of the electricity market:

- Following the introduction of the Single Buyer (which is currently expected to occur in the second half of 2000); and
- Following the introduction of the pool market (which is currently scheduled to occur by the beginning of 2001).

In the charts, contracts for differences represent swap or similar arrangements between power producers and the Single Buyer, retail suppliers or Eligible Customers relating to electricity supply.



STRATEGY

We were established in December 1962 through the nationalization of approximately 1,250 private power companies in Italy. Our principal goal following nationalization was providing low cost electricity to support the development of the country. In 1992, we were transformed into a joint stock company. Our new senior management, appointed in 1996, has:

- Initiated a thorough change in our organizational structure and management culture to improve efficiency and encourage innovative management;
- Implemented an aggressive cost reduction program; and
- Diversified into other businesses to exploit our existing assets and business experience and develop opportunities to offer additional services to our 29.7 million electricity customers.

In implementing this strategy, we have:

- Decreased the number of our personnel by more than 19,000 persons, from 97,937 at December 31, 1995 to 78,511 at December 31, 1999, and achieved a reduction in total annual personnel costs of Lit. 1,960 billion, or approximately 7.5% per year, between 1996 and 1999;
- Reduced our annual costs associated with general services, materials and supplies by approximately Lit. 591 billion, or approximately 4.4% per year, between 1996 and 1999;
- Initiated separate cost reduction and rationalization programs for each of our core electricity businesses, which we intend to complete during the next several years; and
- Established WIND, our telecommunications joint venture with Deutsche Telekom and France Telecom, our first major diversification effort, which we have followed with other diversification initiatives in the areas of gas, water, e-commerce and Internet services.

The change in our business culture and structure has involved:

- Establishing our generation, transmission, distribution and supply to Eligible Customers operations as separate subsidiaries with their own profitability and efficiency targets, a process we began at the end of 1997 and completed in October 1999;
- Introducing a performance-related compensation system for our management, including a stock option plan;
- Recruiting sixteen new division heads or chief executive officers of subsidiaries out of a total of twenty-four; and
- Encouraging entrepreneurial activity, as demonstrated by our start-up of WIND and other new ventures.

As a result of our cost reduction efforts and the cash flow generated by our core electricity business, we have also substantially reduced our ratio of net financial debt to shareholders' equity from 110% at December 31, 1996 to 70% at December 31, 1999. We believe that the strength of our balance

sheet and cash flow gives us the means to make significant capital expenditures and acquisitions in both our core businesses and diversification activities.

We believe that our successful restructuring and other recent achievements, together with our capabilities in our core businesses and the quality of our management, will allow us to respond successfully to the changing regulatory and competitive environment in our core businesses. During the next several years, we intend to:

- Continue to reduce costs aggressively and optimize our electricity businesses;
- Reposition ourselves in the face of increased competition in the electricity market to offer targeted, higher value-added services to our larger customers;
- Continue to diversify into other businesses that allow us to leverage our existing customer and asset base; and
- Implement a focused international expansion.

We view increasing our share of revenues from non-regulated businesses as essential to offset the limits arising from operating in a regulated business, so that our profitability will be determined more by our performance rather than by a third party.

Continue to reduce costs aggressively and optimize our electricity businesses. The Bersani Decree will increase competition in our core generation and supply businesses, both from existing market participants and new entrants. In addition, significant reductions in electricity tariffs beginning in the year 2000 have reduced and will further reduce our revenues from our regulated electricity businesses. In order to respond to these challenges, we intend to continue rationalization and cost cutting programs in each of our core businesses.

In our generation business, we will continue to seek to:

- Reduce costs by decreasing our total head count in generation by approximately 10,092 employees over the five year period from January 1, 1999 through the end of 2003, of whom approximately 5,100 will be attributable to our plan for disposing of three generating company subsidiaries, and optimizing the use of personnel in our plants;
- Reduce maintenance expenses through reduced use of outsourcing and increased use of “when needed” maintenance instead of planned maintenance programs; and
- Control capital expenditures through improved planning, implementation and centralized engineering and procurement.

In addition, we will:

- Convert to Combined Cycle Gas Turbine (“CCGT”) technology thermal plants that represent at least 4,500 MW of the net installed capacity we will retain after the disposal of not less than 15,000 MW of generation capacity mandated by the Bersani Decree. We currently expect to invest approximately Lit. 3,000 billion in this project through its completion in the year 2008; and

- Continue to improve the fuel mix we use for electricity generation to allow us to burn less expensive fuel. Our goal is to reduce the amount of electricity produced from high cost, low sulfur fuel oil and increase the amount produced from natural gas and from low cost fuels such as high sulfur fuel oil and orimulsion, a fossil fuel produced from natural bitumen mixed with water.

In our transmission business, we intend to continue implementing our restructuring program aimed at reducing costs and capital expenditures. Partially as a result of these initiatives, we were able to reduce operating costs in our transmission sector by approximately 8% in 1999 as compared to 1998. Other major initiatives in this area include:

- the development of a new organizational model based on a SAP management information system; and
- the development of a new remote management and control system designed to improve the operating efficiency of our high voltage transmission network.

In our distribution business, we will seek to:

- Reduce personnel costs by decreasing the number of personnel in distribution by more than 12,200 persons over the five-year period from January 1, 1999 through the end of 2003, including personnel affected by consolidation of activities in certain municipalities pursuant to the Bersani Decree; and
- Invest in new technologies and initiatives, including establishment of system-wide remote metering, in which we plan to invest over Lit. 3,600 billion by 2004, and of a national call center, which will be combined with the reduction of the number of regional call centers from 74 to between six and eight. We expect these initiatives to improve customer service and reduce annual costs from 1998 levels by a total of Lit. 550 billion by 2004.

Our cost-cutting program is supported by an intensive benchmarking program, which has identified significant opportunities for cost reductions.

Repositioning our business to respond to changes in the electricity industry in Italy. The Bersani Decree requires that we separate our distribution business into separate companies to serve Eligible Customers, who can contract freely for their supply of electricity, and Non-eligible Customers, who must obtain their electricity from a single supplier. The Decree also provides for a consolidation in electricity distribution that requires us to sell some of our distribution assets to municipally owned distribution companies in areas where we and one of these companies both own distribution assets. You should read “—Regulatory Matters—Electricity Regulation—The new regulatory framework” for a more detailed discussion of these aspects of the Decree. We plan to deal with the effects that these requirements could have on our business by:

- Entering into negotiations with local distribution companies with the target of establishing joint ventures that will also be a way for us to offer diversified multi-utility services in the future; and
- Offering customized pricing and “beyond the meter” services to large customers. We believe that our well-established customer relationships and our generation resources will allow us to retain a leading market share of Eligible Customers, who may now negotiate their own supply arrangements.

The Bersani Decree also provides incentives for the production of electricity using renewable sources of energy. We will seek to consolidate our leading position in the renewable energy business, leveraging our geothermal and other renewable sources, in order to increase our generation capacity and become a major producer in the wind sector.

Diversifying into related businesses in order to exploit our customer base and assets. We intend to continue our strategy of diversifying into other businesses. This strategy is focused on identifying, developing and delivering new services to our 29.7 million customers and exploiting our existing assets and business experience. WIND, our joint venture with France Telecom and Deutsche Telekom in the telecommunications sector, was our first diversification initiative. From December 1998, when it began operations, through May 31, 2000, WIND has built its customer base to include approximately 3.7 million active corporate and consumer telephone lines and approximately 300,000 registered users of its Internet service. Our goal is to become in the medium term a provider of a full range of services to households, enabling us to cross-sell to our electricity customers and thereby increase our share of their consumer spending. We plan to offer gas, water, communications, new technology and value-added services (such as house security or indoor utilities management). We believe that we are well positioned to implement this strategy because of:

- Our extensive coverage of the Italian market and our well-established brand name; and
- The economies of scale that we can achieve in the joint management of a broad range of related businesses such as electricity, gas, water, communications and value-added services by sharing back and front office operations, brand and marketing expenses and operating costs;

In pursuit of our diversification strategy, we have:

- Acquired Colombo Gas Group, a secondary distributor of natural gas in the Italian regions of Piedmont, Lombardy and Emilia;
- Established a business-to-business e-commerce joint-venture with Internet Capital Group;
- Acquired IT-Net, a major Italian business Internet Service Provider;
- In the context of our advanced electronic meter project, developed a plan for the deployment of new networking technology in order to create a complete end-to-end home networking infrastructure that will allow us to deliver a wide range of value-added services to our customers; and
- Together with 11 other major European utility companies, agreed to establish a European business-to-business Internet portal for the electricity, gas and water sectors.

We are also in the process of completing the acquisition from the Treasury of Acquedotto Pugliese S.p.A. (“Acquedotto Pugliese”), the major provider of integrated water distribution services in Italy, and establishing a holding company which will focus on venture capital investments in companies in the telecommunications, new media, utilities and Internet sectors, as well as high technology activities related to the Enel Group businesses.

Implement a focused international expansion. We believe that:

- The experience of our new management,

- Our technical expertise in the electricity sector, and
- Our size and strong balance sheet

constitute a strong platform to pursue a focused international expansion with a risk controlled approach in situations in which there are clear opportunities to add value for our shareholders.

We are currently focusing our internationalization strategy on implementing our multi-utility strategy in those European countries where we believe we can become one of the leading operators in the relevant market, with particular emphasis on Central Europe and the Mediterranean area. We are also pursuing international investment opportunities through Enelpower, S.p.A. (“Enelpower”), our engineering and construction company. In 1999, Enelpower formed a joint venture to develop electricity generating plants in Greece and neighboring countries. Enelpower is also participating in the construction and expansion of generating plants in Greece, Britain, Saudi Arabia and Argentina.

THE ENEL GROUP

Italian Electricity Demand

The demand for electricity in Italy has grown at an average annual rate of approximately 2.4% during the past five years. The following table shows the annual rate of growth in Italy’s GDP in real terms and the annual rate of growth in electricity demand for the years indicated.

	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>Average 1995-99</u>
Growth in real GDP(1).....	2.9%	1.1%	1.8%	1.5%	1.4%	1.8%
Growth in electricity demand(2)	2.9%	0.7%	3.2%	2.9%	2.3%	2.4%

Source:

- (1) Banca d’Italia, 1996, 1998 and 1999 Annual Reports and Istat reports, including revisions to certain historical data made in 2000.
- (2) Enel, Statistical Data about Energy in Italy, for data through 1998 and preliminary data from the *Gestore della Rete* for 1999.

Electricity demand grew by 2.3% in 1999 as compared to 1998. That rate of growth was less than the annual growth rate in 1998 due in part to a slowing of the Italian economy during the early part of 1999. The rate of growth in electricity demand during the second half of 1999, however, was higher than the rate during the first half of the year.

Per capita electricity consumption is lower in Italy than in a number of other leading industrialized countries. In 1998, electricity consumption in Italy was 4,529 kilowatt hours (“kWh”) per capita, compared to an average of 5,690 kWh per capita for the European Union. The penetration of electricity use (i.e., total electricity demand as a percentage of total energy requirements from primary sources) is also lower in Italy than the average for the European Union.

We expect that any increases in electricity demand that may occur are not likely to result in a need for significant additional installed capacity in Italy in the near term because currently there is sufficient capacity in the Italian electricity system to cover expected growth in demand. The table below shows peak capacity demand, net available capacity at the winter peak load (net of plants in conservation or unavailable due to environmental retrofitting), guaranteed capacity under contracts between us and

foreign or domestic producers and our reserve margin for the Italian electricity market during each of the last five years. Reserve margin represents the total of net available capacity and guaranteed capacity under contract less peak capacity demand.

	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
	(Gigawatts (“GW”), except percentages)				
Peak capacity demand	39.7	39.2	41.7	42.6	42.7
Net available capacity.....	44.9	43.7	47.1	48.2	48.5
Guaranteed capacity under contract.....	6.3	6.7	8.0	8.3	9.0
Reserve margin	11.6	11.1	13.4	13.9	14.8
As a percentage of peak capacity demand	29.2%	28.4%	32.2%	32.6%	34.7%

Source: Enel.

Generation

Through Enel Produzione and our other generating companies we have a total of 749 generating plants, consisting of thermal (fuel oil, natural gas, coal, orimulsion and other fossil fuels), hydroelectric, geothermal and other renewable resource plants. At December 31, 1999, these plants had a total gross installed capacity of 59,418 MW, representing approximately 78% of the total gross installed capacity in Italy. Our net electricity production in 1999 was 178,813 Gigawatt hours (“GWh”), representing 70.8% of Italian production during the year.

The following table shows the gross installed capacity at December 31, 1999 and the net production during 1999 for the Italian electricity sector as a whole and is based on data provided by the *Gestore della Rete*. “Imports” include imports resulting from spot purchases and annual and long-term contracts. “Independent power producers” include Edison S.p.A. (“Edison”) and Sondel S.p.A. (“Sondel”), two industrial companies that produce electricity for their own use and the use of affiliated companies and for sale to third parties, as well as other industrial companies and producers. “Pumped storage consumption” refers to the use of electricity by pumped storage plants to pump water to elevated areas where it can be used at a later time to generate electricity.

	<u>Gross Installed Capacity</u>	<u>Net Production</u>	<u>Percentage of Italian Production</u>
	(MW)	(TWh)	
Enel.....	59,418	178.8	70.8%
Independent power producers.....	13,938	63.7	25.2
Municipal utilities.....	<u>2,902</u>	<u>10.2</u>	<u>4.0</u>
Total gross installed capacity and net production in Italy	<u>76,258</u>	<u>252.7</u>	<u>100.0%</u>
Net imports		<u>42.0</u>	
Pumped storage consumption		<u>(8.9)</u>	
Total demand in Italy		285.8	

Source: *Gestore della Rete*.

You should read “—Competition in the Electricity Markets” for a more detailed discussion of the electricity markets in Italy.

The following table shows, by primary energy source utilized, our gross installed capacity at December 31, 1999 and the net production and percentage of our net production represented by each source in 1999.

	Gross Installed Capacity	Net Production	Percentage of our Net Production
	(MW)	(GWh)	(GWh)
Thermal	41,878	136,946	76.6%
Hydroelectric	16,891	37,714	21.1
Geothermal and other renewable	649	4,153	2.3
Total.....	<u>59,418</u>	<u>178,813</u>	<u>100.0%</u>

Disposal of generating capacity

In order to increase competition in the Italian electricity generation market, the Bersani Decree provides that after January 1, 2003 no single company or group may generate or import in aggregate more than 50% of the total amount of electricity generated and imported in Italy on average over any three year period. The Decree requires us to dispose of not less than 15,000 MW of our generating capacity by that date in order to reduce our market share to an allowable level. In August 1999, the Italian government approved our plan to dispose of plants representing 15,057 MW of net installed capacity, which is equivalent to approximately 16,000 MW of gross installed capacity, by January 1, 2003 to comply with these requirements. In June 2000, speaking before the Parliamentary Commission on Productive Activities, the Minister of Industry noted the importance of completing the sale as soon as possible, preferably by the first half of 2001.

As part of our plan, in October 1999 we transferred to three newly created subsidiaries (Eurogen S.p.A. (“Eurogen”), Elettrogen S.p.A. (“Elettrogen”) and Interpower S.p.A. (“Interpower”)) the generation assets we selected for disposal, together with the management teams and employees needed to operate the plants. We will dispose of our entire interest in each of these companies by January 1, 2003. We believe that selling operating companies provides greater value to us than if we sold the generating assets separately.

We transferred the 15,057 MW of net installed capacity to the three companies as follows:

- Eurogen: 7,008 MW;
- Elettrogen: 5,438 MW; and
- Interpower: 2,611 MW.

The generation assets that were transferred broadly reflect the technological features, mix of fuels and geographical distribution of the generation assets that we will retain, and include thermal and hydroelectric plants. We transferred thermal plants representing 9,460 MW of the 14,200 MW of thermal plants that we currently plan to convert to CCGT technology. We also transferred to the three companies an aggregate of approximately 5,100 employees, Lit. 8,200 billion of assets and Lit. 6,400 billion of liabilities.

We plan to dispose of relatively more base load plants, which tend to operate on a continuous basis, than mid-merit plants, which we use principally to cover increases in demand for electricity during higher demand periods. Because we are disposing of more base load plants, our proportionate share of

the total amount of electricity generated in Italy will decline by more than the percentage of our total gross installed capacity that we are transferring. Following the completion of our disposal plan, we expect our gross installed capacity will decrease from approximately 78% to approximately 47% of total Italian gross installed capacity and that that we will generate approximately 40% of the total amount of electricity generated and imported in Italy in 2003.

The governmental decree approving our plan and the implementing regulations issued by the Treasury and the Industry Ministry require us to dispose of ownership of the three new generating companies through direct negotiations with potential acquirors. We may dispose of Eurogen through a combination of direct negotiations and a public offering of shares. No single acquiror may acquire more than one of the three companies. The decree also requires that the new owners of the companies agree to convert plants that are subject to our CCGT conversion plan, maintain certain levels of employment and operate the existing generating plants they acquire for a specified period of time.

As well as disposing of the three generating companies in order to comply with the Bersani Decree, we are also evaluating the possible sale of some of our hydroelectric plants in the provinces of Trento and Bolzano to the local authorities in those provinces. In addition, in April 2000 we agreed to sell to Finaosta S.p.A., a company 100% owned by the Valle d'Aosta Regional Authority, all of our hydroelectric power plants in the Valle d'Aosta region, representing a total effective plant capacity of 781 MW and a value of approximately Lit. 1,500 billion.

Outlook and strategy

We plan to meet the challenges of increased competition and reduced market share by continuing our focus on improving the efficiency of our plants and on reducing costs through the following:

- Improving the fuel mix in our plants to increase the use of less expensive fuels such as high sulfur fuel oil and orimulsion. We expect that our investments in desulfurization and coal denitrogenation units and other measures to improve the environmental standards of our thermal plants, which are described in more detail below, will allow us to increase our use of these fuels while maintaining compliance with applicable environmental regulations;
- Engaging in active trading of fuels with the aim of reducing purchasing costs;
- Looking for new areas of cost reduction;
- Continuing to reduce labor costs through shrinking our workforce and streamlining the use of personnel in our plants; and
- Reducing costs associated with our capital investment program by improving procurement and relying on in-sourcing of activities to build on our electric engineering and power plant construction experience.

The Bersani Decree contains provisions designed to promote the generation of electricity from renewable resources constructed after April 1, 1999 that have qualified for a “green certificate”. See “—Regulatory Matters—Electricity Regulation—The new regulatory framework—Promotion of renewable resources” for a detailed description of these requirements. To comply with these regulatory requirements, electricity from qualifying renewable resources may be produced directly, purchased from other producers or purchased from the *Gestore della Rete*. For example, based on our production for 1999, the Bersani Decree would have required us to provide approximately 3.6 TWh of electricity from renewable resources. Our current capital investments plans provide for an aggregate increase in our gross

installed capacity for production from renewable resources between April 1, 1999 and January 1, 2001 of 99 MW.

We currently expect to produce 0.7 TWh of electricity from qualifying renewable resource capacity in 2002, the first year the requirements apply. We expect to purchase qualifying energy rights from the *Gestore della Rete* or other producers in order to acquire any additional electricity from qualifying renewable resources we will be required to provide.

We have no plans to construct new plants or add significant amounts of generating capacity, other than from renewable resources, in the near term. Instead, we have focused our investment plans for our existing generating plants on two goals:

- Converting our thermal plants to CCGT technology where practicable; and
- Upgrading the environmental performance of our thermal plants.

You should read “—Thermal production” for a more detailed discussion of these plans.

In 1997, we began to implement a strategic plan to improve operating efficiency in our generation activities. Our strategic plan focuses on restructuring our generating activities with the goal of reducing costs to the levels of the most efficient European and American generators of electricity. In implementing the plan, we have improved our allocation of capital expenditures by, among other things, rationalizing plant maintenance programs, and have reduced costs associated with the purchase and use of fuel supplies by improving sourcing, logistics and the mix of fuels we consume. We have also focused on labor cost reductions, reducing the number of personnel in our generation segment by 1,300 between June 30, 1996 and December 31, 1998, and by a further 1,400 persons through December 31, 1999. As a result, our net production per employee increased from 8.5 GWh in 1997 to 9.6 GWh in 1999.

Thermal production

At December 31, 1999, we had 61 thermal plants comprising 225 generating units with a total gross installed capacity of 41,878 MW, or 70.5% of our gross installed capacity at year end. These plants generated net production of 136,946 GWh in 1999, or 76.6% of our net production for the year.

All our thermal plants consist of two or more generating units and most have a standardized design, with the generating units being of one of three types: steam-condensing units, gas turbine units and internal combustion units. Steam-condensing units consist of closed-cycle plants in which water is transformed into steam and used in a turbine to generate electricity. Steam is turned back into water through a cooling process using sea or river water. Gas-turbine units burn natural gas to drive a turbine and generate electricity. Internal combustion units use diesel engines to generate electricity. At December 31, 1999, approximately 90% of the gross installed capacity of our thermal plants consisted of steam-condensing units and approximately 10% of such capacity was represented by gas-turbine units. Internal combustion units represented less than 1% of the gross installed capacity of our thermal plants.

Each of our thermal generating units is designed to operate on one or more kinds of fuel. Single fuel units use either petroleum products or coal but not both, dual fuel units can use petroleum products and either natural gas or coal, while triple fuel units can use petroleum products, coal and either natural gas, orimulsion or lignite. In 1999, single fuel units (the vast majority of which are petroleum powered) generated approximately 50% of our net production from thermal plants and represented approximately 35% of our gross installed capacity of such plants at year end. Dual fuel units (approximately 80% of which use petroleum products or natural gas) accounted for approximately 40% of our net production

from thermal plants and approximately 55% of our gross installed capacity of thermal plants at year end, with triple fuel plants accounting for the remaining approximately 10% of our net production and gross installed capacity of thermal plants.

We have begun a program to convert many of our conventional thermal plants into CCGT plants. Converting thermal plants to CCGT generation generally involves the installation of one or more gas turbines and replacement of conventional boilers in the plants with heat recovery steam boilers. These boilers are used to drive existing steam turbines. Converting plants to CCGT generation increases the efficiency of plants and reduces emissions. We plan for our CCGT plants to have a designed expected average thermal efficiency of 55%. We completed one CCGT plant representing 700 MW of gross installed capacity in 1997 and will complete conversion of an additional 600 MW of gross installed capacity by the end of 2000.

In addition to this 1,300 MW of gross installed capacity, our current plans contemplate the conversion of approximately 14,200 MW of gross installed capacity to CCGT technology, with plants representing approximately 7,000 MW of gross installed capacity to be converted by 2003, and 7,200 MW by 2008. Under our plan to dispose of the three generating company subsidiaries in order to comply with the Bersani Decree, we will dispose of 9,460 MW of the 14,200 MW of gross installed capacity scheduled to be converted to CCGT technology. We currently estimate the average costs of conversion over the course of the project to be approximately Lit. 550 million per MW of gross installed capacity. This plan is based on our current thermal generating capacity.

In addition to our CCGT conversion program, we are planning to convert an additional 2,350 MW of gross installed capacity by:

- Converting a fuel oil plant to orimulsion technology;
- Changing the coal-burning technology of an existing coal plant; and
- Converting a fuel oil plant to low environmental impact technology.

We have an ongoing program of refurbishment and maintenance of our plants. We invested an average of Lit. 80 billion per year during the last three years to refurbish our thermal plants and we plan to invest a similar amount in each of the next five years.

We have made significant investments since 1990 to improve the environmental standards of our thermal plants and comply with the emission targets or thresholds required under applicable environmental laws and regulations. These measures include installing desulfurization and denitrogenation units, modern burners and units for the treatment of water resulting from the electricity generation process, as well as improvement of the treatment of ash. Installation of desulfurization and denitrogenation units increases our flexibility to use different types of fuel, including lower-cost fuels such as high sulfur fuel oil and orimulsion, while maintaining compliance with emissions restrictions.

Our environmental capital expenditures for conventional thermal generation have been substantially the same for the last five years, at approximately Lit. 800 billion per year. Although these investments have grown as a percentage of our total capital investments related to generation in the recent past, they began to decline in both absolute and percentage terms in 1999, as our current cycle of environmental capital expenditures neared completion. You should read “—Regulatory Matters—Environmental Matters” for a more detailed discussion of the environmental laws and regulations affecting our generation operations.

We operate a number of thermal plants which are located on maritime or fluvial areas owned by the Italian government pursuant to concessions from the government. These concessions expire at various times, depending on their individual terms. Should any of these concessions expire without being renewed, we would be required to transfer to the government the real estate assets and permanent fixtures that are located in the area under concession.

Hydroelectric production

At December 31, 1999, we had 651 hydroelectric plants with a total gross installed capacity of 16,891 MW, or 28.4% of our gross installed capacity at year end. These plants generated net production of 37,714 GWh in 1999, or 21.1% of our net production for the year.

We classify our hydroelectric plants with reservoirs according to the fill-in rate of their reservoirs, which represents the time required for a plant's reservoir to fill from empty based on normal water flow. Pondage plants have fill-in rates ranging from two to 400 hours and reservoir plants have fill-in rates exceeding 400 hours. We also have run-of-river and pumped storage hydroelectric plants.

In 1999, pondage plants generated approximately 35% of our net production from hydroelectric plants and represented approximately 25% of our gross installed capacity of such plants at year end, while run-of-river plants accounted for approximately 25% of our net production from hydroelectric plants and approximately 15% of our gross installed capacity of such plants at year end. Pumped storage plants generated approximately 20% of our net production from hydroelectric plants in 1999 and represented approximately 40% of our gross installed capacity of such plants at year end, with reservoir plants accounting for the remaining approximately 20% of both our net production from hydroelectric plants and our hydroelectric gross installed capacity.

We invested an average of Lit. 100 billion per year during the last three years to refurbish our hydroelectric plants and we plan to invest similar amounts in the next five years.

We use the water streams in our hydroelectric plants under licenses from the Italian government for the generation of electricity from large bodies of water. Under the Bersani Decree, our licenses will expire in 2029. If the licenses expire without being renewed, we will have to transfer the affected hydroelectric plants to the governmental authority granting the license without compensation. Under Italian law, the Regional Authority of Valle d'Aosta and the Provincial Authorities of Trento and Bolzano may impose an earlier termination date for licenses relating to hydroelectric plants in those areas. This termination date has been set at 2010 for the provinces of Trento and Bolzano, while the process for Valle d'Aosta is continuing. Our hydroelectric plants in the provinces of Trento and Bolzano and in Valle d'Aosta have an aggregate gross installed capacity of 2,750 MW. Hydroelectric licenses for the generation of electricity from small bodies of water are currently granted for an indefinite term, but are expected to become subject to a different regime in the future. The net book value of our plants under license was approximately Lit. 6,000 billion at December 31, 1999. We pay approximately Lit. 180 billion per year in fees under the hydroelectric licenses. You should read “—Regulatory Matters—Distribution—Licenses and requirements” for a more detailed discussion of the expiration of our licenses.

Production from geothermal and other renewable resources

At December 31, 1999, we had 31 geothermal power plants consisting of a total of 41 generating units with an aggregate installed capacity of 621 MW. In 1999, we increased our gross installed capacity by 42 MW and our geothermal plants generated 4,153 GWh, or 1.0% of our net production for the year. All our geothermal plants are located in central Italy.

We also use other forms of renewable resources, including generation from solar photovoltaic and wind energy sources. At December 31, 1999, we had four wind farms with a gross installed capacity of 25 MW and solar generating stations with a gross installed capacity of 3.1 MW. Together, these plants accounted for 25 GWh of our net production in 1999.

We are the leader in Europe in the production of electricity from geothermal sources, and have more installed capacity than any other producer in Europe. Although certain subsidies intended to give producers in Italy incentives to use renewable resources will expire by 2008, the provisions in the Bersani Decree requiring producers to supply a specified amount of electricity generated from new renewable resources should increase demand for renewable resource energy. We are currently considering acquisitions or joint ventures concerning renewable energy power plants.

Discontinued nuclear operations

We have not generated electricity from nuclear power since 1988 following a 1987 national referendum in which the Italian electorate expressed support for ending the use of nuclear power. We have no plans for the redevelopment of nuclear power. On November 1, 1999 we transferred our discontinued nuclear operations to a wholly owned special purpose subsidiary, SO.G.I.N. S.p.A. (“SOGIN”). The assets and liabilities transferred to SOGIN consisted primarily of Lit. 896 billion in receivables for reimbursements from a national fund known as the Equalization Fund, Lit. 717 billion in liquid assets and Lit. 1,543 billion of provisions for risks and charges, with the total of net assets transferred amounting to Lit. 30 billion. You should read “—Regulatory Matters—Electricity Regulation—The new tariff structure” for a description of the Equalization Fund. The Bersani Decree provides that we are to transfer this subsidiary to the Treasury. The transfer of our discontinued nuclear operations and related arrangements are described in more detail in “—Regulatory Matters—Environmental Matters—Discontinued nuclear operations”.

Fuel

We use fuel oil, natural gas, coal and other fuels for thermal generation, while we do not use significant amounts of fuel in operating either our hydroelectric or geothermal and other renewable plants. Italy has small reserves of fossil fuels. As a consequence, we depend on imported oil, coal and natural gas for a large proportion of our energy needs.

In 1999, our fuel costs, including fuel transport, were approximately Lit. 6,308 billion and constituted 20.9% of our total operating expenses. We spent 50.2% of this amount on fuel oil, 36.8% on natural gas, 9.2% on imported coal and 3.8% on orimulsion, lignite, diesel and other fuels. We attempt to maintain secure and flexible supplies by diversifying our geographic sources of supply and the types of fuel we purchase.

Prior to July 1997, the electricity tariff structure did not directly affect our choice of fuels, as it included a thermal reimbursement element through which our actual fuel costs were effectively passed onto electricity customers. Both the tariff structure for fuel reimbursement in effect from July 1997 to January 2000 and that currently in effect contain incentives affecting our choice of fuels to consume. These tariffs include an energy contribution portion that varies in amount according to, among other things, an index of weighted average fuel prices and a consumption index based on the heat rate expected to be obtained from the fuels comprising the fuel price index. We have sought to improve operating income by using a mix of fuels less expensive in aggregate than the fuels comprising the weighted index and by generating energy more efficiently than the efficiency levels represented by the heat rate used in the Energy Authority’s consumption index. These tariffs also include an incentive to reduce production from thermal plants and increase use of renewable resources.

Once the pool market is introduced in early 2001, the tariff and fuel cost reimbursement structure will be replaced by a market price for electricity generation, and we will have an incentive to reduce all costs, including fuel costs, to compete on the market. You should read “—Regulatory Matters—Electricity Regulation” for a more detailed discussion of the new and former tariff structures.

The following table shows, by primary energy source utilized, our net electricity production for the year indicated and the percentage of our total net electricity production represented by such sources. “Other” thermal energy sources include lignite, light distillate and derived gases.

	1997		1998		1999	
	Net electricity produced	Percentage of total	Net electricity produced	Percentage of total	Net electricity produced	Percentage of total
	(GWh)		(GWh)		(GWh)	
Oil.....	92,159	52.0%	84,413	47.0%	66,995	37.5%
Natural gas.....	28,964	16.3	33,710	18.8	43,922	24.6
Coal and orimulsion.....	18,618	10.5	22,836	12.8	26,006	14.5
Other	<u>178</u>	<u>0.1</u>	<u>60</u>	<u>0.0</u>	<u>23</u>	<u>0.0</u>
Total thermal.....	139,919	78.9	141,019	78.6	136,946	76.6
Hydroelectric	33,595	19.0	34,486	19.2	37,714	21.6
Geothermal.....	3,672	2.1	3,958	2.2	4,128	2.3
Wind and photovoltaic	<u>15</u>	<u>0.0</u>	<u>21</u>	<u>0.0</u>	<u>25</u>	<u>0.0</u>
Total.....	<u>177,201</u>	<u>100.0%</u>	<u>179,484</u>	<u>100.0%</u>	<u>178,813</u>	<u>100.0%</u>

Source: *Gestore della Rete*; Enel

We have initiated a program to diversify fuel supplies and use less expensive fuels (such as high sulfur fuel oil or orimulsion) as well as fuels that have less impact on the environment when consumed (such as natural gas). However, generation using high sulfur fuel oil and orimulsion generally results in higher emissions levels than other fuels. Our ability to increase use of these fuels is dependent on the availability of plants able to reduce these emissions in order to comply with restrictions on emissions established by national and European Union authorities. Although we believe that our use of orimulsion fully complies with existing regulations, growing public concern in Italy about the environmental impact of orimulsion may affect our ability to increase the use of this fuel in the future. As discussed under “—Coal” below, we expect to reduce our use of coal because of a carbon tax that was recently implemented in Italy in accordance with European Union directives. This expectation is based on the assumption that the price of other fuels will not vary significantly from current levels. We estimate that by 2004, the approximate percentages of our electricity produced by thermal generation represented by each of the following fuels will be approximately:

- 55% natural gas;
- 10% fuel oil; and
- 35% orimulsion and other fuels.

In order to ensure stable supplies of fuel, we enter into long-term and medium-term contracts with various suppliers. We supplement these contracts with purchases of fuel on spot markets. We purchase the majority of our fuel directly or indirectly from sources outside Italy. Our long-term fuel contracts, primarily for the purchase of fuel oil and natural gas, will require expenditures based on current prices and existing contracts totaling Lit. 3,400 billion per year over the next five years.

In December 1999, we established Enel Fuel Trade and Logistics (F.T.L.) S.p.A. to be responsible for the purchase, sale, exchange and trading of fuel, as well as the supply and development of the related logistical services. The new company became operational in May 2000. We expect that synergies provided by bringing together active market trading and the supply function will further benefit both activities, leading to new business opportunities both in Italy and abroad.

Fuel oil

We are among the world's largest purchasers of fuel oil. The following table shows the amount of fuel oil we purchased from domestic and foreign producers for each of the years indicated. Domestic producers include producers whose headquarters are in Italy, including Agip, a division of the Italian government controlled energy group Eni S.p.A., while foreign producers include producers and refiners outside of Italy and traders of primarily non-Italian sources of oil.

	Year ended December 31,		
	1997	1998	1999
	(in millions of tons)		
Domestic producers	5.6	6.6	6.1
Foreign producers	<u>14.6</u>	<u>12.6</u>	<u>9.2</u>
Total fuel oil purchased.....	<u>20.2</u>	<u>19.2</u>	<u>15.3</u>

We estimate that in year 2000 we will purchase about 14 million tons of fuel oil.

In 1999, we made approximately 35% of our fuel oil purchases under contracts ranging in term from one to twelve months, 43% on the spot market and 22% under multi-year contracts.

Historically, we have also been one of the world's largest purchasers of low sulfur fuel oil, which produces lower emissions when burned, but is more expensive than most other fuel sources. As we have upgraded the environmental performance of our plants, we have been able to increase the proportion of less expensive high sulfur fuel oil that we burn, while at the same time complying with more stringent emission limits. The following table shows the amounts of fuel oil with low, mid and high sulfur content purchased in each of the past three years.

	Year ended December 31,		
	1997	1998	1999
	(in millions of tons)		
Fuel oil purchased			
Low sulfur.....	4.8	5.4	3.9
Mid sulfur	14.7	11.5	8.3
High sulfur	<u>0.7</u>	<u>2.3</u>	<u>3.1</u>
Total.....	<u>20.2</u>	<u>19.2</u>	<u>15.3</u>

Natural gas

We purchase most of our natural gas under long-term, take-or-pay contracts. The price of natural gas under those contracts is generally tied to market prices. In 1999, we purchased 11.3 billion cubic meters of natural gas. Snam S.p.A., the main Italian gas supplier and transporter and a subsidiary of the Italian government controlled energy group Eni S.p.A., supplied approximately 61% of this natural gas.

We increased our use of natural gas from 20.7% of our fuel requirements in 1997 to 31.0% in 1999. This increase reflected larger volumes purchased under our supply contract with Sonatrach, the

Algerian gas producer, the start of supply under our contract with NLNG of Nigeria and larger purchases from Snam. We obtained approximately 35% of the natural gas we purchased in 1999 pursuant to the Algerian gas contract.

In 1999, 31.7% of the electricity we produced by thermal generation was generated using natural gas. We plan to increase this percentage to approximately 34% by the end of 2000 and 55% by 2004. We expect this to be the result of, among other factors, the use of natural gas in high-efficiency CCGT plants and the greater environmental acceptance of natural gas.

In 1992, we entered into a 20-year take-or-pay contract with NLNG, a Nigerian joint venture, for the supply of 3.5 billion cubic meters of natural gas per year. This gas was to be delivered in liquid form commencing in October 1999. However, due to environmental concerns, a regasification facility has not been constructed in Italy for gas. As a result, we did not directly import natural gas under the contract. Instead, in 1997, we entered into a swap agreement with Gaz de France, and related transportation arrangements with Snam. You should read “—Regulatory Matters—Electricity Regulation—The new tariff structure—Stranded costs” for a discussion of the reimbursement of part of the cost of the NLNG gas under current regulation.

Coal

In 1999, our net production of electricity from coal was 23.4 TWh. We purchased 8.6 million tons of coal and consumed 8.3 million tons. We imported virtually all of the coal we purchased, principally from South Africa, South America and Indonesia. We have increased our use of coal over the past several years because the price of coal has made it an attractive alternative to fuel oil. However, in January 1999, the Italian government introduced a carbon tax in accordance with European Union directives. The amount of the tax, which is based on fossil fuel consumption, will increase on an annual basis from 1999 to 2005. As a result, we expect that we will be forced, based on the economic impact of the tax, to reduce our use of coal significantly. Because all our plants that burn coal also burn fuel oil, we expect to increase our use of fuel oil in those plants.

Purchased power

We purchase power from domestic and foreign producers to fulfill our legal and regulatory obligations, to diversify our sources of electricity and to reduce our costs.

Since 1992, Regulation 6/92 of the *Comitato Interministeriale Prezzi*, an Italian governmental committee, has required us to purchase all of the production of domestic producers of electricity that use renewable resources, or “CIP 6 Producers”, provided that the related production capacity had been constructed with our prior approval. We have made our purchases from CIP 6 Producers under a standard 15-year contract established by a 1992 ministerial decree. This contract has required us to purchase all this capacity at a price equal to our avoided cost, including the avoided cost of production (plant operations and maintenance) and fuel, plus certain incentives for the first eight years of this contract.

Once the Single Buyer becomes operational, it will be responsible for supplying the regulated market for electricity and we will no longer be required to purchase electricity from domestic producers, including CIP 6 Producers. Under the Bersani Decree, our contracts with domestic producers will be assigned to the *Gestore della Rete*.

The table below sets forth the gross installed capacity at December 31, 1999 and net generation of Italian producers other than Enel and our net purchases from those producers during 1999.

	Gross Installed Capacity	Net Generation	Enel's Net Purchases
	(MW)	(TWh)	(TWh)
Independent power producers and self-producers.....	13,938	63.7	32.7
Municipal utilities.....	<u>2,902</u>	<u>10.2</u>	<u>3.3</u>
Total.....	<u>16,840</u>	<u>73.9</u>	<u>36.0</u>

We purchase power from outside Italy through long-term electricity supply contracts and on the spot market. Our long-term purchase contracts include contracts entered into to secure electricity supplies after we stopped generating electricity from nuclear power in 1988 following a 1987 national referendum in which the Italian electorate expressed support for ending use of nuclear power.

The table below sets forth the amount of electricity imported in Italy under long-term and annual contracts and by spot purchases during each of the last five years.

	1995	1996	1997 (TWh)	1998	1999
Long-term contracts.....	31.4	30.5	30.2	30.9	29.5
Annual contracts.....	4.8	4.0	6.6	6.6	9.5
Spot purchases	1.1	2.7	1.9	3.1	2.7
Net imports (exports) from electricity exchanges	<u>0.1</u>	<u>0.2</u>	<u>0.1</u>	<u>0.1</u>	<u>0.3</u>
Total imports.....	<u>37.4</u>	<u>37.4</u>	<u>38.8</u>	<u>40.7</u>	<u>42.0</u>

The Italian network is interconnected to foreign networks through 15 international lines, which can transmit a maximum amount of approximately 40 TWh of electricity per year. In 2000, approximately 50% of this interconnection capacity is being used to import electricity under long-term import contracts that we entered into prior to February 19, 1997. We may be required to assign some or all of these contracts to the Single Buyer when it becomes operational. The remaining electricity that the interconnection lines will be able to transmit will be made available for sales to Eligible Customers. However, all of that transmission capacity is currently in use. In order to address this issue, the Energy Authority has established that for 2000 no single importer may use more than 20% of the total interconnection capacity of the Italian network or, if demand for imports from any given country exceeds the interconnection capacity with that country, 15% of that interconnection capacity, in both cases excluding from the calculation capacity covered by long-term contracts in force at February 19, 1997. You should read “—Regulatory Matters—Electricity Regulation—The new tariff structure” for a more detailed discussion of how the new generation market will affect the profitability of imports of electricity.

Under the new electricity market framework, after the Single Buyer becomes operational, we may continue to purchase power domestically or internationally through Enel Trade. Enel Trade will act as Enel's supplier to Eligible Customers.

Transmission

Through TERNA, we continue to own almost all of the transmission assets of the national grid in Italy. The term “transmission” refers to the transportation of electricity on high and very-high voltage interconnected networks from the plants where it is generated (or, in the case of imported energy, from the points of acquisition), to distribution systems.

The transmission system in Italy is undergoing significant changes as a result of the Bersani Decree. You should read “—Regulatory Matters—Electricity Regulation” for a more detailed discussion of these changes. In June 1999, the Industry Ministry formally defined the Italian national transmission grid by decree as part of the implementation of the Bersani Decree. The Industry Ministry determined that the national transmission grid would include all our 380 kV and 220 kV transmission lines, as well as approximately 50% of our 150 kV and 132 kV transmission lines. In August 1999, we transferred dispatching and national grid management to a wholly owned subsidiary that became the *Gestore della Rete*. This transfer involved 614 employees and the transfer of assets totaling Lit. 117 billion (net of technical depreciation) and of liabilities totaling Lit. 79 billion. The *Gestore della Rete* was transferred to the Treasury at no cost on April 1, 2000.

Under the Bersani Decree, the *Gestore della Rete* is responsible for operation and maintenance of the national transmission grid. Owners of the various portion of the grid (including TERN) operate and maintain the grid pursuant to guidelines issued by the *Gestore della Rete*. We expect TERN and the *Gestore della Rete* to enter into a service contract relating to operation of the transmission grid and compensation of TERN by the end of 2000. The general framework of the contract has been established by governmental decree, and will provide for the following arrangements:

<u>Gestore della Rete</u>	<u>TERN</u>
• Responsible for safety, reliability and efficiency of transmission network	• Owns transmission network and operates the network under the terms of the contract
• Manages power flows	• Operates through remote control system
• Approves network maintenance	• Executes maintenance instructions
• Determines network upgrades	• Executes network upgrades
• Evaluates third-party connection requirements	

Our transmission company will earn revenue from a fee per kWh transported that distributors and suppliers pay to us through the *Gestore della Rete*. The Energy Authority determines that fee, which is designed to cover our operating expenses, depreciation and a specified rate of return on our assets.

The following table shows our transmission network as of December 31, 1999.

<u>Type of facility</u>	<u>Number</u>	<u>Length (km)</u>
Primary transformer stations.....	248	—
Transformers	541	—
Busbar connections.....	3,582	—
380kV lines.....	207	9,768
220kV lines.....	345	10,337
150kV and 135kV lines;	<u>1,189</u>	<u>16,997</u>
Total lines.....	<u>1,739</u>	<u>37,102</u>

During 1999, 234 kilometers of transmission lines entered service, together with thirteen new or repowered 380 kV and 220 kV transformer stations, representing an aggregate increase in transformer capacity of 1,085 MVA.

Our transmission network is connected to our own distribution network through 248 primary transformer stations and with the distribution network of the principal municipal utilities through over 30 stations. Our primary transformer stations typically transform electricity from 220 kV or 380 kV to 132 kV or 150 kV for transmission to our distribution network. Our distribution network uses approximately 1,600 substations or secondary substations that transform 132 kV or 150 kV electricity to low or medium voltage electricity for transfer to end-users.

Since 1997, we have also been engaged in the development of the E-Net project, the installation of a 12,100 kilometer long national fiber optic telecommunications network using high voltage power lines. See “—Other Businesses—Telecommunications—Fiber optic infrastructure.”

The lines used in our transmission system employ rights of way granted by local authorities in areas where the facilities are located. In addition, we have rights of eminent domain over private property. We are required to compensate landowners for any exercise of these rights.

Our transmission network provides links between the Italian electricity system and neighboring countries. We have six international lines at 380 kV and nine international lines at 220 kV. We are currently constructing a 400 kV direct current transmission line with 500 MW capacity to Greece. The line will be 207 kilometers long, with 163 kilometers of submarine cable. We expect the aggregate capital expenditure for the project to be approximately Lit. 653 billion, of which our share is Lit. 500 billion. Athens Public Power Corporation, the Greek government-owned electricity utility, is providing the balance. We have spent approximately Lit. 266 billion as of December 31, 1999. The European Union has committed structural adjustment funds to reimburse 40% of the aggregate capital expenditures relating to the project. We expect to complete the project in the second half of 2001.

In 1999, losses on our network were 1.9% of total electricity demand. This rate compares favorably to that for other European utilities. The following table shows, for the periods indicated, the average duration for the periods shown of the unavailability of electricity occurring at each interconnection point in our network due to errors or breakdowns. Interconnection points are principally points where our network receives electricity from producers or delivers electricity to distributors or Eligible Customers.

	Year ended December 31,		
	1997	1998	1999
	(thousandths of a second)		
Average interruption time.....	0.11	0.11	0.11

In 1998, we implemented a program aimed at rationalizing the operation and maintenance of our electricity transmission system. We developed the program to reduce costs and capital expenditures through streamlining of operations and maintenance of lines and transformer stations, the simplification of technical specifications, a review of project planning and reduction of the purchasing costs of major components. In part as a result of this program, operating costs in our transmission segment declined by 8% in 1999, with investment in lines and transformer stations, excluding special projects such as the international line with Greece, declining to Lit. 444 billion from Lit. 510 billion in 1998. We also have focused on reducing personnel costs. The headcount of our transmission segment decreased from 3,579 at December 31, 1998 to 3,250 at December 31, 1999.

We intend to continue to reduce operating costs through the on-going implementation of the above program and to reduce personnel costs through further reductions in our workforce. We also plan to develop network and transmission line services, such as maintenance and long-distance metering and monitoring, for possible sale to other electricity producers.

Distribution and Sales to Franchise Market

Our distribution network is the principal distribution network in Italy. The term “distribution” refers to transportation of electricity from the transmission network to the customer that actually uses the electricity. In response to the changing regulatory framework for electricity distribution in Italy, in October 1999 we transferred our distribution assets and operations to Enel Distribuzione, our wholly owned subsidiary. Enel Distribuzione will focus on operating and maintaining our distribution network and supplying electricity to the franchise market.

We have focused on reducing operating costs in our distribution and supply operations, using employees more efficiently and reducing total employee numbers. Between December 31, 1997 and December 31, 1999, the number of employees in our distribution segment decreased by approximately 12%. The following table shows the number of personnel in our distribution segment at the dates indicated:

	At December 31,		
	1997	1998	1999
Distribution employees	54,298	51,928	47,841

We are compensated for transporting electricity on our distribution network through a fee determined by the Energy Authority that is part of the tariff we collect from our customers. You should read “—Regulatory Matters—Electricity Regulation—The new tariff structure” for a discussion of this fee.

Distribution network

The table below sets forth our distribution network by type of substation and line at December 31, 1999.

Type of plant	Underground Lines (km)	Insulated Aerial Lines (km)	Bare Aerial Lines (km)	Total Lines (km)	Number of Substations	Transformer Capacity (MVA)
Primary:						
High voltage lines (40-220 kV)	442	—	19,747	20,188	—	—
Primary substations	—	—	—	—	1,864	87,787
Secondary:						
Medium voltage lines (1-30 kV)	111,067	2,244	214,877	328,188	—	—
Low voltage lines	205,075	354,089	143,535	702,699	—	—
Secondary substations	—	—	—	—	403,507	60,933

We believe that losses on our distribution network are in line with those of other leading European electricity companies. Losses on our distribution network in 1999 were 5.4% of total electricity demand and aggregate losses on our transmission and distribution networks were 6.6% of total electricity demand.

Our replacement and construction of distribution lines and substations are subject to Italian laws and regulations limiting these activities based on aesthetic and environmental grounds. In particular, environmental laws establish standards for line placement based on concerns about electromagnetic fields, and public attention has focused on concerns about electromagnetic fields in recent years. These

laws and public concerns in some areas have increased the expense associated with replacement of lines and construction of new lines in recent years. You should read “—Environmental matters” and “—Risk Factors” for a more detailed description of the environmental laws and regulations affecting our distribution operations and the risks they pose for our business.

Consolidation of electricity distribution networks

Our distribution network and the distribution networks of municipally owned utilities serve a number of the same municipalities. The Bersani Decree provides that a single distribution license will be issued for each municipality in Italy and therefore requires the consolidation of multiple distribution networks serving a single municipality. Consolidation may be achieved through, among other things, joint venture arrangements.

The Bersani Decree provides that any distribution company that is owned or partly owned by a municipality and serves at least 20% of the customers in that municipality may request that we sell our distribution network in that municipality to it by March 31, 2001, unless we reached an agreement with it by March 31, 2000 for the consolidation of our respective networks in that municipality. In March 2000, we sold our distribution network in Trieste to A.C.E.G.A.S. S.p.A., the electricity, gas and water distribution company owned by the Municipality of Trieste, for Lit. 22 billion. The network to be sold to A.C.E.G.A.S. supplies electricity to 819 customers in the city’s port and industrial districts. We have received requests for the sale of our distribution networks from substantially all other municipal distribution companies entitled to do so, including those active in Rome, Milan and Turin. If we cannot agree on a sale price with any of these parties by September 2000, the price will be determined by an arbitration panel.

Based on our results for 1999, if we are required to sell all of our networks co-existing with other networks in the same areas as a result of the Bersani Decree, we would lose approximately:

- 1.6 million, or 5%, of our customers;
- 11.2 TWh, or 5%, of our total annual distribution; and
- Lit. 1,530 billion, or 6%, of our annual revenues.

In addition, the distribution networks that we may be required to sell are more profitable than our average distribution networks mainly because distribution in metropolitan areas has lower costs. Therefore the impact on our profits from the disposal of those networks could be more significant than the impact on our revenues. The Energy Authority has indicated that an equalization system will be put in place that may compensate for some or all of the comparative disadvantages of distributors serving non-urban areas.

We cannot predict what the outcome of the consolidation process will be, but it may materially adversely affect the results of our distribution segment. You should read “—Risk Factors” and “—Regulatory Matters” for a more detailed discussion of this consolidation process and the risks involved for us.

The Bersani Decree also contains certain provisions concerning the consolidation of our distribution networks with those of distribution companies (owned or partly owned by a municipality) that serve at least 100,000 customers in municipalities adjoining those where our networks are located. See “—Regulatory Matters—Electricity Regulation—The new regulatory framework—Distribution—Consolidation of the distribution industry”. Pursuant to these provisions, certain of the above distribution

companies have expressed their interest in purchasing our electricity distribution networks in adjoining municipalities. Under the Bersani Decree, any such sale may occur only with the agreement of all of the parties, including Enel.

We are also pursuing other cooperative arrangements in the field of electricity distribution. In April 2000, we and the Valle d'Aosta Regional Authority agreed to establish a joint venture for electricity distribution in that area of northwest Italy. We will contribute to the joint venture approximately 3,900 km of electricity distribution lines located in the region, with a value of approximately Lit. 150 billion. The joint venture will be 51% owned by us and 49% owned by the Valle d'Aosta Regional Authority.

Pursuant to a Government decree of November 1999, the Provincial Authorities of Trento and Bolzano may request that we sell our distribution assets in those provinces to distribution companies owned by the Provincial Authorities or other local authorities. We are currently negotiating the transfer of certain distribution assets in the context of a wider negotiation with the Provincial Authorities. We have also challenged in court certain administrative measures adopted by a government decree concerning our distribution assets in the provinces of Trento and Bolzano. You should read "Legal Proceedings" in Item 3 for a discussion of these court proceedings.

Sales to franchise market

We supply electricity to four main classes of end users: industrial, commercial, household and agricultural users. Our franchise market consists of:

- Non-eligible Customers, which are all customers for which we are the sole provider of electricity and which are not eligible to purchase electricity from other electricity distributors; and
- Eligible Customers that choose not to participate in the free market. Eligible Customers may choose to remain within the franchise market for a maximum of four years. See "—Regulatory Matters—Electricity Regulation—The New Regulatory Framework—Eligible and Non-eligible Customers".

The regulations defining what entities may become Eligible Customers are scheduled to change over time, which will tend to reduce the size of our franchise market. As of December 31, 1999, we serviced approximately 23.2 million households, approximately 92% of all households in Italy.

The following table sets forth the amount of electricity that we sold by class of customer and our total operating revenue from sale of electricity to those customers for the periods indicated. The revenues shown below are different from the amounts shown as "Operating Revenues" in our Consolidated Financial Statements and in other sections of this Annual Report. This is because the revenues shown below include sums that we remit to third parties through the Equalization Fund. See "—Regulatory Matters—Electricity Regulation—The new regulatory framework—Charges payable to the equalization fund".

	1995		1996		1997		1998		1999(1)	
	(TWh)	(in billions)	(TWh)	(in billions)	(TWh)	(in billions)	(TWh)	(in billions)	(TWh)	(in billions)
Industrial	101.8	Lit. 13,715	100.7	Lit. 14,095	104.3	Lit. 15,126	107.1	Lit. 15,903	107.5	Lit. 14,983
Up to 30 kW	5.2	1,675	5.1	1,656	5	1,667	5.1	1,706	5.2	1,792
From 30 to 500 kW	24.1	4,415	24.1	4,508	24.9	4,857	25.8	5,123	26.5	5,035
Over 500 kW	72.5	7,625	71.5	7,871	74.4	8,602	76.2	9,074	75.8	8,156
Commercial and Other services	45.7	9,093	47.7	9,625	49.5	10,321	51.8	10,960	54.1	11,140
Household	51.8	12,278	52.5	12,219	53.0	12,184	53.7	12,610	55.0	12,577
Agricultural	3.9	823	4.0	847	4.2	911	4.3	953	4.5	993
Total	203.2	35,909	204.9	36,786	211.0	38,542	216.9	40,426	221.1	39,693
Other distributors And exports	8.4	497	8.9	517	8.3	488	9.3	509	8.4	458
Total	<u>211.6</u>	<u>Lit. 36,406</u>	<u>213.7</u>	<u>Lit. 37,303</u>	<u>219.3</u>	<u>Lit. 39,030</u>	<u>226.2</u>	<u>Lit. 40,935</u>	<u>229.5</u>	<u>Lit. 40,151</u>

(1) Excludes approximately 1 TWh sold by Enel Trade in 1999.

We estimate that we supplied 92% of the electricity sold in Italy in 1999 and 96% of the electricity sold to industrial customers in the same year. Growth in sales to industrial users is closely related to economic growth in Italy. In 1997, the industrial sector benefited from the introduction of incentives for car buyers. In 1998, the decrease in Italian exports due to the Asian and Latin American financial crisis limited the growth of the Italian economy. In 1999, the Italian economy recovered from the slow growth of the previous years, especially in the second half of the year. We believe that the increase in our sales of electricity to commercial users in the periods shown confirms the growth and the importance of this sector of the Italian economy as a result of its modernization through, among other factors, the increased use of telecommunications services and information technology. Growth of our sales of electricity to households has been limited, principally because the prior tariff structure limited the incentives for household consumption of electricity to the benefit of other sources of energy. The latest generation of household appliances, which tend to consume less energy, and the current tariff structure, which favors residential customers, may provide incentives to increase the consumption of electricity by households. The consumption of electricity by agricultural users has been generally stable during the periods shown, with only minor fluctuations due to weather conditions.

The current tariffs that took effect on January 1, 2000 have significantly changed the tariff levels charged to different classes of customers. You should read “—Regulatory Matters—Electricity Regulation—The new tariff structure” for a more detailed discussion of the new tariffs. In addition, in December 1999, the Energy Authority changed payment terms for electricity bills, modified the rules on customer deposits and the specified amounts of expenses and interest to be paid by customers in case of late payment of electricity bills. These changes are being introduced during the course of 2000. We estimate that, in the aggregate, these changes will increase our working capital by approximately Lit. 200 billion in year 2000.

We are generally required by law to supply electricity to our customers, whether private or government-owned, under the same contractual conditions and with the same tariffs (or tariffs subject to the same limits) within established classes of customer. However, we are required by law to provide certain of our customers with special contractual conditions and discounted tariffs. These customers include the State-owned Italian railway company, Ferrovie dello Stato S.p.A., and a steel company, Acciai Speciali Terni S.p.A., both of which transferred electricity assets to us as part of the nationalization of the Italian electricity industry in 1962. Starting in January 2000, a surcharge designed to recover the costs of these special arrangements will be payable by both Eligible and Non-Eligible customers. See “—Regulatory Matters—Electricity Regulation—The new tariff structure”.

Customer services

Customer service is an important part of our commercial strategy. In 1996, as a result of a joint initiative of all participants in the Italian electricity industry and the public authorities, we signed the electricity service charter. The charter seeks to provide more information to electricity customers about the terms on which we provide services and improve electricity customers' protection and satisfaction. The Energy Authority has recently issued guidelines defining quality thresholds and maximum times for the provision of each kind of service and imposing penalties for failure to provide certain services to customers within specified deadlines. Distributors that outperform certain targets are remunerated through bonuses. See “—Regulatory Matters—Electricity Regulation—The new tariff structure—Quality of service regulation”. We believe that our investments in customer service related initiatives are sufficient to allow us to comply with these guidelines.

In 1999, there was a 4.3% decrease in the average number of accidental interruptions on our network and an approximately 11% decrease in the total duration of these interruptions compared to 1998. The waiting time for connections not requiring work on our electricity distribution network in 1999 remained basically unchanged from 1.4 days in 1998. In 1988, these connections took over 13 days on average.

Currently, our primary customer service activities are conducted by telephone. We plan to restructure our system of telephone customer service to create six to eight unified, nationwide call centers with a single call-in number, compared to the existing 120 active call numbers and 74 local call centers. The call centers would offer an expanded range of services, including bill payment by credit card. We expect the new structure to enhance the support available to our clients because of the integration of technical expert teams into fewer centers. The creation of larger technical expert teams at fewer centers should also allow for greater specialization and improve our efficiency in responding to calls. Because of the integration of back office activities and expected reduction of the number of call centers, we expect that the new call center projects will also result in significant future savings, primarily through work force reductions. We expect to complete the call center project in 2002 and estimate that it will have an aggregate cost of approximately Lit. 250 billion.

We are also introducing a new generation of electricity meters that will allow us to measure the electricity consumption of all of our customers automatically from our own facilities. We currently expect to install the first meters in 2001 and to complete the project by the end of 2004. We currently estimate that costs for the project, including installation of the meters, will amount to Lit. 3,600 billion. The new meters will be designed to offer us a range of new and improved technical operations. We will be able to connect and disconnect customers and vary contracted capacity electronically, while we currently need to gain access to customers' premises for any of these actions. In addition, the new meters will permit a high number of use measurements throughout the day, which may allow for our introduction of different tariffs for different times of consumption, among other things. Because of the increase in automated operations that the new meters will allow, we believe that the new system will produce significant savings. Furthermore, we believe that the installation of the new metering technology will allow us to provide new services to our customers in addition to electricity.

In June 2000, we signed a research and development agreement with Echelon Corporation (“Echelon”) relating to the use of Echelon's LonWorks technology in our digital meter project. We also signed an agreement to purchase 3,000,000 newly-issued shares of Echelon's common stock (representing approximately 8% of Echelon's outstanding shares, based on the number currently outstanding and these newly-issued shares). Under this agreement, we also have the right to nominate one member of Echelon's board of directors. The purchase price for the newly-issued shares will be determined with reference to the average price of Echelon's shares on the NASDAQ during the period prior to the closing, but will not

in any event be less than \$87.3 million or more than \$130.9 million. We have agreed to hold the shares we are purchasing for at least three years, although we are free to sell the shares if the research and development agreement is terminated due to a material breach by Echelon. The closing under the stock purchase agreement is subject to U.S. antitrust approval and other customary closing conditions.

We have also introduced several initiatives to improve customer satisfaction, including in 1998 the “Nuova Bolletta” (the new billing format), that introduced simplified language and content. In addition, in 1997, we introduced “Contowatt”, our new service which seeks to promote our customers’ use of direct debit to pay their bills. In particular, through Contowatt, we provide customers with improved protection against potential technical problems associated with the direct debit process.

Sales to Free Market

We formed Enel Trade to focus on marketing and electricity supply to Eligible Customers, and, once the pool market has been established, on electricity trading on that market. The progressive liberalization of the Italian electricity market will require us to provide our larger customers with increasingly flexible and competitive services that go beyond providing a reliable energy supply. As part of our marketing efforts, we have prepared a series of customer initiatives, including offering specially-tailored contract terms for different types of customers and special conditions for medium and high voltage customers depending on hours of use, as well as value added services such as energy monitoring and management, which we may offer over the Internet. We also intend to offer price risk management to Eligible Customers and are setting up a system for the sale of electricity over the Internet that we expect to be operational by the end of 2000. We also expect that Enel Trade will offer some of these services, as well as trade electricity, in Europe outside of Italy and that it may expand its activities to encompass other products, such as gas, in the future.

The Bersani Decree envisions that electricity consumed by Eligible Customers, including electricity produced by them, should account for 35% of total Italian electricity consumption in 2000 and 40% of total Italian electricity consumption from 2002. However, due to the fact that only a portion of those customers who qualify as Eligible Customers have actually chosen to participate in the free market, we estimate that the actual percentage of the total Italian electricity consumption represented by the free market (including electricity produced by customers for their own consumption) will be 23.5% in 2000. We estimate that Enel Trade will account for approximately 51% of this market, serving about 355 individual customers and 40 qualifying consortia throughout Italy. Until the creation of the pool market, the prices of electricity we sell to Eligible Customers are based on negotiated bilateral contracts between us and each Eligible Customer we serve. You should read “—Regulatory Matters—Electricity Regulation—The new regulatory framework—Eligible and Non-eligible Customers” for a more detailed discussion of regulations regarding Eligible Customers.

Capital Investment Program

We have summarized in the table below our capital expenditures relating to generation, transmission and distribution of electricity during the years 1995 to 1999.

	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
	(lire in billions)				
Thermal	2,008	1,756	1,723	1,327	1,179
Hydroelectric	459	469	417	359	254
Geothermal.....	171	138	174	175	138
Wind and photovoltaic	<u>6</u>	<u>9</u>	<u>8</u>	<u>8</u>	<u>7</u>
Total generation.....	2,644	2,372	2,322	1,869	1,578
Transmission	653	690	659	594	436
Distribution	3,507	3,645	3,092	3,007	3,246
Other	<u>690</u>	<u>665</u>	<u>393</u>	<u>401</u>	<u>393</u>
Total	<u>7,494</u>	<u>7,372</u>	<u>6,466</u>	<u>5,871</u>	<u>5,653</u>

In 1999, a significant part of our capital expenditures for electricity generation related to the conversion of thermal plants to CCGT technology (Lit. 159 billion), while our capital expenditures for our electricity distribution network were primarily attributable to expenditures to meet the increase in electricity demand due to new customers and improve the quality of our services through equipment upgrades and network automation.

We expect that total capital expenditures in our core electricity businesses will increase only slightly in the near term because we do not expect to add new plants or significant generating capacity until after we complete the required disposal of the three new generating company subsidiaries prior to January 1, 2003.

We expect to incur total capital expenditures in our generation, transmission and distribution businesses of approximately Lit. 5,500 billion in 2000, Lit. 5,664 billion in 2001 and Lit. 7,502 billion in 2002.

We made a capital contribution in July 1999 to WIND of Lit. 587 billion. We made this contribution by transferring assets to WIND. Based on the current budget for WIND, our preliminary estimate is that we will make additional capital contributions to WIND of approximately Lit. 1,000 billion in aggregate in the two-year period 2000-2001. We expect to make these contributions in cash.

We also may make additional investments in connection with the further implementation of our strategy to diversify into other businesses beyond our core electricity businesses. The amount and timing of these investments will depend upon the nature of these businesses and the way in which we structure our investments in them.

Competition in the Electricity Markets

Generation

Historically, we have had no competition in our electricity generation business. In 1999, we accounted for approximately 71% of domestic electricity production. We also purchased all of the electricity imported into Italy and purchased electricity from independent power producers and excess production from industrial producers that generate electricity provided for their own consumption.

Our purchases from independent power producers are regulated by long-term contracts which cover a significant part of their generating capacity. The Bersani Decree provides that we have to transfer those contracts to the *Gestore della Rete*.

The following table shows gross installed capacity in Italy by category of producer for the periods indicated.

	At December 31,				
	1995	1996	1997	1998	1999
			(MW)		
Enel.....	55,917	57,072	58,223	58,906	59,418
Independent and other power producers ...	9,596	10,707	11,756	13,149	13,938
Municipal utilities.....	<u>2,735</u>	<u>2,864</u>	<u>2,810</u>	<u>2,901</u>	<u>2,902</u>
Total.....	68,248	70,643	72,789	74,956	76,258

As a result of the limitation on the production and import of electricity imposed by the Bersani Decree, we must dispose of plants with a total capacity of at least 15,000 MW by January 1, 2003. We have begun the process necessary for the sale of Eurogen, Elettrogen and Interpower, the companies to which we have transferred approximately 16,000 MW of gross installed capacity, in order to comply with this limitation. The entities that will acquire these companies will be our competitors on the open generation market.

We expect that our competitors will also include domestic independent power producers, municipal utility companies and any foreign operators that enter the Italian market through interconnection or through the acquisition of Italian generation assets.

The two leading existing independent generators are Edison and Sondel. Edison is Italy's largest independent power producer. At December 31, 1999, Edison had a reported 3,600 MW of generation capacity, which represented approximately 5% of total installed capacity in Italy. At the same date, Sondel had a reported generation capacity of 1,460 MW, or approximately 2% of the total.

The main municipal electricity companies are AEM Milano, ACEA Roma and AEM Torino. AEM Milano and ACEA Roma are publicly traded companies, though the majority of each is still owned by the relevant municipality. AEM Milano has approximately 1,000 MW of generation capacity, ACEA Roma has approximately 360 MW and AEM Torino has approximately 500 MW. In addition to their core electricity business, these companies are implementing a multi-utility strategy to offer telecommunications, gas and water services.

The Italian network is interconnected to foreign networks through 15 international lines, which can transmit a maximum amount of approximately 40 TWh per year. We may be required to transfer all or part of our long-term import contracts for a total of approximately 20 TWh of electricity to the Single Buyer in 2000. The remaining electricity that the interconnection lines will be able to transmit will be made available for sales to Eligible Customers. However, all of that transmission capacity is currently used and allocated according to the rules established by the Energy Authority. You should read "The Enel Group—Purchased Power" for a discussion of these rules.

Electricity sales to Eligible Customers

We expect that there may be significant competition resulting from the opening of the market to Eligible Customers, which are free to choose the supplier of their electricity. Enel Trade's competitors in sales to Eligible Customers are independent power producers, importers, wholesalers and brokers.

International operators have started promoting the sale of electricity to Eligible Customers. We expect that the increase in competition will be gradual because the other operators will initially have a limited amount of produced or imported electricity available to sell to Eligible Customers. Competition will increase more significantly after we dispose of Eurogen, Elettrogen and Interpower.

Other Businesses

Telecommunications

Fiber optic infrastructure

We have been engaged since 1997 in the E-Net project to install fiber optic cable along portions of our electricity transmission and distribution network. At December 31, 1999, we had installed approximately 10,800 km of fiber optic cable and expect to have installed 12,100 km of fiber optic cable at the end of 2001.

We expect that total capital expenditures for fiber optic cable will total approximately Lit. 295 billion in aggregate for the period 1997 to 2001.

WIND

In late 1998, WIND, our joint venture with France Telecom and Deutsche Telekom, began providing telecommunications services in Italy. We own 51% of WIND. DT-FT Italian Holdings GmbH, a company equally owned by France Telecom and Deutsche Telekom (“DT-FT”), owns the other 49%.

WIND was the first Italian provider of integrated fixed-line voice telephony and mobile telephony services and subsequently began to provide data transmission and Internet services. As of December 31, 1999, WIND had more than 2.1 million active corporate and consumer telephone lines. As of May 31, 2000, the number of lines had increased to 3.7 million, while the number of registered Internet users was approximately 300,000. WIND leases a portion of our fiber optic infrastructure from us under a 15-year lease that began in 1999.

WIND’s objectives are to become:

- The first telecommunications operator in Italy that offers its customers a full range of integrated fixed-line and mobile telecommunications services as well as Internet services;
- The leading alternative to Telecom Italia for both corporate and residential customers seeking a comprehensive portfolio of telecommunications services from one supplier; and
- A leader in Italy in the expansion of the telecommunications industry into the information technology and multimedia sectors.

To accomplish these objectives, WIND’s strategy is to:

- Integrate its fixed-line and mobile services fully;
- Offer corporate and residential customers high-quality, reliable services and provide customer care support;

- Offer services with an easy-to-understand structure, and on conditions that are clear to its customers, particularly conditions that relate to price and billing; and
- Provide its customers with a full range of innovative telephony, data transmission and Internet services.

During 1998, WIND obtained a number of important licenses and authorizations, including:

- In February 1998, a license to install and develop a telecommunications network to provide fixed-line voice telephony services, the authorization to provide packet switched data transmission and the authorization to resell network capacity;
- In June 1998, the third license to provide mobile telecommunications services in Italy using digital GSM-1800 and GSM-900 technology; and
- In July 1998, the authorization to offer telecommunications services on dedicated lines and the authorization to provide Internet services through WIND's switched network.

Since WIND began its operations in June 1998, it has focused on developing its technical infrastructure, entering into agreements with other telecommunications operators, setting up its organizational structure and marketing its services.

WIND intends to participate in the bidding procedure for the allocation of the five UMTS licenses in Italy, which are expected to be awarded by the end of 2000.

WIND has entered into a number of non-exclusive agreements with other telecommunications operators, including:

- Interconnection agreements with the other main Italian telephone operators - Telecom Italia, Telecom Italia Mobile, Omnitel Pronto Italia, Infostrada and Blu - with respect to domestic fixed and mobile services. These agreements are reciprocal agreements allowing one operator to make use of other operators' networks in order to have the necessary connections to terminate a call originating in that operator's network;
- National roaming agreements with Telecom Italia Mobile and Omnitel Pronto Italia with respect to mobile services. These agreements are reciprocal agreements allowing one mobile operator to have its customers' calls hosted by other mobile operators' networks in geographical areas which its network does not cover;
- International roaming agreements with the principal mobile operators in several countries for WIND's mobile services; and
- Interconnection agreements with international carriers for its fixed and mobile services.

Effective September 1999, WIND acquired IT-Net, one of the principal providers of Internet services to business customers in Italy. IT-Net had revenues of approximately Lit. 4.9 billion in the six-month period ended December 31, 1999.

Because of the costs WIND is incurring in developing its business, WIND is currently sustaining operating losses and negative cash flows. WIND had a net loss of approximately Lit. 50 billion in 1998, of which our share would have been Lit. 25 billion based on the equity method of accounting, which we

adopted in respect of our investment in WIND in 1999. In 1999, WIND had a net loss of approximately Lit. 812 billion, of which our share was approximately Lit. 414 billion. WIND's cumulative losses as of the end of 1999 exceeded one-third of WIND's share capital and therefore, as required by Article 2446 of the Italian Civil Code, a shareholders' meeting was called in order to adopt the necessary measures in relation to such losses. This shareholders' meeting was held on April 20, 2000 and resolved to reduce WIND's share capital in order to cover such losses and to contemporaneously increase WIND's share capital to approximately Lit. 2,190 billion by issuing 1,300,000,000 new fully paid ordinary shares (nominal value Lit. 1,000 per share) to WIND's shareholders in proportion to their respective shareholdings (Enel 51% and DT-FT 49%).

During 1999, WIND continued to build its advanced and innovative telecommunications network, the key elements of which are:

- A fiber optic national transmission backbone using SDH (Synchronous Digital Hierarchy) technology, the European standard for high speed digital transmission using fiber optic cables;
- A national-circuit switched voice network;
- A national packet switched data network;
- Metropolitan Area Networks in the main Italian cities;
- A national dual band GSM-1800 and GSM-900 digital mobile network; and
- Where feasible, direct access to customers' premises through fiber optic cable or microwave lines or through lines that WIND leases from other companies.

WIND's fixed-line voice telephony network and mobile telephony network share a common system management software referred to as its intelligent network. The intelligent network allows WIND to provide integrated fixed-line voice telephony and mobile telephony services as well as other value added services.

WIND also offers indirect access to its network through a carrier selection option using a predefined access code that allows the selection of WIND's network for long distance and international calls as well as for calls directed to mobile phones. From early 2000, WIND began offering this carrier selection option for local calls in some major Italian cities. As of May 2000, this service was available in 25 cities.

At May 31, 2000, we had installed approximately 11,000 kilometers of fiber optic cable along our electricity transmission grid, of which approximately 9,000 kilometers had been put into operation by WIND. At that date, WIND also had 15 fixed switches, 19 mobile switches and 63 data points of presence. In addition, WIND is building fiber optic metropolitan area networks in 11 Italian cities. WIND is also gradually making its Italian mobile radio network operational. This network covered more than 220 cities at May 31, 2000, and covered approximately 55% of Italy's population. In addition, WIND has opened its first three call centers (in Rome, Naples and Milan) to serve its corporate and residential customers.

In order to respond effectively to the variety of market requirements and to expand its services and technologies portfolio, during 1999 WIND began or continued research and development activities in several key areas, including:

- Development of specifications for and field trials of Narrowband Wireless Local Loop technology at 2.3 GHz;
- Trials and operation of WDM (Wavelength Division Multiplexing) technology;
- Research and analysis into and development of network platforms for providing innovative communications services (UMTS, WAP, etc.);
- Analysis of network and service issues relating to GPRS (General Packet Radio Service, a new mobile technology which will allow higher band-width for data transmission and Internet access) and technical evaluation of possible suppliers of this technology;
- Research into and analysis and development of solutions for innovative services and advanced transmission techniques exploiting Internet Protocol technology; and
- Preparation of an architectural study for a multiservice network.

WIND has also developed and implemented the principal information technology systems required to support its commercial and back-office operations in an environment characterized by rapidly escalating performance requirements. The systems WIND had put into operation by the end of 1999 included:

- A customer administration system for billing and relationship management for WIND's residential and corporate customers;
- Dealer stations for 1,400 dealers all over the country, designed on the basis of a web-based architecture;
- An interconnection billing system for the management of interconnections with other telecommunications operators;
- A fraud management system;
- Business and administration support systems; and
- WIND's Intranet and datawarehouse systems.

WIND launched commercial fixed services for corporate customers in December 1998 and fixed and mobile services for residential customers throughout Italy on March 1, 1999. WIND launched Internet services for consumer customers in November 1999. WIND services its customers through a multi-channeled commercial distribution network with over 3,600 points of contact, including dealers, independent agents, business partners and distributors. As of December 31, 1999, WIND had more than 2.1 million active corporate and consumer telephone lines. As of May 31, 2000, the number of lines had increased to an aggregate of approximately 3.7 million lines and WIND had approximately 300,000 registered users of its Internet services.

In December 1999, WIND obtained an ISO 9001 Quality Certification for its design, sale, implementation and provisioning of telecommunications services and customer service to "top" corporate customers. This certification is a prerequisite to WIND's participation in public tenders. During 1999, WIND continued to closely monitor its compliance with its customer service quality charter (*Carta dei*

Servizi), which it instituted in 1998. WIND seeks to improve its service level through specific analyses of its service provisioning and customer care processes, which it believes are keys to success in the industry.

During 1999, WIND more than doubled its workforce, from 1,272 employees at December 31, 1998 to 3,739 employees at December 31, 1999, an increase of more than 190% at an average hiring rate of more than 200 new employees per month. New employees go through a thorough selection process tailored to the specific professional profile of the post being filled. Hiring plans developed in 1999 call for the continued hiring of a significant number of additional professionals in order to strengthen the overall level of qualifications of WIND's workforce.

In June 1999, WIND began a review of its organizational structure with the goal of improving WIND's focus on its core market segments and boosting its presence in the marketplace. As part of this process, WIND defined two main divisions (Consumer and Corporate) and four territorial "regions" (centered in Milan, Mestre, Rome and Naples) which are assigned commercial, technical and customer care responsibilities. The new organizational model was completed during the second half of 1999 and has been fully operational since January 1, 2000. In 1999, WIND opened four principal offices (in Milan, Rome, Mestre and Naples) and 16 secondary offices in other principal cities.

In July 1999, we contributed to WIND our own telecommunications services division, including assets that we had previously used to provide our own intra-company telecommunications services and to manage our electricity transmission and distribution infrastructure. The total value of the contribution was approximately Lit. 587 billion (including approximately Lit. 35 billion in cash). We also transferred approximately 200 employees to WIND and have seconded approximately 400 employees on a temporary basis. In connection with the transfer of our telecommunication services division, we and WIND signed a five-year outsourcing contract for WIND to provide to us most of the telecommunications services we previously provided for ourselves as well as new telecommunications services.

WIND takes an active role in health and environmental health protection. Because of its recent startup of operations, WIND has been able to take advantage of recently-developed technologies in its implementation of its high quality and safety standards. Each network element is developed in cooperation with the local health and administrative authorities with the focus on two fundamental goals: minimizing environmental impact and maximizing protection for the population. Depending on the installation context, WIND deploys different network infrastructure elements in order to achieve radiation emission ranges lower than the minimum levels required by applicable Italian regulations (Interministerial Decree n. 381 of September 10, 1998). These minimum levels are themselves more than 50% lower than the minimum radiation emission levels set by a number of other European countries. In addition, all plans for WIND's Base Transceiver Stations include a report on electromagnetic emissions that is submitted to the relevant governing bodies.

WIND also participates in the Italian network working groups Anpa and Ispesl and is part of the "Elettra 2000" Consortium. The mission of the Consortium, created in association with Telecom Italia Mobile, Omnitel Pronto Italia, Fondazione Marconi and University of Bologna, is to "support the population and the authorities in providing a scientific perspective into issues related to exposure to electromagnetic fields and to approach such issues through research."

Competition in the Telecommunications Industry

Mobile Services. The Italian mobile telephone market continued to expand through 1999, adding over 9.7 million new customers to the existing base of 20.3 million customers at the end of 1998. At the end of 1999, the total Italian mobile market therefore amounted to over 30 million customers with a penetration of approximately 53% of the population and representing an increase of approximately 17%

over the previous year. In absolute terms, in 1999, with the exception of the U.K., Italy added more new mobile telephone customers than any other European country, thus confirming its position as the leading European country by number of mobile telephone customers. Prepaid cards continued to spur growth in 1999, with over 90% of new customers choosing the prepaid card option.

At the end of 1999, Telecom Italia Mobile had more than 18 million customers (an increase of over 4 million customers over the previous year) accounting for approximately 61% of total mobile customers. Omnitel Pronto Italia had approximately 10 million customers at the end of 1999, or approximately 35% of the total market, with a net overall percentage increase roughly similar to Telecom Italia Mobile's. WIND, which launched its mobile services on March 1, 1999, had 1.3 million customers at year-end, accounting for approximately 4% of the total Italian mobile market at December 31, 1999.

During 1999, competition stepped up significantly, focusing in particular on the following:

- advertising pressure (with a substantial increase of expenditure on advertising campaigns, mainly on TV networks);
- continuous promotional activities;
- differentiation in pricing schemes; and
- introduction of new value-added services, frequently integrated with other telecommunications or Internet services.

GSM digital technology confirmed its leadership position in Italy, with dual-band technology handsets (*i.e.*, those that work under both the GSM-900 and GSM-1800 standards) becoming a key factor in customers' purchasing decisions (over 35% of total handsets sold during the year were dual band).

Fixed telephony services. After the initial liberalization of the Italian telephone market in 1998, strong competition began in long distance, international and mobile voice telephony services during 1999, with more than 70 new companies applying for licenses and becoming operational in rendering services based upon carrier selection. The total customer base of alternative carriers (*i.e.*, carriers other than Telecom Italia) reached 3.5 million, with a net increase of 2.7 million during the year.

Besides Telecom Italia, major players in fixed telephony include Infostrada, WIND, Tele2, Tiscali and Planet, as well as Albacom, which focuses on the corporate market.

Infostrada is the market leader among alternative carriers, with over 2 million customers at the end of 1999. WIND, which launched its services on March 1, 1999, had the second largest customer base, with over 0.6 million customers, its share of new additions to the market representing more than 30% of the total in the last quarter of the year.

Competition in the fixed voice market is primarily based on the extensive use of publicity and marketing campaigns focusing primarily on price and tariff structures. In order to prevent loss of market share, Telecom Italia has started a number of customer retention programs, including changes in pricing schemes for local traffic, the introduction of per-second billing, and special discounts for preferential numbers or long calls.

Internet Services. In 1999, a mass market for Internet services developed in Italy. Starting in the second quarter, Tiscali introduced a *Free Internet* service, whereby customers have free Internet access, paying only for the cost of the telephone connection. Other operators, such as Infostrada, Tin.it and

WIND, quickly followed suit, thus fostering market growth of 3 million subscribers during the year, so as to reach a total of approximately 5 million registered Internet users in Italy at the end of 1999.

In addition, several Internet portals were launched in Italy during 1999 that targeted both corporate and consumer customers. These portals compete to attract users mostly by gathering and making available content and/or services, including e-commerce, financial services, information services and knowledge-based services. In the corporate market, new service providers focusing on the development of web-based applications and on housing and hosting services also gained prominence during 1999.

Convergence. During 1999, convergent services represented a key differentiating factor among market competitors. All of the principal fixed and mobile operators have pursued the integration of the Internet with their core voice telephony services. Some key players in the content and service fields have sought to integrate their services with telecommunications services with emphasis on the Internet.

WIND is the leading operator in Italy in the integration of fixed line products with mobile and Internet services having launched the first pre-paid card for mobile, fixed and Internet services in May 2000.

WIND, like other telecommunications providers in Italy, is subject to regulation by both the Italian government and the European Union. You should read “Regulatory Matters—Telecommunications” for a discussion of the regulatory framework in which WIND operates.

Arbitral Proceedings

In July 1999, we commenced an arbitration proceeding against Deutsche Telekom under the rules of the International Chamber of Commerce in Geneva. We brought this proceeding under the arbitration clause of the shareholders’ agreement relating to WIND. We have claimed:

- That Deutsche Telekom had breached the exclusivity, confidentiality and non-competition provisions of the agreement by signing a business combination agreement with Telecom Italia;
- That we have the right to purchase Deutsche Telekom’s interest in WIND, which is held through DT-FT, under the terms and conditions of the shareholders’ agreement; and
- Approximately Lit. 1,700 billion in damages.

Deutsche Telekom has appeared in the arbitration proceeding claiming substantial damages against us allegedly sustained by them as a result of the failure of Deutsche Telekom to merge with Telecom Italia and the *de facto* exclusion of Deutsche Telekom from the management of WIND. In addition, in February 2000, Deutsche Telekom filed petitions with the arbitral tribunal seeking to obtain injunctions requiring us, France Telecom and WIND to comply with the provisions of the shareholders’ agreement. The arbitral tribunal has not yet issued its decision.

In August 1999, the Court of Rome confirmed that Deutsche Telekom breached the shareholders’ agreement. However, the Court lifted the injunction against Deutsche Telekom, which we had sought and the Court had granted in July 1999, on the grounds that there was no imminent danger of irreparable damage warranting injunctive relief. On September 14, 1999, the WIND shareholders’ meeting resolved to bring an action against the Deutsche Telekom representatives on WIND’s board for breach of their fiduciary duties. As a consequence of that shareholders’ vote under Italian law, the Deutsche Telekom

representatives were terminated as directors of WIND. Deutsche Telekom brought a judicial proceeding to appeal the termination of these directors. In the proceeding, Deutsche Telekom sought an injunction requiring WIND to suspend its shareholders' resolution thus permitting the Deutsche Telekom board representatives to remain on WIND's board of directors pending conclusion of the proceeding. In December 1999, the Rome Court denied the request for the injunction. We cannot predict the outcome of the legal dispute with Deutsche Telekom.

Although we own a 51% interest in WIND, our shareholders' agreement with Deutsche Telekom and France Telecom and WIND's by-laws require unanimous agreement at shareholders' meetings as to the major business decisions taken at the meeting. In addition, most significant decisions by the board of directors of WIND must be taken by a number of directors greater than the number of our representatives on the board.

Engineering and construction

We conduct our engineering, procurement and construction (EPC) operations through Enelpower, which we created in 1999. We formed Enelpower to operate as an engineering and contracting company and developer of integrated power systems on a turnkey basis. After we formed Enelpower, we transferred to it the resources, capabilities and expertise of our engineering and contracting division to enable Enelpower to pursue its mission both in Italy and abroad. In the last thirty years, our engineering and construction division designed and built power plants for our business with a total of 40,000 MW of gross generating capacity, and installed or constructed almost all of the electricity transmission and distribution network in Italy.

Enelpower seeks to operate internationally with a focus on targeted markets in Latin America, the Middle East, Europe and the Mediterranean region. Enelpower may work through alliances with strategic partners and take equity stakes in the projects in which it is involved. In July 1999, Enelpower was awarded its first third-party engineering, procurement and construction contract in the international market by PowerGen, a U.K. independent power producer, for a CCGT plant in Castelford, England.

In July 1999, Enelpower entered into a memorandum of understanding with Exxon Power Investment Company to discuss and assess their possible joint participation in thermal power plant projects in the Middle East and Eastern Europe. In August 1999, Enelpower entered into a joint venture agreement with Prometheus Gas and Damco Energy, both Greek companies. The agreement provides for cooperation among the three venture partners in the electricity business and, in particular, in connection with power plant projects in Greece and neighboring countries. Enelpower has a 50% interest in the joint venture. In January 2000, the joint venture entered into an agreement with Exxon Power Investment Company and GAMA, a major Turkish contractor, to develop a CCGT power plant in Greece in anticipation of the liberalization of the Greek market for electricity in 2001.

In November 1999, Enelpower was awarded a contract for the construction of a thermal power plant in Saudi Arabia. In February 2000, Enelpower entered into agreements with local partners to develop two CCGT power plants in Argentina. In June 2000, Enelpower, in association with a gas turbine manufacturer, was awarded an engineering, procurement and construction contract for a CCGT plant in Ballylumford, Northern Ireland.

Real estate and other services

We conduct our commercial real estate management activities through SEI S.p.A. ("SEI"), which we formed in 1993. SEI is responsible for managing our commercial real estate assets, improving the use of space, restructuring and maintaining buildings for commercial use and providing building cleaning,

maintenance, security, canteen and other services both to us and to third parties. SEI also manages our commercial car fleet and has achieved significant cost savings relative to previous expenditures in 1997 and 1998 through outsourcing. In December 1999, we transferred certain residential and industrial real estate assets having a value of approximately Lit. 710 billion to another wholly owned subsidiary, Dalmazia-Trieste S.p.A., which is now in charge of disposing of residential assets for Lit. 622 billion before the end of 2002. At December 31, 1999, we owned real estate (net of the above-mentioned assets transferred to Dalmazia-Trieste) with an approximate net book value of Lit. 5,100 billion, consisting of approximately Lit. 4,900 billion of office buildings and other commercial properties and approximately Lit. 200 billion of residential real estate, real estate formerly used for industrial purposes and unimproved land. We are focusing on reducing the costs of our real estate portfolio and on leasing property and providing property-related services to third parties. We are also focusing on disposing of residential real estate. In 1999, we sold approximately Lit. 25 billion of real estate assets at a price that in aggregate was 12% higher than the net book value of the properties.

In March 2000, SEI signed a joint venture agreement with American Continental Properties Institutional Investors for the management and development of approximately Lit. 1,000 billion of real estate assets. The agreement provides that SEI will take a loan for about 50% of the assets' value secured by a mortgage on the assets and contribute a business unit consisting of the assets, the debt resulting from the loan and the relevant human resources, into a new company, which will be 51% owned by our partner and 49% owned by SEI. We currently expect to conclude a similar agreement with another partner covering an additional approximately Lit. 650 billion of real estate assets. The two transactions are currently expected to generate approximately Lit. 1,200 billion in positive cash flow.

In June 2000, SEI signed a joint venture agreement with Mitsubishi Electric Europe. The two main activities of the venture will be the installation of air conditioning systems and the provision of integrated facility management services to both affiliated and third-party clients.

Water

Our wholly owned subsidiary Enel.Hydro S.p.A. ("Enel.Hydro") (formerly Ismes S.p.A.) specializes in the construction and management of water distribution networks. Enel.Hydro's principal business used to be ground engineering. We have transferred to Enel.Hydro our personnel who have specialized expertise in hydroelectric engineering and water-related research. We believe that our particular strengths in this area include a high level of technical skills, especially in water collection and other upstream parts of the business, our experience in providing utility services, our presence throughout Italy, the availability of water in our dams in many areas of Italy and our potential for distribution synergies with our electricity distribution network. We intend to operate our water business mainly through special purpose companies, in accordance with Italian legislation, and through acquisitions currently under consideration. We also believe that new legislation in Italy provides opportunities for profitable growth in the water business. We are in the process of completing the acquisition of Acquedotto Pugliese, the major integrated provider of water distribution services in Italy, and a smaller company involved in the water distribution business in Southern Italy. You should read "The Enel Group—Possible Acquisitions" for a more detailed description of these acquisitions.

Gas

The Italian gas market is undergoing a process of liberalization that parallels that of the electricity market to a certain extent. We believe that building our gas distribution activities as part of a multi-utility strategy offers us opportunities for potential synergies and competitive advantages. In March 2000, we acquired the Colombo Gas Group, a secondary distributor of natural gas in the Italian regions of Piedmont, Lombardy and Emilia. The Colombo Gas Group owns 1,290 km of pipelines serving about

76,000 clients. We are finalizing the acquisition of Camingas, a distributor of gas in the Italian regions of Piedmont, Lombardy and Emilia. We are currently considering the acquisition of other companies involved in gas distribution. We are also the second largest importer of natural gas in Italy and may in the future consider alternative uses for gas we now use as a source of energy for our generating plants.

Public lighting

As part of our strategy to provide enhanced services to large customers, we established So.l.e. S.p.A. (“So.l.e.”) as a separate subsidiary in July 1998 to focus on providing lighting services for public places in Italy and abroad. In August 1999, we transferred to So.l.e. the assets of our public lighting business. So.l.e. is targeting the market for public lighting, as well as customized lighting systems for monuments, squares, churches and other landmarks. So.l.e. offers both indoor and outdoor lighting systems. The market for public lighting is evolving as demand for lighting of monuments and other landmarks is increasing and local administrations within Italy are paying increasing attention to the quality and efficiency of the lighting of landmarks. Our current market share of the market for public lighting is approximately 18%. We believe that the strength of the Enel brand, together with our long-standing reputation and broad experience, provide So.l.e. with the opportunity to increase the volume of public lighting services it provides.

Electricity consulting

Enel.si S.p.A. (“Enel.si”) (formerly Se.m.e. S.p.A.) is a wholly owned subsidiary that we formed in March 1999 to offer to our clients construction and maintenance services for their electricity systems and operation and maintenance services for small co-generation power plants. Enel.si draws on the technical capabilities within the Enel Group to assist clients in optimizing their use of electricity, as well as offering consulting and personnel training services to these clients. We expect that Enel.si will offer its services internationally.

Waste-to-energy

Elettroambiente S.p.A. (“Elettroambiente”) is a wholly owned subsidiary that we formed in January 1996 to support our environmental protection activities and our waste management, combustion and disposal business. Elettroambiente is developing industrial waste management systems and technology to recycle urban solid waste through thermal generation. In addition, Elettroambiente is involved in several projects for building and operating waste-to-energy power plants and managing asbestos waste.

New technologies

In March 2000, Enel and the Internet Capital Group agreed to establish a business-to-business e-commerce joint venture, to identify market opportunities and launch new business-to-business initiatives in the European utilities markets and segments of the Italian telecommunications market.

In May 2000, Enel and 11 other major European utility companies agreed to establish a business-to-business Internet portal for the electricity, gas and water sectors. The portal will be managed by a company that will be 80% owned by the utility companies, with no single company holding more than 10%. The remaining 20% of the stock will be offered to industrial and technical partners, suppliers and management.

We are establishing a holding company which will focus on venture capital investments in companies in the telecommunications, new media, utilities and Internet sectors, as well as high technology activities related to the Enel Group businesses.

Possible acquisitions

We are continually evaluating potential acquisitions and other investments to implement our ongoing strategy of diversification. As part of that process, we are currently in the process of completing the acquisition from the Treasury of Acquedotto Pugliese, which is the major provider of integrated water distribution services in Italy and manages aqueducts in several regions in southern Italy, as well as Ente Irrigazione Puglia e Lucania, a smaller company involved in the water distribution business in southern Italy. Acquedotto Pugliese has approximately 2,100 employees and had approximately Lit. 664 billion of revenues, Lit. 124 billion of operating income and Lit. 30 billion of net income in 1998. Acquedotto Pugliese serves approximately 4.5 million inhabitants and distributed approximately 500 million cubic meters of water in 1998. The purchase of Ente Irrigazione Puglia e Lucania is being delayed by its transformation from a public entity into a joint stock company. We initially also intended to purchase Sogesid S.p.A. ("Sogesid"), another company involved in the water distribution business in southern Italy. However, we decided not to purchase Sogesid following a change of its corporate purpose. The Treasury Ministry has provisionally indicated a purchase price of Lit. 3,100 billion for Acquedotto Pugliese, Ente Irrigazione Puglia e Lucania and Sogesid. The final price will be determined by a panel of independent advisors. Following these acquisitions, we believe that we would also need to make capital expenditures to improve the distribution networks. Our current intention is to finance any investment in Acquedotto Pugliese through debt financing. You should read "Legal Proceedings" in Item 3 for a discussion of certain court proceedings initiated by the Regional Authority of Puglia concerning the decree of the Treasury identifying our company as the prospective purchaser of Acquedotto Pugliese.

Support Services

Research and development

We maintain our own research and development program. The objective of our research and development activity is to improve the efficiency and capacity and expand the service offerings of our core electricity businesses and reduce the environmental impact of these businesses. We do this by providing technological innovations to our businesses. We develop new products and processes internally and also acquire technology in the market which we then customize for our own purposes. Our research and development program includes two subsidiary companies:

- CESI S.p.A., which is dedicated mainly to the testing of electrical and electronic equipment and to research on new electrical systems and plants; and
- CONPHOEBUS S.p.A., which is active in the field of renewable energy.

Our research and development program involves approximately 1,500 employees. Our expenditures on research and development were Lit. 280 billion in 1999, Lit. 350 billion in 1998 and Lit. 410 billion in 1997.

We historically have conducted and funded research for the national electricity system. CESI has become responsible for system research following the transfer to it of all related resources of Enel S.p.A. A system charge in the tariffs will finance system research activities. We expect to reduce our shareholding in CESI over time.

Information technology

Enel.it S.p.A. (“Enel.it”) is responsible for providing information technology services to all of our businesses. Enel.it designs new tools and services to support development of new products and markets by our businesses and to enhance the efficiency and effectiveness of our information technology systems. Enel.it employs 1,500 technicians and managers, who are responsible for the management of processing systems, technology infrastructure and software development.

Enel.it has three central data processing centers and five mainframes, with a total data processing capacity of 4,000 millions of instructions per second, 48,000 workstations, 1,200 local area networks, 4,000 servers and one wide area network. Enel.it has begun to offer information technology services to third parties. Together with WIND, it also developed the Power Line communication project for the transmission of data signals through the electricity distribution system, so as to offer Internet based and other interactive services to the Group’s customers. Enel.it is also advising other companies of the Group on possible uses and enhancements of their websites, including the implementation of e-commerce portals.

Factoring

In May 2000, we established Enel.factor S.p.A. (“Enel.factor”), a captive factoring company 90% owned by us and 10% owned by Meliorbanca. Enel.factor will engage in the factoring of receivables owned by third parties against companies of our group. Each year we purchase goods and services (excluding energy and fuel) with an aggregate value of approximately Lit. 9,500 billion from about 70,000 suppliers.

Insurance

We face risks of accidents in our operations, including risk of fire and risks related to construction activities, transportation and third-party liabilities. Following the expiry of our main insurance policies in June 2000, we have adopted a new insurance scheme. Under this scheme, we self-insure for third-party liability, environmental liability and property risks up to Lit. 100 million per claim (Lit. 500 million for environmental liability risk and Lit. 250 million for property risk of generation companies). Liabilities in excess of these amounts, up to per claim limits of Lit. 1.6 billion for environmental liability, Lit. 5 billion for third-party liability and Lit. 2 billion for property risk, are insured by two third-party insurance companies, which in turn reinsure virtually all such liabilities with Enel.re Ltd. (“Enel.re”), a wholly-owned captive re-insurance company we established in May 2000. Liabilities in excess of these amounts, up to per claim limits of Lit. 60 billion for environmental liability, Lit. 1,000 billion for third-party liabilities arising from accidents concerning our dams, Lit. 400 billion for other third party liabilities and Lit. 2,000 billion for property risks, are reinsured by Enel.re with third-party re-insurance companies. We self-insure liabilities above these amounts. We believe that this policy is appropriate to the financial capacity of our Group and that it offers us a less expensive means of risk coverage. We believe that our risk coverage is adequate when measured on the basis of our history of accidents. We continuously monitor our risks, accidents and damages both on an aggregate and on a unit-by-unit basis.

OPERATING ENVIRONMENT

The Republic of Italy

The Republic of Italy is composed of 20 regions covering an area of approximately 301,000 square kilometers on a peninsula in the middle of Southern Europe, with a population of approximately

58 million. The most important industrial and commercial activity is situated in the north-central part of Italy.

Government. The Republic of Italy was proclaimed in 1946 and a President was elected in the same year. The present Constitution, which took effect in 1948, provides for the powers of a democratic state to be divided among the Parliament, the Executive and the Judiciary. The head of state is the President, who is elected by Parliament and holds office for a period of seven years. The President has the power to designate the President of the Council of Ministers, who is then confirmed (and may only be removed) by Parliament. The President of the Council of Ministers heads the executive branch. Parliament consists of the Senate and the Chamber of Deputies. Parliamentary elections must be held every five years, although they have often been held more frequently.

From the end of World War II until 1994, the Christian Democratic Party was the largest political party in Italy, although no single party has had an overall majority in Parliament since 1953. Until 1994, Italian politics was dominated by four- and five-party coalitions consisting of Christian Democrats, Socialists, Social Democrats, Liberals and Republicans. Traditionally, the main opposition parties included the former Communist Party and the right-wing Italian Social Movement.

In 1993, Parliament approved a new law based on the results of the referendum on electoral reform held in April 1993. The general elections of March 1994 were the first to be held under the new voting system, which introduced “first past the post” voting rules for three-quarters of the seats in Parliament and proportional representation for the remaining quarter. Since that time, a series of center right, center left and non-partisan “technocratic” coalitions have controlled the Parliament.

One of the major achievements of this period was Italy’s qualification as a founding member of the third stage of European Monetary Union on January 1, 1999, having met the convergence criteria set forth in the Maastricht Treaty with respect to the public sector deficit, inflation, interest rates and exchange rate stability.

The current government, which is led by Mr. Giuliano Amato, a former President of the Council of Ministers and Minister of the Treasury and supported by the center-left majority in Parliament, has announced that it will attempt to implement a number of measures in order to enhance Italy’s economic and political stability in advance of the general election expected to take place in the spring of 2001.

Foreign Relations. Italy is a founding member of the EU and the third stage of European Monetary Union, a member of NATO and a member of many other regional and international organizations, including the United Nations and many of its affiliated agencies. Italy is also a member of the Organization for Economic Co-operation and Development (the “OECD”), the International Monetary Fund, the International Bank for Reconstruction and Development, the European Investment Bank, the European Bank for Reconstruction and Development, the Asian Development Bank and the Inter-American Development Bank and a charter member of the World Trade Organization.

Economy. In 1999, Italian GDP increased by 1.4%, a lower rate of increase than that experienced by a number of the other principal EU countries. At current prices, GDP reached €1,099 billion in 1999, confirming Italy’s position as one of the leading OECD countries in terms of GDP. Private consumption grew by 1.7% and gross capital formation increased by 4.4% from 1998, primarily due to an increase of 6.2% in investment in machinery and equipment, while expenditures in the construction sector grew by 1.8% over the previous year. Exports of goods and services decreased by 0.4% from 1998 levels. The principal components of value added for 1999, at current prices, were as follows: services (66.4%); manufacturing, mining and utilities (26.2%); construction (4.8%); and agriculture, forestry and fishing (2.6%).

The Italian current account, based on initial estimates, was in surplus by €6.0 billion for 1999, a decrease from the 1998 surplus of €19.5 billion. The rate of increase in the consumer price index was 1.7% in 1999, as compared with 2.0% in 1998. The government deficit as a percentage of GDP was equal to 1.9% in 1999, as compared with 2.8% in 1998.

The following table sets forth certain statistical information on the Italian economy for each of the years indicated:

	1995	1996	1997	1998	1999
GDP at current prices (in billions of euros).....	923.05	982.44	1,024.57	1,067.88	1,099.11
Real GDP growth.....	2.90%	1.10%	1.80%	1.50%	1.40%
Current account balance (in billions of euros).....	20.99	31.38	28.41	19.54	6.04
Total employment (in thousands).....	22,528	22,600	22,666	22,914	23,135
Consumer price index (% change).....	5.40%	4.00%	1.90%	2.00%	1.70%
Public administration deficit as a percentage of GDP.....	7.60%	7.10%	2.70%	2.80%	1.90%

Sources: General Report on the Country's Economic Situation, 1999; Banca d'Italia, Collected Economic Statistics, Annual Report.

Enel in Italy. The size and international status of the Enel Group has significant economic implications for the Republic of Italy. The Enel Group's net sales and revenues in 1999 accounted for approximately 1.9% of Italy's GDP and Enel's Italian employees represented approximately 1.8% of Italy's industrial work force.

REGULATORY MATTERS

Electricity Regulation

The Industry Ministry and the Energy Authority share responsibility for overall supervision and regulation of the Italian electricity industry.

The Industry Ministry is responsible for establishing the strategic guidelines for the electricity industry and for ensuring the safety and economic soundness of the electricity sector.

The Energy Authority commenced operations in April 1997. The statute that created the Energy Authority provides that the Authority is an independent governmental body consisting of a President and two members, each of whom is selected by the Council of Ministers. The President and members of the Energy Authority serve for seven-year terms and cannot be reappointed. The Energy Authority is responsible for:

- Setting and adjusting electricity tariffs on the basis of general criteria established by law;
- Advising the Industry Ministry on the structuring and administration of licensing and authorization regimes for the energy sector;
- Issuing guidelines with respect to the production and supply of electricity to ensure the quality of services provided to customers;
- Overseeing the separation of utility companies into separate units for accounting and management purposes; and

- Protecting the interests of electricity customers. For this purpose, the Energy Authority can preside over mediation and arbitration proceedings between customers and electricity companies and can impose fines and other sanctions for violation of electricity regulations.

Prior to April 1999, the regulatory framework for the Italian electricity industry:

- Gave the ultimate authority for the generation, transmission and distribution of electricity to the Italian government, which licensed such activities to us and to municipal electricity utilities;
- Restricted power generation to authorized entities and restricted other electricity producers to use their production only for their own consumption, for sales to affiliated companies, or for sales to us; and
- Provided that each year the Energy Authority determined electricity tariffs based on a “cost-plus” system.

The regulatory framework for the Italian electricity sector has changed significantly as a result of a recent legislative reform. The European Union issued a directive in December 1996 (the “Electricity Directive”) that requires EU member states to liberalize their electricity sectors. In particular, the Electricity Directive seeks to create an internal market for electricity by providing for separation among generation, transmission and distribution activities and introducing competition in generation activities. In addition, each member state of the European Union must ensure that a specified percentage of its electricity market (as established yearly by the Commission) is open to competition.

On April 1, 1999, the Bersani Decree, which implemented the principles contained in the Electricity Directive, became effective in Italy. It began the transformation of the electricity sector from a highly regulated industry to one in which energy prices charged by generators will eventually be determined by competitive bidding. The Bersani Decree requires that distribution companies servicing the same municipality consolidate their networks. It also provides for a gradual liberalization of the electricity market so that customers whose annual consumption exceeds specified amounts will be able to contract freely with power generation companies to buy electric power.

The Energy Authority has also replaced the “cost-plus” system for tariffs with a new “price-cap” tariff methodology. Under the price-cap methodology, tariffs will be reduced by a fixed percentage each year. This system creates incentives for operators to improve efficiency and gradually passes savings onto final customers.

The new regulatory framework, when fully implemented, will replace most laws and regulations applicable to the Italian electricity industry. Both the new regulatory framework, the implementation of which began in April 1999, and the old regulatory framework, which was in effect during periods prior to April 1999 for which financial statements are presented herein, as well as the new and old tariff systems, are summarized below.

The new regulatory framework

The Bersani Decree establishes a general regulatory framework for the Italian electricity industry that gradually introduces free competition in power generation and sales to Eligible Customers while maintaining a regulated monopoly structure for power transmission, distribution and sales to Non-eligible Customers. In particular, the Bersani Decree and the subsequent implementing regulations:

- Liberalized, as of April 1, 1999, the generation, import and export of electricity, as well as the sale of electricity to Eligible Customers;
- Provide that after January 1, 2003 no electricity company will be allowed to produce or import more than 50% of the total of imported and domestically-produced electricity in Italy and, in connection with this limit, mandate that we sell not less than 15,000 MW of our generating capacity by January 1, 2003 to reduce our market share and increase competition in power generation. In June 2000, speaking before the Parliamentary Commission on Productive Activities, the Minister of Industry noted the importance of completing the sale as soon as possible, preferably by the first half of 2001;
- Distinguished between Eligible Customers, which may negotiate supply agreements directly with any domestic or foreign producer, wholesaler or distributor of electricity, and Non-eligible Customers, which must purchase electricity from the distributor that serves the area in which they are located and pay tariffs determined by the Energy Authority;
- Provided for the establishment of the Single Buyer, a central purchaser of electricity from producers on behalf of all Non-eligible Customers;
- Provide for the creation of a *Borsa dell'Energia Elettrica*, or pool market for electricity, by January 1, 2001, in which producers, importers, wholesalers, distributors, other Eligible Customers and the Single Buyer will participate, with prices being determined through a competitive bidding process;
- Provide for the creation during 2000 of the *Gestore del Mercato* or Market Operator, charged with managing the pool market;
- Provide that the transmission and distribution of electricity are reserved to the Italian government and performed by licensed operators, and in this respect:
- Provide that management and operation of the national transmission network is licensed to an independent system operator, the *Gestore della Rete*, while owners of the transmission network (including the Enel Group) retain ownership of the network assets; and
- Establish a new licensing regime for electricity distribution and require that distributors servicing the same municipality consolidate their networks.

Generation

The Bersani Decree liberalized the regime for the generation of electric power. In order to increase the level of competition in the market, the Bersani Decree provides that, by January 1, 2003:

- We, like any other generation company, will not be allowed to produce or import more than 50% of the total amount of electricity produced or imported in Italy. This will require a significant reduction from our estimated share of the total amount of electricity produced or imported into Italy in 1999 of approximately 75%; and
- We will be required to sell not less than 15,000 MW of generating capacity out of our approximately 59,418 MW of gross installed capacity, so as to reduce our market share. To comply with this requirement, we developed a plan to dispose of 15,057 MW of net installed capacity, or approximately 16,000 MW of gross installed capacity, which we submitted to the

Council of Ministers and which the Council approved in August 1999. This capacity has been contributed to the three generation companies (Eurogen, Elettrogen and Interpower) we created in October 1999. See “—The Enel Group—Generation—Disposal of generating capacity”. The January 1, 2003 deadline is extendible for one year if market conditions require (as determined by the Italian Antitrust Authority after consulting with the Energy Authority).

The Bersani Decree also requires that the Italian government adopt streamlined authorization procedures relating to the construction of new power generation plants and the renovation and expansion of existing plants.

Promotion of renewable resources

In order to promote the generation of electricity from renewable resources, the Bersani Decree requires that, starting in 2001, all companies that introduce in excess of 100 GWh of electricity generated from conventional sources (net of co-generation, self-consumption and exports) into the national transmission network in any given year are required, in the following year, to introduce into the national transmission network an amount of electricity produced from newly qualified renewable resources that is at least equal to 2% of the amount of such excess over 100 GWh. This electricity may be produced directly, purchased from other producers or purchased from the *Gestore della Rete*. Renewable resources include geothermal and hydroelectric energy sources. The electricity generated from those resources must be from generating capacity installed after April 1, 1999, the date the Bersani Decree became effective. In addition, the Bersani Decree directs the *Gestore della Rete* to dispatch electricity into the national transmission network in the following order of priority: first, energy produced from qualified renewable resources, then that from co-generation and finally electricity produced from domestic fuel sources that the government seeks to favor. Electricity generated from renewable resources will be certified by means of a “green certificate” issued by the *Gestore della Rete*. We plan to meet the specified thresholds for producing renewable resource electricity through the establishment of new geothermal and wind plants, the expansion of our biomass and waste generation activities and increased output from our existing hydroelectric plants. If we are unable to produce the specified amount of electricity from renewable resources on our own, we will be entitled to buy or import additional electricity from other plants using renewable resources.

Hydroelectric power

Under the Bersani Decree, all of our licenses for the generation of electricity from large bodies of water, which were granted to us for an indeterminate period of time, will now expire in April 2029. In addition, the Bersani Decree automatically extended to December 31, 2010 the term of all hydroelectric licenses for the generation of electricity from large bodies of water that were granted to other electricity producers and were scheduled to expire before such date. All of these hydroelectric licenses expiring after December 31, 2010 retained their original expiration date. After the expiration of any licenses we hold, we may bid for new licenses, which will have a duration of 30 years. Hydroelectric licenses for the generation of electricity from small bodies of water have been granted for an indefinite term, but are expected to be subject to a different regime in the future. Italian law also provides that the Provincial Authorities of Trento and Bolzano and the Regional Authority of Valle d’Aosta, which enjoy special autonomous status under Italian law, may reduce the duration of hydroelectric licenses in their jurisdiction to less than thirty years. Pursuant to a governmental decree of 1999, all of our hydroelectric licenses for the provinces of Trento and Bolzano, as well as all license held by other electricity producers in the same provinces which expire before December 31, 2010, will now expire on December 31, 2010 and, from that date, will be granted for 30-year periods. The process for Valle d’Aosta is continuing.

Imports

The volume of electricity that can be imported into Italy is limited by the capacity of transmission lines that connect the Italian network with those of other countries, currently a maximum of approximately 40 TWh per year. In 2000, approximately 50% of this capacity is covered by imports under long-term contracts between us and third-party importers. Geographical, financial and logistical limitations render it unlikely that this limit will be increased significantly through the construction of new interconnections in the near future. In order to address the allocation of the remaining capacity, the Bersani Decree provides that the Energy Authority may set limits if import demand exceeds total interconnection capacity. In accordance with this provision, the Energy Authority has established that for 2000 no single importer may use more than 20% of the total interconnection capacity of the Italian network or, if demand for imports from any given country exceeds the interconnection capacity with that country, 15% of the interconnection capacity, in each case excluding from the calculation capacity covered by long-term contracts in force at February 19, 1997. We have challenged this decision of the Energy Authority before the Administrative Court of Lombardy. The proceedings are still pending.

Eligible and Non-eligible Customers

One of the most important features of the new regulatory framework under the Bersani Decree is the distinction between Eligible Customers and Non-eligible Customers. All customers that do not qualify as Eligible Customers are defined as Non-eligible Customers.

Eligible Customers consist of:

- Customers whose annual consumption of electricity at a single delivery point in the previous year (including electricity produced by them) was at least 30 GWh prior to December 31, 1999, 20 GWh from January 1, 2000 to December 31, 2001 and nine GWh after January 1, 2002;
- Groups of business customers whose aggregate annual consumption of electricity meets the thresholds indicated above, but only if each member of such group or consortium (i) had in the previous year an annual consumption of at least two GWh through December 31, 1999 and one GWh in 2000 and thereafter, and (ii) is located in the same municipality or in a contiguous municipality to other members of the group;
- Entities outside Italy that have the right to choose freely their supplier of electricity, with respect to electricity consumed outside of Italy;
- The local distribution company created by the autonomous Italian provinces of Trento and Bolzano that serves those provinces;
- Local distribution companies, but only with respect to electricity distributed by them to other Eligible Customers; and
- Electricity wholesalers, but only with respect to electricity sold by them to other Eligible Customers.

After January 1, 2002, Eligible Customers will also include customers whose annual consumption of electricity in the previous year was at least one GWh at each delivery point and 40 GWh in the aggregate.

Eligible Customers may negotiate supply agreements directly with any domestic or foreign producer, wholesaler or distributor of electric power. Wholesalers, including our subsidiary Enel Trade, may buy electricity from any producer (or on the pool market once it is in operation) for resale to Eligible Customers. Once the pool market begins to operate, Eligible Customers will still be able to negotiate contracts directly with producers rather than participating in the pool market, provided that they have the necessary authorization from the Energy Authority. In addition to the price of electricity, Eligible Customers (together with Non-eligible Customers) must pay transmission and distribution fees and certain charges known as system charges to distributors. You should read “—The new tariff structure” for a discussion of these fees and charges.

Non-eligible Customers may only purchase electricity from the distribution company serving the geographic area in which they are located. The tariffs applicable to residential Non-eligible Customers and tariff limits applicable to other Non-eligible customers are established by the Energy Authority and are intended to be the same throughout Italy for each category of customers. You should read “—The new tariff structure—Tariffs for Non-eligible Customers” for a discussion of tariffs and tariff limits.

Eligible Customers may choose to remain subject to the regime and tariff structure applicable to Non-eligible Customers for a period of two years. This period may be extended once by an Eligible Customer for two additional years. Until the pool market for electricity becomes operational, Eligible Customers may also make such election for a period shorter than two years, but once having done so, must become Eligible Customers at the end of that period.

The Bersani Decree established the following targets with regard to the percentage of electricity consumed by Eligible Customers (in each case including self-consumption):

- 30% of total Italian electricity consumption in 1999;
- 35% of total Italian electricity consumption in 2000 and 2001; and
- 40% of total Italian electricity consumption from 2002.

The list of Eligible Customers is publicly available and included 821 Eligible Customers as of May 2000. On the basis of this data and other information available in May 2000, we estimate that, in the course of year 2000, Eligible Customers will account for approximately 23.5% of total Italian electricity consumption (including self-consumption).

The Industry Ministry may gradually lower the consumption thresholds required for customers to qualify as Eligible Customers as necessary to meet the above-mentioned targets. The consumption thresholds may also be lowered to accelerate the development of competition. In June 2000, the Italian Senate approved a bill which reduces the above eligibility thresholds to include as Eligible Customers all those customers whose annual consumption of electricity in the prior year exceeded 0.1 GWh at a single delivery point. Under the bill, this threshold would come into effect from 90 days after the date on which we complete our disposal of 15,000 MW of generating capacity, as required by the Bersani Decree. The bill has to be approved by the Italian Chamber of Deputies before becoming a law.

The Single Buyer

The Single Buyer is a joint stock company wholly-owned by the *Gestore della Rete* and charged with ensuring the efficient, adequate and non-discriminatory supply of electricity to Non-eligible Customers. It was incorporated in November 1999 by the *Gestore della Rete* and will become operational following the enactment of a decree by the Industry Ministry. Electricity distribution companies,

including us, may become shareholders of the Single Buyer, subject to the approval of the Industry Ministry after consultation with the Energy Authority. However, the *Gestore della Rete*, which is owned by the Treasury Ministry, must remain the majority shareholder of the Single Buyer. No other shareholder will be allowed to control, directly or indirectly, more than 10% of the share capital of the Single Buyer.

The Single Buyer will be responsible for purchasing electricity from producers on the basis of periodic estimates of future electricity demand and Industry Ministry guidelines and for selling such electricity to distribution companies for supply to Non-eligible Customers, thereby ensuring that Non-eligible Customers pay the lowest competitive price for electricity. The Single Buyer will also be able to contract with producers for reserve capacity in order to satisfy demand from Non-eligible Customers at peak periods.

Until the Single Buyer begins operations, electricity distributors will continue to purchase electricity from generating companies for supply to Non-eligible Customers. Under the Bersani Decree, starting on January 1, 2001, electricity generation will be subject to a competitive bidding process conducted through the pool market. If the Single Buyer begins operations before the pool market is established, it will negotiate bilateral contracts with the various producers. Through those contracts, the Single Buyer will seek to satisfy all the estimated demand from Non-eligible Customers for the transition period at a minimum aggregate price.

The total payments by the Single Buyer to electricity producers (plus its own operating costs) will need to match the total revenues it earns from sums paid to it by Non-eligible Customers under the regulated tariff structure. As a consequence, the tariffs may need to be readjusted from time to time to reflect the prices actually paid by the Single Buyer, as well as other factors.

The Pool Market and the Market Operator

The Bersani Decree provides for the creation of a *Borsa dell'Energia Elettrica*, or pool market for spot trading electricity, to be operational by January 1, 2001 and administered by an independent entity to serve as Market Operator. The Market Operator will be a wholly owned subsidiary of the *Gestore della Rete*. The Market Operator will issue regulations for the pool market with the approval of the Industry Ministry (acting in consultation with the Energy Authority) and is expected to be responsible for awarding bids and settling transactions once the pool market begins operations.

Transmission

As noted, the term “transmission” refers to the transportation of electricity on high and very-high voltage interconnected networks from the plants where it is generated or, in the case of imported energy, from the points of acquisition, to distribution systems. As part of the implementation of the Bersani Decree, the Industry Ministry has determined that the national electricity transmission network includes all of our very high voltage lines (380/220 kV) and approximately 50% of our high voltage lines (150/132 kV) used for transmission in Italy.

The Bersani Decree provides that the transmission of electricity is reserved to the Italian government, but delegates the management and operation of the national electricity transmission network to the *Gestore della Rete*, under a license to be issued by the Industry Ministry. The *Gestore della Rete* may, subject to the authorization of the Industry Ministry, authorize third parties to operate limited portions of the network pursuant to service agreements. The Bersani Decree requires the owners of assets included in the national electricity transmission network to transfer to the *Gestore della Rete* the right to manage and operate those assets. It does not otherwise affect the ownership of those assets.

In August 1999, we transferred our electricity dispatching and national transmission network management operations to the *Gestore della Rete*, which at that time was a subsidiary of our group. In April 2000, pursuant to the Bersani Decree, we transferred ownership of the *Gestore della Rete* to the Treasury at no cost. The *Gestore della Rete* will remain government-owned.

Pursuant to the Bersani Decree, strategic and operational guidelines for the activity of the *Gestore della Rete* were established by the Industry Ministry in January 2000. The *Gestore della Rete* has responsibility for the planning, operation and control of the national electricity transmission network, with a mandate to ensure the efficiency, adequacy and safety of Italy's electricity supply and equal access to the network for all producers and consumers of electricity. As noted above, the *Gestore della Rete* must give priority for transmission to electricity generated from renewable resources and co-generation in accordance with guidelines to be issued by the Energy Authority.

The *Gestore della Rete* will enter into service agreements with the owners of transmission assets based on a model agreement to be approved by the Industry Ministry that will regulate the payment of fees and performance of the obligations concerning the maintenance and upgrading of the national electricity transmission network. The contract will also include the fees for services supplied by the owners of the national electricity transmission prior to its date. We will transfer to the *Gestore della Rete* all contracts with independent power producers that we had been obliged to enter into by law and that were designed to subsidize those producers. For a discussion of our arrangements with those producers, you should read “—The Enel Group —Purchased Power”.

In addition, the Bersani Decree liberalized third-party access to power transmission and distribution networks as of April 1, 1999. The *Gestore della Rete* and distributors must grant free access to such networks to generators and importers of electricity for the purpose of supplying energy to Eligible Customers, subject to payment of the tariffs established by the Energy Authority.

Distribution

As noted, the term “distribution” refers to transportation of electricity from the transmission network to the customer that actually uses the electricity. The principal effects of the Bersani Decree on distribution are:

- The formal adoption of a licensing regime applicable to the distribution of electricity; and
- The promotion of the consolidation of electricity distribution activities.

Licenses and requirements

The Bersani Decree requires the Industry Ministry to issue, not later than March 31, 2001, licenses for electricity distribution to the entities that were engaged in the distribution of electricity as of April 1, 1999. These licenses, which will expire on December 31, 2030, will regulate the operation, maintenance and development of electricity distribution networks, as well as the interconnections among them. There is no limit on the number of licenses that one distributor can hold. The licensing process is designed to promote an increase in the efficiency of energy use pursuant to criteria established by the Industry and Environment Ministries.

The Bersani Decree requires distribution companies to provide service to all customers who request it, subject to payment of applicable tariffs and to compliance with technical and safety requirements. In addition, the Bersani Decree requires distribution companies that serve more than 300,000 customers to conduct the distribution of electricity to Non-Eligible Customers through separate

companies that have such activity as their exclusive purpose. We began operating a separate subsidiary, Enel Distribuzione, for this purpose in October 1999.

Consolidation of the distribution industry

The Bersani Decree aims at the consolidation of the Italian electricity distribution industry. It provides for the issuance of only one distribution license within each municipality and establishes procedures to promote the consolidation of distribution activities under a single operator in municipalities where both the Enel Group and a local distribution company are engaged in electricity distribution. The decree asked operators with distribution networks in the same municipality to submit joint consolidation proposals to the Industry Ministry by March 31, 2000; these proposals are considered to be approved unless the Industry Ministry objects within 60 days.

If a joint proposal for the consolidation of networks in the same municipality is not submitted, or is not approved by the Industry Ministry, any local distribution company owned or partly owned by a municipality that serves at least 20% of the electricity customers of that municipality may request that we sell to it, by March 31, 2001, our distribution assets in that municipality at a price to be determined by agreement between us and that local distribution company. If the parties do not agree on a price by September 30, 2000, then an arbitration panel will determine the sale price using accepted valuation methodologies that take into account market prices. The panel will consist of one person nominated by each of the parties and a third person nominated by the President of the court having jurisdiction over the geographic area in which the local distribution company is located.

In March 2000, we signed a preliminary agreement for the sale of our distribution network in Trieste to A.C.E.G.A.S. S.p.A., the electricity, gas and water distribution company owned by the Municipality of Trieste. In addition, we have received requests to sell our distribution networks from substantially all other distribution companies in municipalities with co-existing networks, including the companies owned by the municipalities of Rome, Milan and Turin.

The distribution networks that we are required to sell in the context of the consolidation process are more profitable than our distribution networks on average, mainly because distribution in metropolitan areas has lower costs. The Energy Authority has indicated that an equalization system will be put in place that may compensate for some or all the comparative disadvantages of distributors serving non-urban areas. You should read “—Risk Factors” for a more detailed discussion of this consolidation process and the risks involved for us.

Under the Bersani Decree, local distribution companies owned or partly owned by a municipality that serve at least 100,000 customers may also request an authorization from the Industry Ministry to submit a joint proposal with us for the consolidation of their electricity distribution networks with our networks in adjoining municipalities. Certain distribution companies have expressed their interest in purchasing our electricity distribution networks in adjoining municipalities.

Restructuring of Enel

The Bersani Decree contains provisions mandating a significant restructuring of our Group in order to implement the new regulatory framework. Pursuant to these provisions, we have adopted a holding company structure, creating the following separate subsidiaries that conduct our power generation, transmission, distribution, electricity supply and other businesses:

- August 1999: *Gestore della Rete* (operation of national electricity transmission network),

- October 1999: Enel Produzione (generation),
- October 1999: Eurogen (generation),
- October 1999: Elettrogen (generation),
- October 1999: Interpower (generation),
- October 1999: E.R.G.A. (generation from renewable resources),
- October 1999: TERN (electricity transmission network owner),
- October 1999: Enel Distribuzione (distribution),
- November 1999: SOGIN (dismantling of nuclear plants) and
- November 1999: Enel Trade (sales to Eligible Customers).

Pursuant to the Bersani Decree, we have contributed our discontinued nuclear power operations to SOGIN, a wholly owned subsidiary. The Bersani Decree provides that we are to transfer this subsidiary to the Treasury Ministry at no cost. We expect that this transfer will occur in the second half of 2000.

The new tariff structure

The new tariffs set by the Energy Authority took effect on January 1, 2000. This new tariff structure regulates the price paid by Non-eligible Customers for electricity. Eligible Customers will pay the market price for electricity, as well as regulated transmission fees and system charges set by the Energy Authority. The Energy Authority, acting pursuant to a decree of the Industry Ministry, has also established a mechanism that allow us to recover a significant portion of our stranded costs through the tariffs paid by all customers.

We expect that the new tariff structure will result in significant reductions in our tariff revenues, beginning in 2000. These reductions will result from lower rates in 2000 for generation, transmission and distribution fees, the application of price cap reductions to transmission and distribution fees after 2000 and reductions in generation fees in connection with the operation of the pool market beginning in 2001.

Tariffs for Non-eligible Customers

Under the new structure, after an interim period during which tariffs for all Non-eligible Customers are set directly by the Energy Authority, only tariffs for residential customers will be set directly by the Energy Authority. This interim period is currently scheduled to end at the beginning of July 2000, though it may be extended by the Energy Authority. Tariffs for all other classes of Non-eligible Customers will be set by distributors within certain limits established by the Energy Authority, though the Energy Authority will still retain the right to approve the tariffs.

The limits to be set by the Energy Authority on tariffs for non-residential customers are of two types. An aggregate limit sets the maximum amount of tariff revenues that each distributor will be allowed to receive from all customers belonging to the same category in a single year. A second limit sets the maximum amount of tariff revenues that any distributor will be allowed to receive from a single customer of a given category. The determination of whether the aggregate limit has been exceeded will

be done at the end of the relevant year. If the limit is exceeded in any given year, customers will receive reimbursements equal to the excess revenues (plus an additional bonus) in the following year. Compliance with the individual limit will be ensured at the time tariffs are set by the distributors and approved by the Energy Authority. Within these limits, each distributor is free to offer tariff options to its customers in accordance with a trade policy code aimed at ensuring transparency.

In setting tariffs for residential customers and determining the above-mentioned limits applicable to the other classes of Non-eligible Customers, the Energy Authority has sought to allow the recovery by electricity suppliers of:

- The costs of supplying electricity, including both:
 - Operating costs of generation, transmission and distribution activities, including procurement costs and amortization and depreciation. In order to be recovered, these costs must be both actually incurred by the electricity companies and recognized by the Energy Authority; and
 - An appropriate return on invested capital, including both equity and debt financing; and
- The costs associated with system charges, which include the costs of complying with public policy requirements for the Italian electricity system, together with the costs of the *Gestore della Rete*, the Market Operator and the Single Buyer.

Generation costs. The first component of the tariffs reflects the generation costs incurred by electricity producers. Until the Single Buyer begins to operate, the Energy Authority determines these costs based on fixed-cost and variable-cost components tied to the costs of producers. The fixed-cost component, which is intended to reflect non-fuel operating costs, is based on an estimate of the average recognized cost of generation plants in Italy. The Energy Authority established this value for 2000 and will monitor its relationship to the pool price in future years. It is, however, expected that the value will generally remain unchanged until 2002. However, in order to ensure a gradual transition to the new tariff system, the fixed-cost component will include an additional cost component in each of 2000 and 2001. The variable cost component of the tariffs, referred to as “Component B”, is intended to reflect fuel costs associated with thermal power generation and purchases of electricity. You should read “—Charges payable to the Equalization Fund” for a discussion of Component B. The Energy Authority adjusts Component B every two months to reflect changes in international prices associated with a basket of fuels used for electricity production.

After the Single Buyer begins to operate, the price paid to electricity producers will be determined by the bilateral contracts between the Single Buyer and producers and, once the pool market becomes operational, by the competitive bidding system on the pool market. Consequently, the generation-cost component of the tariff for Non-eligible Customers will reflect the price of electricity as determined on the competitive generation market.

However, the Energy Authority will monitor this price to ensure compliance with the principles of competition in the generation market. In particular, the Energy Authority will set a price that the Single Buyer and the pool market will use as a reference price. If the Energy Authority determines that the price paid by the Single Buyer or the price on the pool market differs significantly from the Energy Authority’s reference price, the Energy Authority may, as an alternative to pursuing different regulatory measures, impose its reference price as the price to be used in calculating the generation cost to be

reflected in the tariff. Therefore, even after the pool market has become fully operational, the price to be reflected in the tariffs levels may still be a regulated price set by the Energy Authority.

Both the price applicable to producers before the Single Buyer begins to operate and the reference price set by the Energy Authority after the Single Buyer begins to operate will apply to electricity produced by all types of generating plants. As a consequence, the generation cost component of tariffs may result in an increase in the relative profitability of:

- Hydroelectric or geothermal generation, as a result of the tariff system's inclusion of a component calculated with reference to fuel costs, which hydroelectric or geothermal plants do not incur; and/or
- Electricity imported under long-term contracts already effective as of February 19, 1997, which may be cheaper than electricity generated in Italy.

The Energy Authority will seek to reduce this potential windfall profit for hydroelectric or geothermal producers by establishing a new surcharge to be paid by these producers to the *Gestore della Rete* with respect to the electricity sold by them. This surcharge will partially offset the stranded cost surcharges paid by customers. You should read “—Stranded costs” for a more detailed discussion of this surcharge.

Transmission costs. The transmission costs taken into account in setting tariffs and tariff limits reflect the fee paid by distributors to the *Gestore della Rete* for the use of the network. The transmission fee pays for a number of network services and for the transportation of electricity on high and very high voltage interconnected networks from the plants where it is generated (or, in the case of imported energy, from the points of acquisition) to distribution systems. The transmission fee is designed to cover the costs of the network owners and to provide them with a fair return on capital. This fee is paid to the *Gestore della Rete* for use of the national grid and to the operators of the other networks, if any, that are used to deliver the electricity to distributors or Eligible Customers. The components of this fee include:

- The standing charge, which is set on the basis of capacity contractually committed to the customer, the amount of electricity delivered and the time the network is actually in use;
- A fee for use of the system and related services such as regulation of voltage, frequency power switching services, dispatching, monitoring and maintenance of the capacity reserve; and
- A component to cover system charges, as explained in more detail below.

The transmission fee generally does not vary depending on the distance between the site of production and the site of delivery.

Distribution costs. The distribution cost component of the tariff is designed to compensate distributors for the transportation of electricity through the local distribution network and for the sales-related services they provide to final consumers.

This distribution cost component is based on the average costs incurred by all Italian distributors and is designed to cover those costs as well as a specified return on invested capital. Because Non-eligible Customers in the same category pay the same price for electricity (or, in the case of non-residential customers, benefit from the same price caps) regardless of where in Italy they are located, distributors that serve areas where costs are significantly different than the national average due to such

factors as population density and geography benefit from comparative advantages or suffer from comparative disadvantages. Therefore, the Energy Authority has indicated that, by the end of the year 2000, it will put in place an equalization system to reduce those comparative advantages or disadvantages by providing appropriate compensation.

Adjustment of transmission and distribution cost components. In order to reduce electricity prices over time based on efficiency targets set by the Energy Authority, the components of the current tariff relating to the costs of transmission and distribution will be adjusted in each of 2001, 2002 and 2003 through a price cap mechanism. During this 2001-2003 period, tariffs will reflect an annual decrease in real terms of 4% in each of the transmission and distribution cost components. This cap reflects the productivity improvement target that the Energy Authority has assigned to electricity companies for the period. Any improvement in productivity that electricity companies will achieve in excess of the price cap will increase their profits until the end of the period. At the end of the period, the Energy Authority will determine the new tariff basis and the annual decrease cap for the following four-year period, based on the actual increases in productivity achieved by electricity companies during the previous period. The Energy Authority has also created a mechanism to reset the tariff basis so that any benefits resulting from improvements in productivity above the target set for the previous period will be shared between electricity companies and consumers. The Energy Authority has indicated that not less than 50% of these benefits will be passed on to consumers.

System charges. The new tariff structure also addresses the need to cover various costs resulting from public policy-related requirements imposed on the electricity business, as well as other general interest costs, by providing for the following charges:

- Charges concerning the electricity system, which apply to both Eligible Customers and Non-eligible Customers. These charges, established by the Industry Ministry, consist of:
 - A nuclear surcharge, covering part of the costs incurred by SOGIN in connection with the dismantling of nuclear plants and decommissioning of nuclear fuels; this surcharge is designed to cover substantially all of such costs when added to the funds that we transferred to SOGIN. The surcharge may be adjusted by the Energy Authority on the basis of a detailed three-year plan of activity and budget prepared by SOGIN;
 - A surcharge for renewable resources, intended to incentivize generation from renewable resources;
 - Special surcharges, covering the cost of supplying electricity at statutorily imposed discounted tariffs to certain customers (primarily the Italian State-owned railway company and Acciai Speciali Terni S.p.A., both of which transferred electricity assets to us as part of the nationalization of the Italian electricity industry in 1962);
 - Research and development surcharges, covering related costs; and
 - Stranded costs (partially offset by contributions from producers which generate electricity from hydroelectric and geothermal sources and, therefore, do not incur fuel costs). You should read “—Stranded costs” for a discussion of these costs.
- Other general interest charges established by the Energy Authority to adjust or refine the operation of the tariff mechanism (and applicable only to Non-eligible Customers), which consist of:

- a transitory surcharge designed to phase-in the effect of the new tariff system on the various categories of Non-eligible Customers; this surcharge will be reduced by 50% in 2001 and eliminated in 2002;
- Adjustments to the equalization mechanism, covering possible differences between costs recognized as recoverable by distributors under the current tariff structure and actual tariff revenues;
- A temporary bonus for generation of electricity to be sold to Non-eligible Customers, which will be eliminated after 2001; and
- Charges recovered through upward adjustments to the price caps, as established by the Energy Authority (and applicable only to Non-eligible Customers), which cover:
 - Incentives for the enhancement of the quality of service;
 - Costs deriving from unforeseeable events, changes in the regulatory framework or new obligations for universal service;
 - Costs deriving from demand side management initiatives intended to promote a more efficient use of resources by electricity customers, including information campaigns; and
 - Additional recognized costs incurred in connection with the offer of value-added services in addition to basic options.

Charges payable to the Equalization Fund. Revenues from certain tariff components are remitted to and managed by the Equalization Fund, a public entity charged with redistributing such revenues to the electricity companies entitled to receive them. These revenues include those deriving from system charges (excluding stranded costs and those system charges which are recovered through upward adjustments to the price caps) and from the so-called “Component B.”

Component B is intended to cover the “energy cost contribution” recognized for thermal power generation and the purchase of electricity. In order to create incentives for the efficient production of thermo-electric power in Italy, this contribution is calculated based on the estimated national average variable unit cost of power generation, unlike the former thermal charge account system, which served merely to reimburse power generation costs. Specifically, the Energy Authority calculates the energy cost contribution by reference to an index of weighted average industry fuel prices (60% fuel oil, 23% natural gas and 17% coal) and a specific consumption index equal to 2,290 kCal/kWh. The calculation of the contribution (and consequently, of Component B) is updated every two months based on a basket of international fuel prices. Electricity distribution companies collect amounts with respect to Component B that are established by the Energy Authority for each category of users and deposit them with the Equalization Fund. Every two months, the Equalization Fund redistributes these amounts in the form of equalization grants among distributors that are also producers of electricity.

Tariff categories

The Energy Authority has simplified tariff categories by defining the following nine homogeneous classes of consumers:

- low-voltage domestic consumers (residential customers);

- low-voltage public lighting;
- low-voltage Eligible Customers for other uses;
- low-voltage Non-eligible Customers for other uses;
- medium-voltage public lighting;
- medium-voltage Eligible Customers for other uses;
- medium-voltage Non-eligible Customers for other uses;
- high-voltage Eligible Customers; and
- high-voltage Non-eligible Customers.

The Energy Authority has set the same tariffs for all residential customers, regardless of their location. Subsidies that benefit residential customers who use only small amounts of electricity are being phased out. Tariffs for non-residential customers are set by distributors and may therefore vary. However, as noted above, these tariffs are subject to a limit set by the Energy Authority, which sets the maximum amount of tariff revenues that a distributor is allowed to receive from a single customer of a given category. This limit applies to all non-residential customers in any given class, regardless of their location.

The changes in the tariff structure primarily benefit low voltage non-residential customers, which include customers from the commercial and other services sector. We expect that the new tariffs will provide an incentive for these customers to increase their level of electricity consumption.

The Energy Authority set these new tariffs to reflect the cost of delivery. Accordingly, the Energy Authority reduced or eliminated various cross-subsidies between electricity users. The new tariff structure establishes that subsidies currently applied to residential customers who only use a small amount of electricity will be abolished at the end of 2002. In the interim, a transitory regime has been put into place, during which time prices of subsidized and non-subsidized supplies gradually converge to a single tariff applicable to all residential consumers. In the future special tariffs could be applied to a limited number of customers in unfavorable economic conditions, charging the corresponding cost to the remaining domestic customers by means of a specific surcharge.

Stranded costs

Stranded costs are current costs deriving from contractual commitments or investment decisions that electricity companies:

- Undertook for reasons of public policy;
- Undertook at a time when the electricity markets were not yet open to competition; and
- Could have been recovered in a monopoly regime but could not be recovered under a regime of competitive electricity pricing.

To facilitate the transition to open electricity markets, the European Commission has stated that electricity companies should be refunded their stranded costs provided that:

- They minimize the impact of those costs (and, hence, the amount of the refund) on their future operations; and
- They submit an industrial plan demonstrating the long-term profitability of the activity related to the stranded costs.

Our stranded costs mainly consist of costs resulting from requirements that were imposed in the past on the design and operation of our generation plants. In particular, because of governmental policies, we built most of our plants to ensure a high degree of flexibility in the type of fuel that they could use.

The Industry Ministry and the Treasury Ministry have determined which costs are to be considered as stranded costs and established a system to recover them. Commitments for investments we undertook prior to February 19, 1997 relating to generating plants currently in service are regarded as stranded costs, except for investments in plants that benefit from the CIP 6 regime. You should read “—The Enel Group—Purchased Power” for a description of the CIP 6 regime. Under the recovery program adopted by the Industry Ministry, we will be allowed to recover a significant portion of our stranded costs between 2000 and 2006. The Energy Authority will assign a recognized cost to each of our plants based on actual operating costs, depreciation and a 7.9% return on investment. During the recovery period, the Energy Authority will compare these recognized costs for each plant with the fixed costs recovered through the pool price. If the recognized costs are higher in aggregate than those fixed costs, we will be entitled to recover an amount equal to the difference.

If a plant for which stranded costs have been recognized is sold, the purchaser is entitled to recover those costs on the same terms established for the seller.

Our contractual obligations in connection with our imports of liquefied natural gas from Nigeria are also regarded as stranded costs. These stranded costs will be recovered over a ten-year period, which may be extended if certain conditions are satisfied.

During the recovery period, the impact of these stranded costs surcharges on the tariffs paid by consumers will be partially offset by contributions paid to the *Gestore della Rete* from generating companies producing electricity from hydroelectric or geothermal plants, which do not incur fuel costs. These contributions will amount to 75% of the difference between the pool price and the fixed recognized costs of hydroelectric and geothermal plants in the years 2001-2002, 50% of that difference in 2003-2004, and 25% of that difference in 2005-2006. The contributions will be eliminated after 2006.

The maximum amount we may recover as stranded costs is Lit. 15,000 billion. The plan for the recovery of stranded costs must be submitted by the Italian Government for approval by the European Commission to ensure compliance with the Electricity Directive and with the European Union’s rules on governmental assistance to private businesses.

Quality of service regulation

The Energy Authority has also established a system of bonuses and penalties to enhance the quality of service provided by electricity companies. Quality of service is measured in terms of waiting time for the performance of the most frequent commercial activities (such as connection cost estimates, connections, disconnections and reconnections) and the frequency and total duration of interruptions of service. The performance of commercial activities is assessed with reference to special and general targets set by the Energy Authority, which are the same throughout Italy. Interruptions of service are assessed with reference to annual targets set by the Authority, which vary in relation to the concentration of customers in the various areas.

Distributors that outperform the targets are remunerated through bonuses paid through adjustments to the price cap mechanism. Penalties are imposed if the targets are not met. We believe that the level of revenues expected under the current tariff structure will allow distributors to cover the costs they need to incur to meet the above-mentioned targets. We expect that we can comply with the quality of service regulation by implementing the investments already planned for quality enhancement.

Impact of new tariff structure

Assuming electricity consumption remains consistent with current levels, we expect that approximately one-half of our tariff revenues, not including fuel cost reimbursements, will be attributable to generation and one-half will be attributable to transmission and distribution. Based on our tariff revenues for 1999 and assuming comparable levels of electricity consumption in 2000, we expect that the new tariffs will result in an aggregate decrease of approximately 10% to 11% in our total tariff revenues (not including fuel cost reimbursements) in 2000 compared to 1999. The revenue reduction will be mitigated by the bonus for the electricity produced and devoted to Non-eligible Customers (amounting to 6 Lit/kWh in 2000 and 2001) and the positive impact of the gradual implementation of the new tariff structure. At the time the Bersani Decree was enacted in 1999, the Energy Authority estimated that our tariff revenues in 2003, including fuel cost reimbursements, would be 17% lower than our then-expected tariff revenues for 1999, assuming that the cost of fuels remains unchanged. Our actual tariff revenues for 1999 were in line with the estimates used by the Energy Authority in this analysis. These figures are estimates only and may change if regulatory tariff policies change or as a result of changes in electricity consumption or other factors (including fuel costs).

The historical regulatory framework

Before the nationalization of the Italian electricity industry in 1962, the generation, transmission and distribution of electricity were largely unregulated. The law nationalizing the electricity industry in 1962 established Enel, and delegated to us the generation, transmission, transformation, distribution and sale of electricity within Italy and the import and export of electricity to and from Italy. Three types of electricity producers were exempted from our monopoly:

- A number of municipally owned electric utilities;
- A number of industrial companies generating electricity for their own consumption, provided that at least 70% of the electricity they generated was used in their own industrial processes and any surplus production was sold only to us; and
- Small producers, defined as companies distributing less than 15 GWh per year.

Since 1962, legislation has progressively weakened our monopoly by permitting additional categories of entities to operate in the electricity industry. In particular, Italian legislation has sought to provide incentives for the production of energy from renewable resources. For example, Law 393/1975 authorized all municipalities and provinces (including those that were not so authorized under the Nationalization Law) to generate electric power from renewable resources and/or in combination with co-generation, burning of urban waste and desalinization. Law 308/1982 authorized the generation by private parties of electricity from renewable resources and/or from co-generation plants with an installed capacity of less than 3 MW, provided that all production of electricity in excess of certain limits was sold to us. Law 9/1991 authorized independent producers to generate electricity from renewable resources regardless of the installed capacity of the power plant, abolished the rule that industrial producers had to consume at least 70% of the power they generated for their own use or for the use of affiliated companies and authorized the free movement of electricity among specified categories of customers.

Historical tariff structure

The electricity tariff in force before implementation of the new tariff structure in January 2000 was made up of the following items: (i) standing charge, (ii) first component of unit price, (iii) second component of unit price, (iv) charges payable to the Equalization Fund and (v) taxes.

The standing charge, a fixed component of the tariff, reflected the price of the contracted capacity required by a customer, independent of the actual level of consumption. The first component of unit price reflected the price of the electricity which covered, together with the standing charge, the electricity system's fixed costs. The second component of unit price reflected the variable electricity production costs (fuel and import costs).

The above items varied depending on the type of customer:

- *Public lighting.* This comprised power purchased by the government and by regional and local administrations.
- *Residential.* Tariffs were lower for the primary residence of customers. In addition, discounts were applied for usage below certain thresholds of monthly consumption.
- Commercial and industrial users.
- *Agricultural.* These tariffs varied depending on the type of use, the region and the particular agricultural activity.
- Electricity distributors.

The above items also varied depending on:

- Electricity voltage at delivery; if the voltage at delivery was low, it meant that we provided a more extensive transportation and transformation service;
- Capacity of the supply;
- Duration of usage; and
- Time of usage.

As under the current tariff structure, charges payable to the Equalization Fund included certain system charges and Component B. You should read “—The new tariff structure—Charges payable to the Equalization Fund” for a discussion of these charges.

In addition, under the historical tariff structure, charges payable to the Equalization Fund also included Component A1, a charge intended to cover the deficit during the years 1994, 1995, 1996 and the first six months of 1997 in the *conto onere termico* (“thermal charge account”), a fund established in order to partially cover the fuel costs associated with thermoelectric power generation. The Energy Authority abolished Component A1 of the electricity tariff effective January 1, 1999, as a result of the elimination of the deficit in the thermal charge account.

Prices of electricity

The table below shows the average prices of electricity to customers to whom we directly supplied electricity, by type of customer, expressed in Lit./kWh, as of January 1996, 1997, 1998 and 1999 under the historical tariff structure and as of January 2000 under the current tariff structure.

Type of customers	January 1996	January 1997	January 1998	January 1999	January 2000	% change January 1996/ January 2000	% change January 1999/ January 2000
Residential							
Extariff	164.4	147.0	147.0	147.0	148.2	-9.9	0.8
Component B.....	52.6	57.1	65.6	48.4	60.9	15.8	25.8
Other Components.....	17.0	21.3	17.1	19.9	16.5	-2.9	-17.1
Before tax.....	234	225.4	229.7	215.3	225.6	-3.6	4.8
Taxes.....	51.9	51	51.5	50	51.1	-1.5	2.2
Total	285.9	276.4	281.2	265.3	276.7	-3.2	4.3
Industrial							
Extariff	86.4	86.5	86.6	86.6	72.6	-15.6	-16.2
Component B.....	39.6	43.2	49.7	36.1	59.4	50.0	64.5
Other Components.....	14.5	17.9	14.5	18.5	16.9	16.6	-8.6
Before tax.....	140.5	147.6	150.8	141.2	148.9	6.0	5.5
Taxes.....	18.2	18.2	18.2	18.2	18.4	1.1	1.1
Total	158.7	165.8	169	159.4	167.3	5.4	5.0
Services							
Extariff	148.1	148.1	148.1	148.1	126.3	-14.7	-14.7
Component B.....	51.2	55.8	64.2	46.5	64.2	25.4	38.1
Other Components.....	17.2	21.4	17.1	19.5	26.5	15.4	35.9
Before tax.....	216.5	225.3	229.4	214.1	217.0	0.2	1.4
Taxes.....	36.2	36.6	37.4	36.6	36.5	0.3	-0.3
Total	252.7	261.9	266.8	250.7	253.5	0.2	1.1
Average Direct Customers							
Extariff	123.1	118.9	119.0	119.0	106.5	-13.5	-10.5
Component B.....	45.8	49.8	57.3	41.8	61.1	33.4	46.2
Other Components.....	15.8	19.7	15.8	19.1	20.7	31.0	8.4
Before tax.....	184.7	188.4	192.1	179.9	188.3	1.9	4.7
Taxes.....	31.3	31.2	31.5	31.0	31.4	0.3	1.3
Total	216.0	219.6	223.6	210.9	219.7	1.7	4.2

From January 1996 to January 2000, our average price to final customers increased by 1.7% in nominal terms, which corresponds to a decrease of 5.7% in real terms. Price trends are different among type of customers. Prices to residential customers during that period decreased by 3.2% or 10.4% in real terms, while price to industrial customers increased by 5.4% in nominal terms, which corresponded to a decrease of 2.3% in real terms.

Taxes

Electricity is currently subject to three indirect taxes, the first two of which are not applicable to residential customers who qualify for the social protection pricing scheme:

- A state revenue tax that varies from 0.65/kWh up to a maximum of Lit. 9.1/kWh depending upon the type of service contract;
- Additional local taxes that vary from Lit. 4/kWh up to a maximum of Lit. 39.5/kWh; and

- Value-added tax of 20% for all users with the exception of residential and industrial customers (who are taxed at a rate of 10%).

In 1997, the Italian Government issued a decree under which local authorities may impose a right of way tax for the occupation of public areas referred to as the “COSAP”. This tax replaces a similar state tax referred to as the “TOSAP”. A number of provinces and city authorities have issued regulations concerning the application of the COSAP. In many cases, the tax rate is significantly higher than the former TOSAP. We have brought administrative proceedings against some local authorities and we have sought the annulment of their COSAP regulation. In addition, we have started negotiations with the Italian association of local authorities in order to agree to a uniform tax mechanism which meets the requirements set out by the governmental decree. However, if the litigation has an unfavorable outcome to us, the COSAP could have a material adverse effect on our results of operations and financial condition.

Telecommunications

Italian regulation of the telecommunications industry requires telecommunications operators to obtain a license or authorization to provide fixed-line voice telephony, mobile telephony, data transmission and Internet services. Italy established an independent telecommunications regulatory authority known as the Communications Authority in July 1997. The Communications Authority began operating in August 1998. The Communications Authority regulates all aspects of the fixed-line telephony and mobile telephony services and Internet markets. Its regulatory powers include licensing, interconnection, frequency allocation, numbering, universal service obligation, tariff regulation and rebalancing and arbitration of disputes between carriers. However, the Italian government retains ultimate control of license terms and conditions. From 1999, licensed telecommunications service providers are required to pay contributions to the Ministry of Communications. In 1999, the Communications Authority cancelled its requirement that fixed and mobile operators provide a bank bond in support of their licensing obligations.

In its 1998 and 1999 Annual Reports, the Communications Authority set forth the following main objectives:

- To promote convergence among mobile telephony, fixed-line telephony, television and Internet services as well as the development of third-generation wireless and mobile systems;
- To introduce further competition into the Italian telecommunications market; and
- To promote liberalization in the broadcasting and media industry.

In the first phase of its activity, the Communications Authority has promoted competition by, among other things, issuing approximately 100 licenses to telecommunication operators, including four operators for mobile telephony services and approximately 70 operators for fixed-line voice telephony services.

Interconnection

In 1999, Telecom Italia had approximately 90% of the Italian fixed-line voice telephony services market. Telecom Italia owns and operates the largest fixed-line voice telephony network in Italy. As a result, interconnection with this network significantly affects other operators’ ability to provide fixed-line voice telephony and other telecommunications services in Italy. Each year Telecom Italia must issue a price list for interconnection of fixed-line networks operated by other carriers with its own network. This

price list is approved by the Communications Authority to ensure cost-orientation and compliance with the recommended European Union benchmark levels. The price list for 2000 has not yet been approved by the Communications Authority. Interconnection rates charged by Telecom Italia for calls originated on its fixed network and terminating on mobile networks are also subject to the approval of the Communications Authority. In 1999, the Communications Authority approved reduced interconnection rates to be charged by Telecom Italia for such calls.

Fixed-line voice telephony

The Communications Authority and the Ministry of Communications are also promoting further competition in the fixed-line voice telephony services market by:

- Introducing a price-cap method for the determination of Telecom Italia's rates for fixed telephony services to end customers and rebalancing those rates with the aim of increasing monthly fees and decreasing long distance and international rates;
- Adopting, in December 1999, rules on fixed telephony number portability, which allows customers to keep the same telephone number when they change carrier. While the rules provide that number portability will be introduced beginning in January 2000, such introduction is being delayed;
- Unbundling the local loop of Telecom Italia by September 2000;
- Introducing carrier selection in 1999, which allows customers to select carriers on a call-by-call basis by dialing a carrier selection code. Since January 2000, carrier selection is also possible for local calls;
- Introducing carrier pre-selection at the end of 1999, which allows customers to register with alternative carriers to gain indirect access for all local, long-distance, fixed-line to mobile and international calls without dialing a carrier selection code. Carrier pre-selection is expected to become fully operational in the entire Italian territory in the second half of 2000;
- Establishing that prices to be paid by customers for calls originating from Telecom Italia's network and terminating on mobile networks are to be determined by Telecom Italia, subject to the approval of the Communications Authority; and
- Establishing that, for 1998, Telecom Italia is not entitled to be compensated by new entrants (including WIND) for the net costs incurred in connection with its "universal service" obligations, as these net costs did not represent an unfair burden on Telecom Italia during that year. The Communications Authority may reconsider this decision in the following years.

Mobile telephony

Telecom Italia Mobile, Omnitel Pronto Italia, WIND and Blu are currently the four operators in the Italian mobile telephony services market. In 1999, the Communications Authority determined that Telecom Italia Mobile and Omnitel Pronto Italia are operators with significant market power and, as such, will have to apply non-discriminatory and cost-oriented rates for interconnection with their networks by other operators. Blu, a joint venture in which Autostrade Italiane and British Telecom have the largest interest, launched its commercial service in June 2000. In addition, the bidding procedure for the grant of licenses for third-generation mobile services, or UMTS, is expected to begin in July 2000. Five UMTS licensing will be granted through this procedure. The UMTS standard will enable carriers to offer new

value-added services without capacity problems, with higher quality standards and at competitive prices. UMTS services should become available by 2002.

Internet and electronic commerce

Internet operators must obtain an authorization to provide Internet services from the Communications Authority. However, Internet service providers are not subject to universal service obligations, tariffs regime or the other strict regulatory requirements applicable to fixed-line voice telephony and mobile telephony services operators.

The current interconnection regime has made it economically feasible for new telecommunication operators to offer Internet services without any fee in addition to the standard rate for local calls.

In February 1999, the Italian Government adopted the necessary technical rules to implement the governmental decree on electronic signatures issued in November 1997. These rules will contribute to the establishment of the regulatory environment necessary to develop electronic commerce in Italy. In particular, these rules seek to provide full enforceability of commercial transactions in electronic form. Electronic commerce also falls within the scope of European Union and Italian legislation on consumer protection. Pending EU legislation (together with subsequent implementing measures adopted by EU member states) is expected to complete the EU regulatory framework for electronic commerce.

Environmental Matters

Our electricity operations are subject to extensive environmental regulation, including laws adopted by the Italian Parliament or government to implement regulations and directives adopted by the European Union and international agreements on the environment.

The principal objective of our environmental policy is to comply with all relevant legislation and to seek to reduce adverse effects that our activities may have on the environment. Since 1996, we have issued a public environmental report on a yearly basis. We believe that environmental performance will represent an increasingly important competition factor in a liberalized market.

Environmental regulation affecting our business primarily relates to electromagnetic fields, air emissions, water pollution, waste disposal, noise and the clean-up of contaminated sites. The principal air emissions of fossil-fueled electricity generation are sulfur dioxide (SO₂), nitrogen oxides (NO_x), carbon dioxide (CO₂) and particulate matters such as dust and ash. A primary focus of environmental regulation applicable to our business is to reduce these emissions. You should read “—The Enel Group—Generation—Thermal production” for a discussion of our investments to comply with this regulation.

Electromagnetic fields

In 1992, the Italian government adopted a regulation relating to exposure to electromagnetic fields. The government supplemented the regulation with an additional decree in 1995. The regulation applies to the extremely low frequency (50 Hz) used for the transmission, distribution and consumption of electricity. This regulation sets:

- Maximum levels of exposure to electromagnetic fields from new and existing transmission and distribution lines and distribution substations. Compliance with maximum exposure limits for already installed lines generally involves increasing the height of towers carrying lines where necessary. We will complete implementation of compliance measures relating to these maximum exposure limits by 2004, as required under the regulation; and

- Minimum distances between transmission or high-voltage distribution lines or substations and residential buildings, office buildings and similar areas for lines built after the adoption of the 1992 regulation.

The minimum distance requirements for transmission and distribution lines installed after the adoption of the 1992 regulation result in distances for these lines that exceed what would be required to comply with the maximum exposure levels. All of our lines installed after the adoption of the 1992 regulation are in compliance with the minimum distance requirements.

Under a restrictive interpretation of the regulation, a portion of our substations located within buildings could be regarded as being non-compliant with the requirements concerning minimum distances between these substations and residences and other occupied buildings. We believe that this restrictive interpretation is not correct and that we comply with existing regulation.

Italian regulation of electromagnetic exposure complies with the maximum exposure limits set by international organizations such as the International Radiation Protection Association, the International Non-Ionizing Radiation Committee and the International Commission on Non-Ionizing Radiation Protection, and those set by a European Union recommendation issued on July 12, 1999.

The level of expression of public concern within Italy about the potential effects of exposure to electromagnetic fields has increased significantly in recent years, at both a national and regional level. In October 1999, the Italian Constitutional Court recognized the right of regional authorities to impose measures stricter than exposure limits established at the Italian national level. Following that decision, the Veneto Regional Authority adopted legislation imposing limits on exposure levels from new installations of distribution and transmission lines which are stricter than those established at the national level. The Liguria and Abruzzo Regional Authorities have recently passed similar legislation.

In September 1998, the Italian government adopted a regulation setting limits to exposure to electromagnetic fields generated by high frequency infrastructure such as the transmission stations that WIND uses to provide mobile telephone services. This regulation:

- Sets maximum exposure levels;
- Sets “caution levels” (for buildings that are occupied for at least four hours per day) and “quality targets” to be met by operators;
- Gives Italian regional authorities the power to regulate the installation and modification of high-frequency infrastructure to ensure implementation of the regulation and responsibility for monitoring compliance with the maximum exposure levels and required preventive measures; and
- Requires owners of high-frequency infrastructures that do not comply with the maximum exposure levels and with the preventive measures to undertake any remediation measures that the regional authorities require.

In 1998, the Italian government submitted to the Italian Parliament a bill which would replace the current legislation regarding electromagnetic fields. The proposed legislation, which the Parliament is currently considering, would impose new “maximum exposure levels”, “caution levels” and environmental “quality targets”. These caution levels are intended to be precautionary measures against the potential alleged long-term health effects of exposure to electromagnetic fields, which include leukemia and chronic headaches. Quality targets require the utilization of the best available technology.

There is conflicting scientific evidence as to these alleged long-term effects; statistical epidemiological studies have provided controversial results but laboratory studies have not proved the existence of a link between electromagnetic fields and the potential alleged long-term health effects. The proposed legislation would cover both low-frequency infrastructure, such as electricity transmission and distribution lines and distribution substations, and high-frequency infrastructure, such as that used for telephony, including mobile telephone services. The caution levels and quality targets for the 50Hz frequency currently under consideration are hundreds of times stricter than present limits. The bill in its current version does not modify “caution levels” and “quality targets” for high-frequency infrastructures as set by the above-mentioned regulation of September 1998.

The proposed legislation may make it more difficult for us to install new transmission and distribution lines and substations in the future.

The pending legislation also provides for a twelve-year program to restructure the Italian electricity grid and bring it into compliance with the new electromagnetic requirements. This program may require us to move existing transmission and distribution lines and substations. As a result, if the bill is enacted in its current form and the limits indicated in it are confirmed, we would incur significant capital expenditures to comply with these requirements and this may have an adverse impact on our results of operations and financial condition.

The current version of the bill would require the Energy Authority to set the criteria, terms and conditions for the recovery, through tariffs, of the costs which the owners of the electricity transmission and distribution lines and substations would bear in implementing the restructuring plan. We expect that we would be reimbursed through this recovery mechanism for the expenditures that we would incur to comply with the pending legislation. However, because of the uncertainty surrounding the ultimate outcome of the ongoing legislative process, we cannot assure you that the legislation, if enacted, would provide for reimbursement of all of these costs. In April 2000, the Energy Authority addressed an opinion to the Italian Senate evaluating the impact on tariffs of the implementation of the bill and reimbursement of the related costs.

In addition, the Bersani Decree requires that the *Gestore della Rete* pay to the owners of transmission lines consideration which adequately reflects the costs which these owners have incurred to comply with regulatory requirements. You should read “The Enel Group—Transmission” and “Regulatory Matters—Electricity Regulation—The new regulatory framework—Transmission” for a more detailed discussion of the *Gestore della Rete* and “—Risk Factors” for a more detailed discussion of the risks electromagnetic field-related regulation poses for our business. You should also read “Legal Proceedings” in Item 3 for a discussion of certain legal proceedings against us relating to electromagnetic fields.

Principal EU legislation and international treaties regarding SO₂ and NO_x

The principal EU directive on air emissions affecting the electricity industry is the large combustion plants directive (the “LCPD”). The LCPD requires each European Union member state to establish and implement a program of progressive reduction of total SO₂ emissions and total NO_x emissions from generation plants licensed before July 1, 1988 and to establish emission limits for SO₂, NO_x and particulate matter from individual generation plants licensed after July 1, 1988. The European Commission is currently reviewing the LCPD and may issue a new directive in 2000.

Italy is a member of the Helsinki Protocol and the Oslo Protocol, which require signatory countries to reduce SO₂ emissions, and the Sofia Protocol, which requires signatories to reduce NO_x emissions. The requirements under these protocols have been reflected in Italian law.

Principal Italian legislation regarding SO₂ and NO_x

Italy implemented the LCPD by a ministerial decree in 1989 by establishing strict limits on emissions from new plants and requiring the gradual reduction of aggregate emissions from plants licensed prior to July 1, 1988. In some cases the Italian limits are stricter than those imposed by the protocols and the LCPD. The following tables show the SO₂ and NO_x aggregate emission reduction targets of the 1989 Italian ministerial decree and our actual level of emission reductions in 1993, 1998 and 1999:

<u>Reductions of SO₂ emissions against 1980 levels</u>		
<u>Year</u>	<u>Target</u>	<u>Enel's result</u>
1993	30%	57%
1998	39%	62%
1999	-	69%

<u>Reductions of NO_x emissions against 1980 levels</u>		
<u>Year</u>	<u>Target</u>	<u>Enel's Result</u>
1993	2%	19%
1998	30%	51%
1999	-	60%

In addition, in 1990 Italy established a regulation limiting emissions of polluting substances from thermal plants licensed before July 1, 1988 that is stricter than the LCPD and covers a much broader range of pollutants. This regulation requires that individual existing thermal plants in Italy reduce emissions to levels similar to those established under the LCPD for individual plants licensed after July 1, 1988. This regulation also provides a time schedule for the implementation of environmental compliance measures at existing plants.

In response to this regulation, we implemented in 1990 a significant program of environmental measures that affect our entire thermal operation. We submitted this program to the relevant ministries of the Italian government, including those for industry, environment and health. This program provides for modifications to both physical plant and operating practices. The following table shows the targets which Italian regulation provides for the implementation of these environmental compliance measures for generating facilities and our levels of implementation for the relevant periods. Both the targets and our results are expressed as percentages of the total installed thermal capacity of generating facilities for the periods indicated. Our levels of implementation for 2002 are estimated.

<u>At December 31,</u>	<u>Target</u>	<u>Enel's adopted or Planned Measures</u>
1997	35%	41.5%
1999	60%	62%
2002	100%	100%

In 1997, the Italian Parliament imposed a tax on total SO₂ and NO_x emissions from thermal plants that have a nominal capacity of greater than 50 MWh. These plants are the same plants as those regulated under the LCPD. In 1999, our cost in connection with this tax was approximately Lit. 70 billion.

CO₂ emissions

Both the European Union and Italy are signatories to the Kyoto Protocol, which was signed under the United Nations Framework Convention on Climate Change. In accordance with a burden-sharing agreement among EU member states, Italy has set a target to reduce emissions of CO₂ and the other greenhouse gases listed in the Kyoto Protocol (“GHGs”) over the 2008-2012 period by 6.5% from their 1990 levels.

In implementing the Kyoto protocol, on November 19, 1998, the Italian interministerial committee for economic planning issued the guidelines for Italian policies and measures for the reduction of GHG emissions in order to implement the Kyoto Protocol. These guidelines set targets for CO₂ and other GHG emissions to be achieved through measures concerning various sectors of the Italian economy, including reduction of carbon produced in thermal electricity generation, increased use of electricity generation from renewable resources and demand side management to increase the efficiency of energy use. In 1999, we produced approximately 20% of total GHG emissions in Italy. Almost all of our emissions in 1999 consisted of CO₂ emissions.

To comply with the Italian government’s guidelines regarding the reduction of GHG emissions, we have proposed a voluntary agreement with the Environment and Industry Ministries. We expect that the agreement will include a number of measures to reduce GHGs emissions. These measures will include employing high-efficiency technologies, such as CCGT plants, promoting the use of renewable resources and developing innovative generation technologies using biomass and other wastes. We also expect to take advantage of the flexibility provided under the Kyoto Protocol for reducing GHGs emissions through joint projects in industrialized and developing countries and national or international carbon credits trading.

In January 1999, Italy introduced the “carbon tax”, a tax on fossil fuel consumption that also applies to fuels for electricity generation. The carbon tax will progressively increase until 2005. The amount of the carbon tax is not proportional to the level of CO₂ emissions from the various fuels. For example, the carbon tax on emissions from coal is almost four times higher than the tax on emissions from natural gas. Implementation of the tax increases scheduled after 2000 will take into account whether and how carbon taxes are implemented in other European Union member states. Based on the current implementation schedule, we expect that we will decrease our use of coal in order to limit our exposure to this tax. In 1999, our carbon tax liability amounted to approximately Lit. 70 billion.

PCBs and asbestos

In May 1999, the Italian government enacted a legislative decree concerning the recovery and disposal of electric transformers and other equipment containing polychlorinated biphenyls, or PCBs. Pursuant to this decree, we are delivering all of our equipment containing PCBs to companies authorized to recover and dispose of such equipment. We are also delivering waste products containing asbestos to specialized companies authorized to treat and dispose of asbestos. Such waste products derive from the clean-up of our plants we conduct in accordance with our general maintenance and environmental clean-up programs.

Water pollution prevention

We are subject to environmental laws and regulations limiting heat and other characteristics of water discharges from our thermal plants and liquid waste from our hydroelectric plants. In May 1999, the Italian Parliament adopted a new law for the prevention of the pollution of fresh and salt water. The rules concerning heat limits of water discharges from power plants into rivers and coastal waters do not

affect the operation of our plants, as discharges from our plants already complied with the limits set by those rules. Similarly, the water treatment plants already operating in our generation plants are in line with the new requirements on liquid waste.

Solid waste management

In February 1997, the Italian government issued a legislative decree implementing the EU directives on solid waste management. In accordance with this decree, we have increased the level of recycling of our waste. We have implemented specific measures concerning fuels derived from waste, which we intend to use in dedicated plants or together with coal at our thermal generation plants.

Site clearance

New legislation provides for ground and underground inspections to evaluate the possible contamination of sites, particularly in areas declared to be of national interest, using specific chemical, physical and historical analyses. If sites we own are found to be contaminated, the current regulation requires that we undertake a program of site clearance and restoration. In that case, under the new legislation the Italian government may provide financial support for restoration of contaminated sites located in areas of national interest. Based on our environmental compliance practices and the current regulatory regime, we do not expect to have significant liability associated with contamination of sites being inspected.

Landscape safeguards

We have taken the following actions to reduce the environmental impact of our transmission and distribution lines:

- Re-using routes of previous power lines wherever possible;
- Soliciting proposals internationally for the design of new towers for our transmission lines aimed at reducing the environmental and aesthetic impact of towers in non-urban areas of particular landscape value;
- Acting to reduce the impact of lines in environmentally sensitive or protected areas;
- For medium-voltage lines, placing underground cables in urban areas and aerial cables with low environmental impact in other areas with specific environmental value; and
- Using aerial insulated cables or underground cables in low voltage networks (at present, we have built approximately two-thirds of our network in this way).

We limit our use of underground high-voltage cables to urban areas because they are significantly more expensive than aerial cables and the process of installing them may involve significant logistic and environmental problems. Between 1994 and 1999:

- We added approximately 21,000 kilometers of aerial insulated and underground medium voltage cables. In 1999, aerial insulated cables and underground cables represented 34.5% of our medium voltage lines, compared to 29.8% in 1994; and

- We added approximately 87,000 kilometers of aerial insulated and underground low voltage cables. In 1999, aerial insulated cables and underground cables represented 79.6% of our low voltage lines, compared to 72.8% in 1994.

Environmental registrations, certifications and authorizations

We have joined a European Union initiative to implement a voluntary environmental management and registration system (“EMAS”), which seeks to improve the level of environmental efficiency and disclosure of European industrial companies, and includes ISO 14001 certification for registered plants and assets. We are committed under the initiative to obtain EMAS registration for 26 of our generation plants, representing 55% of our installed capacity, by 2001. As of June 2000, three of our plants had obtained the EMAS registration and a fourth plant is expected to obtain registration in July 2000. We are implementing measures at the other 22 plants in connection with the certification process.

The Italian Parliament recently passed a bill to implement the 1996 EU directive on the prevention and reduction of pollution (the “IPPC directive”). This directive requires all industrial plants to operate under a new integrated environmental license by 2007 and make use of state-of-the-art technologies for the prevention and reduction of pollution. The new license will set pollution limits and will be reviewed every five years or at any time plants undergo significant renovation. Licenses for EMAS-registered plans will be reviewed every eight years.

Cost of compliance

The costs of ensuring compliance with applicable environmental regulation generally consist of costs associated with equipping newly constructed facilities with required technology or modifying existing facilities to comply with applicable regulation. In 1999, our environmental capital expenditures totaled Lit. 1,337 billion, representing 23.6% of our total capital expenditures. We estimate that we will spend an aggregate of Lit. 1,495 billion in 2000 and 2001, or approximately 16% of our total planned capital expenditures, to equip new facilities or to modify existing facilities in order to comply with applicable environmental regulation.

We expect our total environmental capital expenditures will decrease due to the gradual phasing out of our program of environmental compliance measures for our thermal plants, which we will complete in 2002. This program represented approximately 52% of our total environmental capital expenditures in 1999.

Discontinued nuclear operations

We have not produced electricity from nuclear power plants since 1988. Our four nuclear plants had an aggregate net installed capacity of 1,500 MW.

In addition to our nuclear power plants, we owned a 33% stake in NERSA, an electricity generation company that operated a nuclear power plant located in France. French and German utilities owned the balance of NERSA. In July 1998 we sold our stake in NERSA. We, however, retained ownership and responsibility for the decommissioning of our share of the nuclear fuel in the plant.

Following a national referendum in 1987 in which the Italian electorate expressed its opposition to the use of nuclear power, the Italian government ordered the interruption of power production from nuclear fuels and we ceased operations at our four nuclear plants in Italy.

Pursuant to the Bersani Decree, we have transferred our discontinued nuclear operations to SOGIN, a wholly owned subsidiary. The principal activity of SOGIN will be the decommissioning of the nuclear plants, including disposal of nuclear fuel and nuclear waste. The plan for decommissioning of each plant is divided in three phases:

- The first phase includes defuelling of the plant's reactor and the off-site shipment of irradiated fresh fuel, treatment and conditioning of operational waste and confinement and containment of the residual radioactivity in specific buildings within the plant.
- The second phase, known as "passive safe storage", involves only surveillance of the plant while the residual radioactivity undergoes natural decay.
- The third phase involves final dismantlement of the plant and abandonment of the site.

The defuelling of the plants' reactors has been completed. According to a plan we had developed before the Bersani Decree was enacted, we expect that all four of the nuclear plants transferred to SOGIN will enter into the second phase by the year 2010 and that the third phase will be completed by 2050.

The Bersani Decree provides that we will transfer to the Treasury Ministry all the shares of SOGIN at no cost. It is expected that this transfer will occur in the second half of 2000.

Nuclear liability

Italy is a party to the 1960 Paris Convention on Third Party Liability in the Field of Nuclear Energy and the 1963 Brussels Supplementary Convention (1963). Italian law in implementing the conventions imposes strict liability for claims relating to nuclear plants and the transportation and storage of nuclear matter. Strict liability under Italian law means that someone does not need to be negligent in order to be found liable. The law imposes strict liability for nuclear accidents only on the entity that is the operator of the plant at the time of the accident. Consequently, we will not be liable for any accident occurring after the transfer to the Treasury Ministry of SOGIN's shares, even if the cause of the accident predated the transfer. However, we will remain liable for any accident that occurred before the transfer, even if the damage, or the accident itself, is discovered after the transfer. The operator of the plant may claim from a third party which has contributed to the cause of the accident the reimbursement of any sums it may have to pay but only if that party has accepted liability contractually or is a physical person who has intentionally caused the damage. Italian law implementing the conventions imposes a maximum period of ten years from the date of the accident in which someone claiming damages must bring claims.

Our direct liability arising from nuclear liability claims is limited to five million International Monetary Fund Special Drawing Rights, or SDRs, per accident. To the extent any claim exceeds five million SDRs, under Italian law, someone claiming damages may sue us for only five million SDRs and must sue the Italian government for the excess liability up to 175 million SDRs. If the claim is in excess of 175 million SDRs, that person must sue the signatories to the conventions, but then only up to 300 million SDRs. However, the Italian government can claim reimbursement from us for any sums it may have to pay because of a nuclear accident arising from negligence on our part. In January 12, 2000, five million SDRs equaled approximately Lit. 13.5 billion.

A provision of the Italian law implementing the conventions states that when damage has been caused concurrently by a nuclear accident and the emission of ionizing radiation, the liability of the person that caused this radiation is not subject to the limitations described above for damages caused by that emission. This provision does not fully conform to the conventions because it does not specify that the ionizing radiation must not independently qualify as a nuclear accident in order to give rise to

unlimited liability. We believe, however, that the correct interpretation of Italian law implementing the conventions is that only radiation not classified as a nuclear accident gives rise to liability outside the limitations described above. We believe all emissions of radiation originating from within nuclear plants would qualify as nuclear accidents. As a consequence, because we hold nuclear material inside our plants, we believe that we could only be liable outside the limitations described above under remote circumstances.

EMPLOYEES

At December 31, 1999, we had 78,511 employees in active service, of whom 743 held managerial positions. The following table shows the breakdown of employees in each of our principal segments (excluding WIND) at December 31, 1999 :

<u>Division</u>	<u>Number of Employees</u>	<u>Percentage of Total Number of Employees</u>
Distribution	47,841	60.9%
Generation	18,710	23.8
Transmission.....	3,250	4.2
Engineering and construction.....	1,585	2.0
Other areas (excluding WIND).....	<u>7,125</u>	<u>9.1</u>
Total Enel Group (excluding WIND).....	<u>78,511</u>	<u>100.0%</u>

The data in the above table and elsewhere in this section “Employees” does not include employees of WIND. WIND had 3,739 employees at December 31, 1999.

We have pursued a policy of work force rationalization, primarily through attrition, which has resulted in a steady reduction in employment levels and increasing efficiency levels over that period. As a result:

- Over the four-year period ended December 31, 1999, the number of our employees declined by 19.8%, from 97,937 employees at December 31, 1995 to 78,511 employees at December 31, 1999;
- The number of customers per employee has risen from 296 in 1995 to 384 in 1999; and
- The volume of electricity sold per employee has increased from 2,198 MWh in 1995 to 3,027 MWh in 1999.

Based on the current retirement system available to our employees, our management estimates that the following number of employees may retire during the periods shown:

	<u>Estimated number of potential retirees</u>
2000	Not less than 3,500
2001	Not less than 3,500
2002	Not less than 3,500
2003	Not less than 2,000

If Italy's current system of governmental retirement benefits changes significantly, we will consider adopting other voluntary measures to reduce employment levels. These measures may involve some increased costs.

The increased use of automated, remote-controlled plants and of advanced information technology and other rationalization measures has improved our ability to conduct operations with fewer employees.

The table below shows our employment levels at the dates indicated:

	At December 31,				
	1995	1996	1997	1998	1999
Employees (other than managers)	96,452	94,050	87,912	84,096	77,768
Managers	<u>1,485</u>	<u>1,414</u>	<u>1,045</u>	<u>842</u>	<u>743</u>
Total.....	<u>97,937</u>	<u>95,464</u>	<u>88,957</u>	<u>84,938</u>	<u>78,511</u>

Most of our non-management employees are members of labor unions. The principal labor unions are the National Federation of Energy Workers, to which 33.5% of our employees belong, the Italian Electrical Companies Federation, to which 28.9% of our employees belong, and the Italian Union of Chemical, Electrical and Manufacturing Workers, to which 10.2% of our employees belong. Other employees are members of smaller labor unions, none of which includes more than 2.0% of our employees.

Typically, we and representatives of the three unions covering the largest number of our employees negotiate a collective bargaining agreement every four years and, once agreed, sign the same agreement. Representatives of the smaller unions typically sign the same agreement at a later date. Under the collective bargaining agreement, wages and other compensation arrangements are negotiated every two years. A new collective bargaining agreement for all electric employees is presently being negotiated. The new collective bargaining agreement will also apply to independent producers and to municipally owned electric utilities.

Under the terms of the collective bargaining agreements currently in effect, employees covered by the agreement enjoy stability of employment and we may terminate their employment only when they reach retirement age or for cause. We expect similar terms to be included in future collective bargaining agreements. We believe that we can achieve the objective of workforce rationalization principally through attrition.

Our relations with the unions are generally satisfactory. We have a policy of working closely with the trade unions representing our employees. Regular consultations are part of this policy. However, decision making with respect to the business remains management's responsibility.

Under the terms of the collective bargaining agreement currently in effect, our employees have the right under Italian law to strike, although the unions have guaranteed that a minimum level of service will be provided in the event of a strike in each of the generation, transmission and distribution areas. We have entered into an agreement with our principal labor unions which regulates the exercise of our employees' right to strike. As a consequence, strikes or other work stoppages have not significantly affected our operations in recent years.

Employee compensation in the past has been almost exclusively based on the seniority and the position held by each employee. In 1999, we introduced compensation based on performance for our senior and junior management (with certain correction mechanisms to ensure that compensation does not

significantly depart from market levels). We expect that this compensation method will be applied to between 35% and 40% of our management in 2000. For top managers, the variable component of compensation accounts for 20% of total compensation. Salary incentives based on sales have also been introduced for account managers of certain companies of our group.

Employee benefits

We sponsor retirement plans that pay pension benefits as required by Italian law and collective bargaining agreements. The costs related with these plans are expensed as the benefits vest. In addition, our employees are eligible, upon termination, for severance pay under Italian law. We accrue a reserve for these employee termination liabilities, net of applicable advances, over the employees' service periods.

Until the end of 1999, most of our employees were enrolled in the Electricity Fund managed by INPS, the Italian National Pension System. In 1999, the Italian Parliament enacted a law that required the government to terminate industry specific retirement funds, such as the Electricity Fund, and to merge them into the retirement fund in which Italian workers generally are enrolled. The Electricity Fund was terminated on January 1, 2000 and covered workers have been enrolled in the general pension fund for Italian employees. We are required to pay substantially all of the Lit. 1,500 billion that electricity companies will have to pay in each of 2000, 2001 and 2002 to eliminate the deficit in the Electricity Fund. However, our payments to INPS for family benefit programs are reduced, as of January 1, 2000, by 3.72%. We estimate that this would correspond to a reduction in these payments of approximately Lit. 165 billion per year, or a net payment of Lit. 1,335 billion per year. For Italian GAAP purposes, we have the option to expense the amounts paid in the years 2000-2002 either as paid over the three-year period or proportionately over the twenty-year period between 2000 and 2019 and have chosen the twenty-year option. However, for U.S. GAAP purposes, we will be required to expense these amounts in 2000-2002, during the year that the contribution are actually paid. The difference between the treatment of these payments under Italian GAAP and U.S. GAAP will therefore have a significant negative effect on our U.S. GAAP results in each of those three years. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations" and "—U.S. GAAP Reconciliation" in Item 9.

In addition, we make contributions to certain employee associations that provide medical and other employee benefits to both current and retired employees. Italian law provides a fund, known as the *cassa integrazione guadagni*, or wage supplementation fund, which guarantees part of the wages of workers in the industrial sector who are temporarily laid off or who are working reduced hours. As an entity more than 50% owned by the Italian government, under current law we are exempt from the requirement to contribute to the wage supplementation fund. We do not currently pay these or other unemployment contributions. WIND, however, is subject to the contribution requirement.

RISK FACTORS

Investing in our ordinary shares or American Depositary Shares involves certain risks. You should carefully consider each of the following risks and all of the information included herein.

Recent regulatory changes may have a significant adverse effect on our business and profitability

The laws, regulations and policies of the European Union and the Italian government significantly affect our revenue and profits and the way we conduct our business. The regulatory framework for the Italian electricity market changed significantly in 1999 and the first half of 2000 because of the implementation of the Bersani Decree, which was designed to liberalize and create more competition in

the Italian electricity market. The restructuring and other changes in our business that the new regulatory framework requires, together with increased competition in the generation business and electricity supply, may have a material adverse effect on our results of operations and financial condition. You should read “—Regulatory Matters—Electricity Regulation” for a detailed discussion of these regulatory changes.

To comply with the Bersani Decree, we have:

- Prepared a plan that was approved by the Italian government in August 1999 to sell 15,057 MW of our net installed capacity, which is equivalent to approximately 16,000 MW of gross installed capacity by January 1, 2003, through the sale of three newly formed generating company subsidiaries;
- Reorganized our generation, transmission and distribution operations into separate companies;
- Restructured our transmission business to transfer the management of the transmission network to the *Gestore della Rete*, a system operator owned by the Italian government; and
- Created a separate company for the sale of electricity to the free market.

The Bersani Decree will also require consolidation of distribution operations in municipalities and other changes that will affect our business. Because the Bersani Decree is still in the process of being implemented, we cannot predict its full effect on our business and the Italian electricity market.

Future changes in European Union or Italian government policy may also influence regulation and affect our business in ways that we cannot predict. The profitability of most of our activities depends on the level of electricity tariffs, which, under current law, are determined by an independent government regulator. The future level of electricity tariffs, which is not under our control and which we cannot predict, may change in ways that would materially adversely affect our future profitability.

A new tariff regime took effect on January 1, 2000 that will significantly reduce our tariff revenues and may materially adversely affect our results of operations

The Italian regulatory authorities implemented a new tariff regime that took effect on January 1, 2000. The new tariff regime has resulted in, and will continue to result in, significant reductions in our tariff revenues. Lower fixed tariff rates apply in 2000 for generation, transmission and distribution. For the period 2001-2003, a price cap will apply to fixed tariffs for transmission and distribution. Generation prices may fall in 2001 with the introduction of the pool market and competitive bidding. Based on our tariff revenues for 1999 and assuming comparable levels of electricity consumption in 2000, we expect that the new tariffs will result in an aggregate decrease of approximately 10% to 11% in our total tariff revenues, not including fuel cost reimbursements, in 2000 as compared to 1999. The revenue reduction will be mitigated by the bonus for the electricity produced and devoted to Non-eligible Customers and the positive impact of the gradual implementation of the new tariff structure. At the time the Bersani Decree was enacted in 1999, the Energy Authority estimated that our tariff revenues in 2003, including fuel cost reimbursements, would be 17% lower than our then-expected tariff revenues for 1999, assuming that the cost of fuels remains unchanged. Our actual tariff revenues for 1999 were in line with the estimates used by the Energy Authority in this analysis. However, all of these figures are estimates only and may change if regulatory tariff policies change or as a result of changes in electricity consumption or other factors (including fuel costs).

If we are unable to increase electricity sales or reduce operating and other costs to offset the impact of the new tariff regime, the new tariffs may have a material adverse effect on results of operations and financial condition. You should read “—Regulatory Matters—Electricity Regulation—The new regulatory regime—The new tariff structure” for a more detailed description of the new tariffs.

Our generating capacity in Italy will decrease due to regulatory constraints; our operating profits may decrease as a consequence

The Bersani Decree provides that after January 1, 2003 no single company or group may generate and import in aggregate more than 50% of the total amount of electricity generated and imported in Italy. In 1999, we:

- Generated 61% of the total electricity generated and imported in Italy; and
- Generated and imported approximately 75% of the total electricity generated and imported in Italy.

The decree requires us to dispose of not less than 15,000 MW of our generating capacity by January 1, 2003 in order to reduce our market share. In August 1999, the Government approved our plan to dispose of plants representing 15,057 MW of net installed capacity, equivalent to approximately 16,000 MW of gross installed capacity, through the sale of three generating company subsidiaries to comply with this requirement. Following completion of our disposal plan, we expect that we will generate approximately 40% of the total amount of electricity generated and imported in Italy in 2003. Our operating profits will decline unless we are able to offset the decrease in volumes of our generation business through improved efficiency, diversification of our operations or international expansion.

The disposal of our new generating company subsidiaries must be completed within a set time frame and, as a consequence, it may occur at unfavorable terms

The Bersani Decree says that our disposal of the three new generating company subsidiaries should occur at market prices. Our sale of those companies, however, must be completed by January 1, 2003. The Minister of Industry has publicly noted the importance of completing the sale as soon as possible, preferably by the first half of 2001. The existence of time constraints may adversely affect our negotiating position with potential purchasers. We may have to sell the generating companies at prices and terms unsatisfactory to us and that are not comparable to what we would obtain in the absence of these constraints.

The Bersani Decree may require us to sell a portion of our distribution networks and our operating profits may decrease as a consequence

In a number of municipalities, both we and a utility owned in whole or in part by the local municipality currently distribute electricity. Under the Bersani Decree, we may have to sell our distribution network in these municipalities. The Bersani Decree requires that only one license be granted for each municipality. We have received requests for the sale of our distribution networks from substantially all of the qualifying distribution companies, including those active in Rome, Milan and Turin.

Under the Bersani Decree, if we do not agree on a purchase price with a municipally owned distribution company by September 2000, an arbitration panel will determine the sale price of any network assets we are required to transfer. The price that we receive in any such sale may not reflect

what we believe is the actual value of our distribution assets or may be below the price that we could obtain in a negotiated sale.

Several of the co-existing distribution networks are located in major metropolitan areas. Historically, urban areas have been where the distribution business is more profitable and where our highest value customers are concentrated. We cannot predict the actual number of local distribution networks we will have to sell, but sales of these networks may adversely affect the results of our distribution activities. In addition, the loss of customers in those municipalities could reduce our ability to expand into other utility businesses.

The competition we face in the electricity market will increase

For many years we had virtually no competition in electricity generation, transmission and distribution markets in Italy. The increase in competition under the new electricity market structure called for by the Bersani Decree may materially adversely affect our results of operations and financial condition. In particular, electricity prices in competitive markets may be lower than existing tariffs and our results of operations may be adversely affected as a consequence.

We currently face limited competition from independent power producers and municipal utilities in generation. We also face competition from suppliers and wholesalers for sales to customers that are intensive users of electricity and may freely purchase electricity from different producers. Competition will increase as the industry is liberalized. In particular, competition in the generation of electricity will increase after we dispose of the three new generating companies. In addition, although we do not expect that the amount of imported electricity will increase because of capacity constraints on transmission interconnections with other countries, the ability of other suppliers to purchase imported electricity, which is generally less expensive, and resell that electricity in the Italian market will tend to reduce electricity prices. For a more complete description of the new regulation of the industry and the way it will affect the market, you should read “—Regulatory Matters—Electricity Regulation”.

We are diversifying our business in part through acquisitions and, as a consequence, we face the risks and uncertainties typical of acquisitions

We are investing in businesses outside of our core electricity business, including telecommunications, communications services, gas and water distribution and Internet and e-commerce services. In entering those businesses we will face commercial and other risks, as well as regulatory regimes relating to the acquired businesses, that are different from the ones we faced in the past.

We are continually evaluating potential acquisitions and other investments to implement further our diversification strategy. See “Strategy” and “The Enel Group—Possible Acquisitions”. As part of that process, we are completing the acquisition of Acquedotto Pugliese, a major provider of integrated water distribution services in Italy. By acquiring Acquedotto Pugliese, we would increase our exposure to the regulation of water distribution business in Italy. Water distribution is in the process of being liberalized, and is expected to experience increasing levels of competition. In March 2000, we acquired Colombo Gas Group, a secondary distributor of natural gas in the Italian regions of Piedmont, Lombardy and Emilia. Our entry into the gas sector, which is also being liberalized, poses similar challenges, including increased competition. Furthermore, because we have not been involved in the water or gas distribution business, we may not be able to achieve the same level of profitability in these new activities as in our existing businesses.

We have also made investments in the new technologies and telecommunications sectors and are considering additional investments in these and other sectors. Our ability to continue to diversify through

acquisitions will depend upon our ability to consummate acquisitions on terms acceptable to us and to our shareholders. We face challenges in integrating any acquisitions into our businesses and will need to invest significant capital and resources in the acquired businesses. Because of the uncertainty associated with acquisitions, our new ventures may not achieve a profitability similar to our electricity business. In addition, because we may incur additional debt to finance new acquisitions, our financial expense may increase as we pay interest on that debt.

We are required to make substantial cash payments to the Italian national pension system in the years 2000-2002

The Italian state budget for 2000 provided for the termination of the electricity pension fund and enrollment of electricity workers in the general pension fund for Italian employees. We are required to pay substantially all of the Lit. 1,500 billion that electricity companies have to pay in connection with the termination of the fund each year in the three year period 2000-2002; however, our payments to the national pension system for family benefits program has been reduced as of January 1, 2000 by 3.72%, or approximately Lit. 165 billion per year. Under Italian GAAP, we have the option to expense the payments in the years 2000-2002 either over the three-year period they are actually paid or proportionately over the twenty-year period 2000-2019, and have chosen the twenty-year option. However, for U.S. GAAP purposes, we will be required to expense these amounts in 2000-2002, during the year that the contributions are actually paid. The difference between the treatment of these payments under Italian GAAP and U.S. GAAP will therefore have a significant negative effect on our U.S. GAAP results in each of those three years. You should read “—Employees—Employee benefits”, “Management’s Discussion and Analysis of Financial Condition and Results of Operations—US GAAP Reconciliation” in Item 9 and our Consolidated Financial Statements contained in this Annual Report for a more detailed description of the reform of the electricity pension fund.

WIND, the telecommunications company in which we hold a 51% interest, faces challenges that may limit its ability to expand its business

Strong and increasing competition

The Italian fixed and mobile telecommunications markets are rapidly growing and highly competitive. Blu S.p.A.’s entry into the market during 1999 has increased competition. In addition, competition is likely to further intensify after the telecommunications regulator issues licenses for third generation mobile communications services, or UMTS, which will have the speed and capacity to support multimedia transmission. We expect these licenses to be issued and services to begin to be provided by 2002. The intense competition in the telecommunications market may result in price reductions that affect WIND’s revenues and its profitability.

Dispute among its three shareholders

Although we own a 51% interest in WIND, the WIND shareholders’ agreement and its by-laws require unanimous agreement at shareholders’ meetings as to the major business decisions taken at the meeting. In addition, most significant decisions by the board of directors of WIND must be taken by a number of directors greater than the number of our representatives on the board. We, France Telecom and WIND have initiated arbitration proceedings against Deutsche Telekom under non-competition and other provisions in the shareholders’ agreement based on Deutsche Telekom’s agreement to enter into a business combination with Telecom Italia, WIND’s principal competitor. We are seeking to compel the sale of Deutsche Telekom’s interest in WIND to us and approximately Lit. 1,700 billion in damages. The shareholders’ dispute could in the future materially disrupt or threaten to materially disrupt business or strategic decisions requiring shareholder approval. You should read “The Enel Group—Other

businesses—Telecommunications—WIND—Arbitral proceeding” for a more complete discussion of the proceedings between us and Deutsche Telekom.

If the Government reduces early retirement pensions, it will be more expensive for us to continue our plan of voluntary workforce reduction

Our ability to improve labor productivity and reduce the aggregate number of our employees may be affected by changes in Government regulation. We have from 1996 to today reduced our headcount substantially, primarily by providing incentives for early retirement and through attrition. The Italian Government has announced plans to implement a significant reform of the national pension system in 2001. This reform may reduce the availability of early retirement pension benefits. If this occurs, it may be more expensive for us to continue our plan of voluntary headcount reduction.

The Treasury Ministry is our majority shareholder and will control important actions of our company

The Treasury Ministry holds approximately 68% of our outstanding share capital and therefore controls us.

So long as the Treasury Ministry holds a majority of our ordinary shares, it will have the right to:

- Control a number of important actions that we take, including the power to block capital increases and other amendments to our by-laws;
- Elect the chairman of the board of directors and all but one-fifth of the other directors; and
- Appoint a member and an alternate member to our board of statutory auditors.

The Treasury Ministry may sell additional portions of its shareholding in Enel at any time and has announced that it is considering a sale of a portion of its holdings before the end of 2000. The Treasury Ministry has not, however, indicated whether it is considering reducing its holdings to less than 50% at that time.

The special powers of the Italian government may limit our shareholders’ ability to benefit from a premium in connection with a change of control transaction

The Italian privatization law and our by-laws confer upon the Italian government, acting through the Treasury Ministry (which will act after consultations with and in agreement with the Industry Ministry), certain special powers with respect to our business and actions by our shareholders. These powers will permit the government to influence our business regardless of the level of its shareholding. The Government may review the scope and duration of the Treasury Ministry’s special powers in five years.

The Treasury Ministry appoints one member of our board of directors and the chairman of our board of statutory auditors in addition to the members elected by the Treasury Ministry in its capacity as a shareholder. In addition, the Treasury Ministry has veto power over:

- Whether any investor acquiring 3% or more of our share capital has the right to vote at our shareholders’ meetings. Where the Treasury Ministry has exercised this veto power, these investors must sell their shareholding in us within one year;

- Whether shares that are subject to shareholders' agreements covering 5% or more of our share capital may be voted at our shareholders' meetings; and
- Major corporate actions such as a merger or a demerger.

As a result, independent of the Treasury Ministry's interest in our share capital, we may not enter into change of control transactions without the approval of the Treasury Ministry, in agreement with the Industry Ministry. This may limit our shareholders' ability to benefit from a premium in connection with a change of control transaction other than a change in control effected by means of a tender offer. You should read "Exchange Controls and Other Limitations Affecting Security Holders" in Item 6 for a more complete discussion of the special powers of the Italian government.

Our core electricity business and other businesses are subject to numerous environmental regulations that could significantly affect our results of operations and financial condition

Our core electricity business and other businesses, such as electricity engineering and construction, telecommunications and water distribution, are subject to extensive environmental regulation under Italian law, including laws adopted to implement European Union regulations and directives and international agreements on the environment. Environmental regulations affecting our business primarily relate to air emissions, water pollution, waste disposal and electromagnetic fields. The principal air emissions deriving from fossil-fueled electricity generation are sulfur dioxide (SO₂), nitrogen oxides (NO_x), carbon dioxide (CO₂) and particulate matters such as dust and ash. A primary focus of environmental regulation applicable to our business is to reduce these emissions.

We incur significant costs to comply with environmental regulations requiring us to implement preventive or remediation measures, although in some cases we may benefit from a reimbursement mechanism provided by law. In addition, expressions of public concern about environmental problems may result in even more stringent regulation in the future. Environmental regulatory measures:

- May take such forms as emission limits, taxes or required remediation measures; and
- May influence our policies in ways that affect our business decisions and strategy, such as by discouraging our use of certain fuels.

We spent a total of Lit. 2,700 billion (including environmental taxes) in 1999 on measures to minimize the impact of our operations on the environment, including measures to comply with applicable law. Major expenditures include capital expenditures to limit SO₂ and NO_x emissions in generation and to install underground cables in our distribution network. In addition, we also incurred Lit. 900 billion in 1999 in additional fuel costs to comply with environmental regulations.

We have not incurred significant environmental penalties in recent years. Our liability in connection with the carbon tax, a tax on fuel consumption which also applies to electricity generation and was introduced in January 1999, amounted to approximately Lit. 70 billion. Our liability in connection with a tax on total SO₂ and NO_x emissions from thermal plants with a nominal capacity of greater than 50 MW in 1999 amounted to be approximately Lit. 70 billion. In 1998, this liability was Lit. 85 billion.

We are parties to a significant number of legal proceedings relating to environmental matters. The aggregate amounts of damages that we may be required to pay and the aggregate costs of remediation or preventive measures may be significant.

You should read “—Regulatory Matters—Environmental matters—Electromagnetic fields” and “Legal Proceedings” in Item 3 for a more complete discussion of environmental matters.

We may become subject to stricter legislation on electromagnetic fields in the future; we may not be fully reimbursed for the costs that may be imposed on us as a consequence

The growing debate in Italy on the alleged potential long-term health effects of exposure to electromagnetic fields has given rise to proposals for stricter legislation. Low frequency infrastructure, such as electricity transmission and distribution lines and substations, and high-frequency infrastructure, such as the transmission stations that WIND uses to provide mobile telephone services, create electromagnetic fields that extend some distance from this infrastructure. Existing regulation in Italy limits the permissible amount of electromagnetic emissions and establishes minimum distances for the placement of wires and distribution substations from residential buildings, office buildings and similar areas. The Veneto, Liguria and Abruzzo Regional Authorities have set stricter requirements in their areas of jurisdiction. For a more detailed account of this environmental issue and the status of legislative proposals you should read “—Regulatory Matters—Environmental matters—Electromagnetic fields”. The Italian government, the Italian Parliament, Italian regional authorities or the European Union may adopt stricter laws and regulations that would require us to upgrade, move or make other changes to some of our existing electricity lines and transmission and distribution facilities as well as our telephony infrastructure, which would involve significant costs. These stricter laws and regulations could also limit WIND’s ability to expand the radio coverage for its operations. Although we expect that, with respect to electricity transmission and distribution lines and substations, we would be reimbursed by way of a system charge in the tariff or otherwise for any additional costs imposed by the new national legislation, actual reimbursements may be lower than our actual cost. Our results may be adversely affected as a consequence.

The value of the ordinary shares or ADSs you purchase may be adversely affected by sales of substantial amounts of ordinary shares by the Treasury Ministry or the perception that such sales could occur

The Treasury Ministry may sell additional portions of its shareholding in Enel at any time and has announced that it is considering a sale of a portion of its holdings before the end of 2000. There are no minimum ownership or similar requirements under Italian law that would limit sales of additional shares by the Treasury Ministry. Sales of substantial amounts of our ordinary shares in the public market by the Treasury Ministry, or the perception that such sales could occur, could adversely affect the market price of the ordinary shares and ADSs and could adversely affect our ability to raise capital through offerings of equity.

The dollar value of dividends we pay in respect of our ordinary shares and ADSs will be affected by the euro/dollar exchange rate

We pay cash dividends in lire and will start paying cash dividends in euro in 2002; as a result, exchange rate movements may affect the U.S. dollar amounts that investors receive from the depositary if they hold ADSs. The price of our shares are quoted in euro. Exchange rate movements may also affect the U.S. dollar price of the ADSs and the U.S. dollar equivalent of our ordinary share price.

If you hold ADSs rather than ordinary shares it may be difficult for you to exercise some of the rights of a shareholder

It may be more difficult for you to exercise the rights of a shareholder if you hold ADSs than it would be if you directly held ordinary shares. For example, if we offer new shares and you have the right

to subscribe for a portion of them, the depositary is allowed, in its own discretion, to sell for your benefit that right to subscribe for new shares instead of making it available to you. Also, in some cases you may not be able to vote by giving instructions to the depositary on how to vote for you.

Item 2. *Description of Property*

The Enel Group has freehold and leasehold interests in thousands of real estate parcels and facilities throughout Italy, though no one individual property is material to the Group as a whole. See Item 1 “Description of Business” for information on the Group’s principal facilities and real estate holdings.

Item 3. *Legal Proceedings*

We are defendants in a number of legal proceedings incidental to the generation, transmission and distribution of electricity. Because of the nature of these proceedings, we are not able to predict the ultimate outcomes of these proceedings, some of which may be unfavorable to us. However, we do not expect the outcome of these proceedings, either individually or in the aggregate, to have a material adverse effect on our financial position or results of operations.

Our pending legal proceedings include various civil and environmental claims and disputes relating to the construction and operation of several power stations, transmission and distribution lines, and other matters that arise in the normal course of our business. We have established a reserve for litigation and contingent liabilities where we consider it probable that a claim will be resolved unfavorably and where we can reasonably estimate the potential loss involved. This reserve, which also included provisions for other contingencies and uncertainties, is included in other non-current liabilities in the consolidated balance sheets in our Consolidated Financial Statements, and amounted to Lit. 2,187 billion at December 31, 1998 and Lit. 2,588 billion at December 31, 1999.

We have briefly summarized below the most significant proceedings. For a general discussion of legal proceedings, you should read note 21 to our Consolidated Financial Statements.

We are currently defendants in numerous pending proceedings relating to the electromagnetic fields created by our transmission and distribution lines and in one proceeding relating to electromagnetic energy emanating from substations. In most of the proceedings, the plaintiffs seek the relocation or removal of lines or substations that are near to inhabited or occupied residential or office buildings. In a limited number of proceedings, the plaintiffs also seek damages based on our alleged non-compliance with regulations setting maximum exposure levels or minimum distance requirements for lines and substations or on the alleged health effects of exposure to electromagnetic fields.

Alleged damage as a result of exposure to electromagnetic fields has also been the subject of certain criminal proceedings in which we are involved. In June 1999, the criminal court of Rimini fined us symbolic damages of Lit. 2 million in one proceeding and transferred the case to the civil court for the quantification of the physical damage to the individual plaintiff. We have appealed the decision. In December 1999, we became aware of the fact that the public prosecutor of Venice had initiated criminal investigations against two of our employees and the Chief Executive Officer of the *Gestore della Rete* based on an alleged connection between certain instances of diseases (some of which were fatal) that had occurred in the Veneto region and the electromagnetic fields created by our transmission and distribution lines. The court supervising the investigation has rejected the public prosecutor’s request to appoint an expert to evaluate the alleged causal connection between electromagnetic fields and the cases identified on a number of grounds, including the vagueness of the charges and allegations of such a casual connection.

As a result of the increasing level of expression of public concern in Italy about the potential effects of electromagnetic fields, the number of proceedings against us could increase and the outcome of these proceedings could differ from the historical pattern, which has generally been favorable to us.

We believe that certain of these proceedings could become moot if the Italian Parliament passes a bill currently under consideration that would replace existing legislation on electromagnetic fields and introduce measures for the restructuring of the Italian electricity grid. In any event, if the outcome of the above civil cases is unfavorable to us, our potential liability would be limited mainly to damages, to the extent plaintiffs satisfied their burden of proof by showing the causal connection between electromagnetic fields and the alleged damage. You should read “—Risk Factors” and “—Regulatory Matters—Environmental matters—Electromagnetic Fields” in Item 1 for a more detailed discussion of electromagnetic fields.

In 1997, following a claim brought by an Italian consumers association, the public prosecutor of Rome commenced criminal proceedings against some of the current and former members of our board of directors and board of statutory auditors on the basis of an allegation that they had approved false financial statements. In doing so, the public prosecutor appointed and relied on the opinion of an independent expert who has alleged that:

- We set up a fund for charges that we incurred in connection with our interest in NERSA, a French company operating in the nuclear power generation business, instead of reflecting these charges as operating costs in our consolidated income statements; and
- Therefore, we distributed to our sole shareholder income which had not accrued.

We are contesting these allegations on the grounds that we complied with applicable Italian law and accounting principles in the transaction at issue. In particular, we complied with special Italian legislation on State-owned enterprises that required us to obtain:

- Experts’ reports on our accounting treatment of the relevant transaction; and
- The Treasury Ministry’s approval of that transaction.

A new public prosecutor who is now conducting this criminal investigation has asked the court supervising the investigation to order a reassessment of the conclusions reached by the expert.

Since 1997, several suppliers of equipment to our distribution division have brought civil actions against us claiming that we abused our market power in the Italian electricity distribution sector by imposing contractual terms and conditions on them. The plaintiffs have sought increases in the compensation paid to them under supply contracts with us. The aggregate value of these claims is approximately Lit. 390 billion. We are contesting the suppliers’ claims. The first three decisions rendered on these cases upheld our contention that civil courts lack jurisdiction to hear these cases. In 1995, the Italian Antitrust Authority, prompted by similar claims filed by the same suppliers, issued an opinion in which it held that our conduct did not constitute an abuse of market power.

Beginning in 1998, we have brought several claims as a precautionary measure before the Administrative Court of Bolzano against certain local authorities of the province of Bolzano, in which we have sought the annulment of preliminary administrative measures requiring us to transfer a portion of our distribution assets located in the province to local municipal utilities. These measures were taken under a governmental decree concerning the businesses of electricity generation and distribution in the provinces of Trento and Bolzano. Our challenges were rejected by the court on the basis that the

challenged measures are of a preliminary nature, do not actually order a transfer of the assets and, as such, do not cause us any actual damage. We may still appeal this decision and we intend to challenge any subsequent administrative measures ordering a transfer of assets. In addition, we have commenced negotiations with the Provincial Authorities of Trento and Bolzano with regard to consolidation of assets in those provinces. These negotiations could result in the settlement of the current proceedings and the avoidance of future administrative measures ordering us to transfer our distribution assets. However, if administrative measures ordering the transfer of assets are adopted, our challenges of those measures are rejected definitively and negotiations fail, we could be required to transfer part of our distribution assets in the province of Bolzano. This transfer could have an adverse effect on our financial results and condition.

In April 2000, the Regional Authority of Puglia challenged before the Administrative Court of Lazio the decree of the President of the Italian Council of Ministers which identified our company as the prospective purchaser of Acquedotto Pugliese. The Regional Authority claims that the Government had no power to rule on the matter, as matters relating to regional water resources fall within the jurisdiction of regional authorities, and that the procedure resulting in our selection violated Italian law, since the Regional Authority of Puglia had not been consulted on the matter. The Regional Authority of Puglia has also challenged the decree on the grounds that the Government violated EU rules on state aids and the protection of competition, and, alternatively, asked the Administrative Court to submit its claim to the European Court of Justice. Finally, the Regional Authority of Puglia has brought two proceedings before the Italian Constitutional Court over the Government decree providing for the transformation of Acquedotto Pugliese into a joint stock company, claiming that this matter falls within the jurisdiction of regional authorities. The Italian government is a party to all these proceedings and is actively contesting the claims. We believe that the Regional Authority's claims are essentially without merit. No assurance can be given, however, as to the outcome of these proceedings or the ultimate effects of the claims on our acquisition of Acquedotto Pugliese.

Item 4. *Control of Registrant*

Prior to our initial public offering in November 1999, the Treasury Ministry had been our sole shareholder since we became a joint stock company in July 1992. Before that date, we were a public statutory body owned by the Italian government. The offering of a total of 3,848,802,000 ordinary shares (in the form of ordinary shares and American Depositary Shares ("ADSs")(each representing ten ordinary shares)) was the second largest in history and generated gross proceeds of approximately €16.55 billion (Lit. 32,045 billion). Following the offering and as of June 1, 2000, the Treasury Ministry owned 8,277,348,379 of our ordinary shares, or 68.26% of the total number of outstanding ordinary shares. As of June 1, 2000, no other entity or individual held 2% or more of our outstanding ordinary shares.

The following table sets forth the number of our ordinary shares held by each of our directors and statutory auditors as of December 31, 1999:

<u>Name of Director and Statutory Auditors</u>	<u>Number of ordinary shares held as of December 31, 1999</u>
Francesco Tatò	1,500
Vittorio Grilli.....	500
Franco Morganti.....	1,500
Claudio Poggi.....	5,000
Bruno DeLeo.....	1,000
Gustavo Minervini.....	500
Oreste Piemontese.....	1,000
All other directors	0
Total:.....	11,000

We do not have access to current information on the number of our shares held by the individual executive officers identified in Item 10, as such information is not required to be disclosed under Italian law. However, we estimate that the percentage of our share capital represented by the aggregate number of our shares held by such individuals as a group does not exceed 0.001%. Under Italian law, entities or individuals controlling more than 2% of the stock capital of an Italian company whose shares are traded in a regulated market of a EU member state must report such shareholding to CONSOB (the Italian Securities Commission). None of the individual directors, executive officers or statutory auditors identified in Item 10 has filed such a report with CONSOB.

In connection with the Italian retail portion of our initial public offering, the Treasury undertook to provide additional “bonus” ordinary shares to Italian retail purchasers in the initial offering who held their ordinary shares for at least one year. As a result, on November 5, 2000, Enel employees who acquired ordinary shares in the initial Italian retail offering will receive eleven additional shares for every 200 shares that they have held since the offering. Similarly, purchasers in the Italian retail offering who are not Enel employees, but who have held their ordinary shares for the required period of one year, will receive ten additional shares for every 200 shares so held. We estimate that the maximum number of additional ordinary shares that will be provided by the Treasury in connection with this “bonus” is 122,158,580. If this maximum number of “bonus shares” are in fact disposed of by the Treasury (and assuming that no other dispositions of shares by the Treasury have occurred), it would reduce the number of our ordinary shares the Treasury holds to 8,155,189,799, or 67.25% of the total number outstanding.

The Treasury Ministry is a ministry of the Italian government. One of its responsibilities is to coordinate the privatization of the Italian public sector economy. In recent years, the Treasury Ministry has carried out major divestitures of the Italian government’s holdings in, among others, IMI S.p.A., INA S.p.A., ENI S.p.A., Telecom Italia S.p.A. and Banca Nazionale del Lavoro S.p.A.

The Treasury Ministry may sell additional portions of its shareholding in Enel at any time and has announced that it is considering a sale of a portion of its holdings before the end of 2000. The Treasury Ministry has not, however, indicated whether it is considering reducing its holdings to less than 50% at that time. There are no minimum ownership or similar requirements under Italian law that would limit sales of additional shares by the Treasury Ministry. Additional sales of our ordinary shares may have a material adverse effect on the price of the ordinary shares and ADSs.

Within the context of the privatization procedures and regulations under Italian law, the Treasury Ministry may as a significant shareholder ask our board of directors to examine the possibility of

dispositions, in whole or in part, of some entities we control. Our Board would implement any such transaction solely to enhance value for all shareholders.

The Treasury Ministry has indicated that it intends to continue to participate in the nomination and election of our Board to protect its investment as a shareholder. Under the 1994 privatization law and a 1999 decree of the President of the Council of Ministers, the Treasury Ministry has special powers, regardless of the level of its shareholding in us, related to:

- The acquisition of our shares by third parties;
- Shareholders' agreements;
- Major corporate changes; and
- Appointment of one director and the chairman of our board of statutory auditors.

In addition, the privatization law provides that our by-laws may include:

- Special rules concerning appointments of directors in order to ensure that minority shareholders are represented; and
- Limitations on the maximum number of shares that a shareholder, or group of shareholders, other than the Treasury Ministry, may hold.

Our by-laws, as well as the special powers the Treasury Ministry retains, are described in more detail in Item 6 "Exchange Controls and Other Limitations Affecting Security Holders".

As the entity primarily responsible for electricity generation, transmission and distribution in Italy, we provide service to many other State-owned entities. In the vast majority of situations, the rates charged are comparable to the tariffed rates charged to similar commercial organizations, with the primary exceptions being the State-owned railway company (Ferrovie dello Stato S.p.A.) and Acciai Speciali Terni S.p.A., which are entitled to favorable rates under Italian law. Total revenues from all State-owned companies were approximately 2% of our total revenues for each of the three years in the period ended December 31, 1999. Sales to ENI S.p.A., the Italian oil and gas company whose largest shareholder is the Treasury Ministry (also 63.7% owned by the public as of December 31, 1999), and Ferrovie dello Stato S.p.A. make up the majority of sales to State-owned companies.

We purchase fuel for generation from ENI S.p.A. Total purchases from ENI S.p.A. were approximately 7% of our total operating expenses for each of the three years ended December 31, 1999. Total purchases from State-owned companies were approximately 10% of our total operating expenses for each of the three years in the period ended December 31, 1999. See note 22 to our Consolidated Financial Statements included herein.

Item 5. *Nature of Trading Market*

The principal trading market for Enel's ordinary shares is the Italian Stock Exchange, where they are traded under the symbol "ENEL". American Depositary Shares (each representing 10 ordinary shares) are listed on the New York Stock Exchange, where they are traded under the symbol "EN". Citibank, N.A. is Enel's depository (the "Depository") for purposes of issuing the American Depositary Receipts ("ADRs") evidencing the ADSs. Trading in our ordinary shares on the Italian Stock Exchange and in our ADSs on the New York Stock Exchange commenced on November 2, 1999.

The following table sets forth, for the periods indicated, the reported high and low sales prices of the ADSs on the New York Stock Exchange.

		ADSs	
		High	Low
		(in dollars)	
1999			
	Fourth Quarter (starting Nov. 2)	45.00	41.125
2000			
	First Quarter	46.000	38.625
	Second Quarter (through June 23).....	45.375	41.125

The following table sets forth, for the periods indicated, the reported high and low “official” sales prices for the ordinary shares on the Italian Stock Exchange. Beginning on January 1, 1999, the prices of all publicly-traded stocks in Italy have been quoted in euro. See “— Securities Trading in Italy”.

		Ordinary Shares	
		High	Low
		(in euros)	
1999			
	Fourth Quarter (starting Nov. 2)	4.40	4.09
2000			
	First Quarter	4.71	3.78
	Second Quarter (through June 23).....	4.82	4.36

The ordinary shares are among the constituents of the MIB 30 Index, the primary Italian stock market index and the EuroStoxx 50 Index, a leading pan-European stock index.

As of June 23, 2000, 12,126,150,379 ordinary shares were outstanding. As of the same date, there were outstanding 1,366,900 ordinary ADSs (equivalent to 13,669,000 ordinary shares) held by 46 record holders.

Since certain of the ordinary shares and ADSs were held by brokers or other nominees, the number of direct record holders in the United States may not be fully indicative of the number of direct beneficial owners in the United States or of where the direct beneficial owners of such ordinary shares are resident.

Securities Trading in Italy. Equity securities listed on the Italian Stock Exchange, including Enel’s ordinary shares, are traded on the *Mercato Telematico Azionario* (“Telematico”), the Italian automated screen-based trading system. Trading in Italian equity securities on Telematico was first introduced in November 1991.

Telematico is managed by the *Borsa Italiana S.p.A.* (“Borsa Italiana”) subject to the supervision of the *Commissione Nazionale per le Società e la Borsa* (“CONSOB”). CONSOB is the public authority charged, among other things, with regulating investment firms, securities, markets and public offerings of securities in Italy. Borsa Italiana is a joint stock company (*società per azioni*) that was established to

manage the Italian regulated securities markets (including Telematico) as part of the implementation in Italy of the EU Investment Services Directives. Borsa Italiana became operative in January 1998 and has since issued rules governing the admission to listing and trading on the Italian regulated securities markets. The shareholders of Borsa Italiana are financial intermediaries, primarily banks, which purchased shares in an auction regulated by ministerial decree.

Since February 16, 1996, securities transactions on Telematico have been settled on a cash basis only. Prior to March 28, 2000, cash transactions were settled on the fifth business day following the trading date. Beginning March 28, 2000, cash transactions are settled on the third business day. The Borsa Italiana issues a daily official list with certain information on transactions in each listed security, including the volume traded and the high and low prices of the day. No “closing price” is reported for the electronic trading system, but an “official price” calculated as a weighted average of all trades effected during the trading day (net of trades executed on a “cross-order” basis) and a “reference price” calculated as a weighted average of the last 10% of the trades effected during such day (again, net of “cross-order” trades) are published. Beginning on January 1, 1999, all transactions on the Italian Stock Exchange, including the quoted official and reference prices, have been denominated in euros. The Bank of Italy clearing system assists with the settlement of transactions and the delivery of securities traded.

If the opening price of a security (established each trading day prior to the commencement of trading based on bids received) differs by more than 10% (or such other amount established by Borsa Italiana) from the previous day’s reference price, trading in that security will not be permitted until Borsa Italiana authorizes the re-commencement of trading. If in the course of a trading day the price of a security fluctuates by more than 5% from the last reported sale price (or 10% from the previous day’s reference price), a five-minute automatic suspension in the trading of that security will be declared. In the event of such a suspension, orders already placed may not be modified or cancelled, and new orders may not be processed. Borsa Italiana has the authority to suspend trading in any security in response to extreme price fluctuations or for other reasons. In urgent circumstances, CONSOB may, when necessary, adopt measures required to ensure the transparency of the market, orderly trading and protection of investors.

In order to expedite trading, shares must ordinarily be traded in minimum lots of a prescribed size (or multiples thereof) determined for each security. For Enel, the prescribed minimum lots are currently 500 shares. Lots smaller than the prescribed minimum may be traded on Telematico subject to certain limitations.

Residents of Italy and non-residents through their authorized agents may purchase or sell shares on the Italian Stock Exchange, subject to satisfying (i) in case of sales, either the Margin or the Deposit, and (ii) in case of purchases, the Margin. “Margin” means a deposit equal to 100% of the agreed price, and “Deposit” means a deposit of an equal number of the same shares as those sold.

Effective September 1, 1996, the Italian financial markets are regulated by Legislative Decree No. 415 of July 23, 1996 (the “Eurosime Law”), which, among other things, implemented in Italy two EU Directives relating to financial markets and, in large part, replaced Law No. 1 of January 2, 1991 (the “SIM Law”). The Eurosime Law has modified the system of supervision and regulation applicable to securities trading, by establishing a new regulatory framework for the Italian financial markets. Certain provisions of the Eurosime Law have been amended by Legislative Decree No. 58 of February 24, 1998 (the “Draghi Law”), which entered into effect on July 1, 1998.

Under current legislation, trading of equity securities on the Italian markets is reserved to SIMs, which are subject to regulation and supervision by CONSOB with respect to their trading activities, and by the Bank of Italy with respect to required regulatory capital levels. Investment services (including

securities dealing, underwriting, asset management and receipt and transmission of orders) may be offered to the public by investment services firms including SIMs, authorized banks and certain types of finance companies. Banks and investment firms organized in a member nation of the EU are permitted to operate in Italy under certain circumstances. Non-EU banks and non-EU investment firms may operate in Italy subject to compliance with certain requirements, including the specific authorization of CONSOB and the Bank of Italy.

According to current regulations, securities that are listed on Italian regulated markets must generally be traded on those markets. As an exception to this principle, securities may be traded outside of the Italian regulated markets when (i) the transaction outside of the regulated market provides the customer with a better price (and the customer has granted his prior authorization to execute such a transaction); (ii) the customer does not reside in Italy; (iii) the securities traded consist of Italian State-issued or guaranteed securities; or (iv) the securities are traded in bulk (such bulk trades being proportional to the number of securities of the same type having been publicly traded over the six months prior to the transaction outside the Italian regulated markets).

Recent Activity on the Italian Stock Exchange. The following table sets forth the average daily trading volume on the Italian Stock Exchange for the periods indicated, as well as the Milan Stock Exchange Historical Index (“MIB”) at the end of each indicated period. The MIB is an index based on all shares listed on the Italian Stock Exchange.

	Average Daily Trading Volume		MIB Index at Period End*
	Shares	euros	
	(in millions of shares and millions of euros)		
1995.....	221.7	590.9	9,138
1996.....	241.2	630.1	10,332
1997.....	424.0	1,382.5	16,341
1998.....	637.0	3,317.0	23,035
1999.....	521.7	1,970.3	28,169
2000 (through May 31)	775.0	3,842.6	30,535

*MIB Storico Index, based on value of 1,000 as of January 2, 1975.

Trading by the Company or its subsidiaries in Enel Shares. Under Italian law, we and our subsidiaries may purchase our shares in certain limited circumstances.

Item 6. Exchange Controls and Other Limitations Affecting Security Holders

No exchange control consent is required in Italy for the transfer to persons outside of Italy of dividends or other distributions with respect to, or of the proceeds from the sale of, shares of an Italian company.

The Italian privatization law and our by-laws confer upon the Italian government, acting through the Treasury Ministry, certain special powers with respect to our business and actions by our shareholders. These powers apply regardless of the Treasury Ministry’s shareholding in us. The government may review the scope and duration of the Treasury Ministry’s special powers in five years. In this review, the government will take into account, among other factors, the liberalization level achieved by that time in the European energy sector. The Treasury Ministry exercises these special powers after consultations with, and with the agreement of, the Industry Ministry.

Our by-laws reflect the following special powers of the Treasury Ministry:

Approval of material acquisitions of shares. The Treasury Ministry must approve or disapprove the acquisition of material interests in our share capital. Our by-laws define material interests as interests representing 3% or more of our voting share capital (including ordinary shares held in the form of American Depositary Shares). This limit is based on the limit currently set by the Treasury Ministry under the privatization law. If the Treasury Ministry changes this limit, we will amend our by-laws accordingly. Our board of directors must file a notice with the Treasury Ministry at the time an acquiror of a material interest files a request for registration with the register of shareholders. Approval or disapproval by the Treasury Ministry must be given within 60 days from the date of this notice. Until the approval is granted, or the expiration of the 60-day period without the approval having been granted, the purchaser may not exercise any rights, including voting rights, other than economic rights pertaining to the ordinary shares representing the material interest. In the event the approval is denied by the Treasury Ministry or the 60-day period has expired without the approval having been granted, the purchaser must sell the ordinary shares representing the material interest within one year and may not exercise any rights, including voting rights, other than economic rights pertaining to these ordinary shares. In the event of failure to comply with this requirement, the Treasury Ministry may petition the courts to order the forced sale of the ordinary shares representing the material interest. Each of the holders and beneficial owners of ADSs are subject to the 3% limit.

Approval of material shareholders' agreements. The Treasury Ministry has the authority to approve or disapprove material shareholders' agreements or other arrangements, which are currently defined in our by-laws as shareholders' agreements or other arrangements relating to 5% or more of our voting share capital. However, the Treasury Ministry may lower this limit in the future. The approval or the disapproval must be given within 60 days from the date of the notice to be provided to the Treasury Ministry by CONSOB following the notifications of these material shareholders' agreements or other arrangements to CONSOB. Until the approval is granted, or in any case after the expiration of the 60-day period without the approval having been granted, shareholders that are parties to the agreement or other arrangement may not exercise any rights, including voting rights, other than economic rights pertaining to the ordinary shares subject to the agreement or other arrangement. In the event the approval is denied by the Treasury Ministry or the 60-day period has expired without the approval having been granted, the agreement is deemed ineffective. If the conduct of shareholders during a shareholders' meeting nevertheless supports an inference that the shareholders are acting pursuant to the terms of such a shareholders' agreement or other arrangement, then any resolutions adopted at that meeting that would not have been adopted but for the vote of these shareholders may be challenged.

Members of our Board of Directors and Board of Statutory Auditors. The Treasury Ministry has the power to appoint one member of our board of directors and the chairman of our Board of Statutory Auditors in addition to the members elected by the Treasury Ministry as a shareholder.

Veto power over material changes. The Treasury Ministry may veto resolutions to dissolve us, cause a significant transfer of our business, merge or demerge, transfer our registered office outside of Italy, change our corporate purposes or eliminate or modify any of the Treasury Ministry's special powers.

The special powers of the Treasury Ministry reflected in our by-laws have also been introduced into the by-laws of Enel Produzione, TERNA and Enel Distribuzione.

Limitations on shareholdings. Our by-laws provide that no person, in any capacity, may own ordinary shares representing 3% or more of our voting share capital without the approval of the Italian government. The 3% limit may be cancelled only after a three-year period has expired. This limit does

not apply in the event that it is exceeded as a result of certain types of tender offers as provided under Italian law.

The limitation on shareholding is calculated taking into account, among other things, shares owned by:

- Controlling entities and directly or indirectly controlled entities, as well as entities controlled by the same controlling entity; and
- Affiliated personal entities, including spouses and other closely related personal relatives.

Our by-laws restrict the ability of any entity to exercise any voting rights attributable to ordinary shares held or controlled by that entity representing more than 3% of our voting share capital. This restriction does not apply to any shareholdings held by the Italian state, other public entities, or other entities controlled by the state or other public entities. The voting rights of each entity to whom this limit on shareholding applies are reduced correspondingly. In the event that ordinary shares held or controlled in excess of the 3% threshold are voted, any shareholders' resolution adopted pursuant to this vote may be challenged if the majority required to approve this resolution would not have been reached without the vote of ordinary shares exceeding this threshold. Ordinary shares not entitled to be voted are nevertheless counted for purposes of determining the quorum at a shareholders' meeting.

Minority shareholders' rights. Any shareholder may, within three months, challenge any shareholders' resolution on which he did not vote or in respect of which he dissented on the basis that it was not adopted in conformity with applicable law or our by-laws. Directors and statutory auditors may also challenge shareholders' resolutions on this basis. In case of resolutions approving mergers or split-ups involving the distribution of unlisted shares, dissenting shareholders may require us to buy back their shares for the average price of the previous six months.

Each shareholder may bring to the attention of the board of statutory auditors facts or acts which are deemed wrongful. If the shareholders represent more than 2% of our share capital, the board of statutory auditors must investigate without delay and report its findings and recommendations to the shareholders' meeting.

Shareholders representing more than 5% of our share capital have the right to report major irregularities to the relevant court.

Under Italian law, the by-laws of privatized companies that impose a maximum limit on the number of shares that may be held by any shareholder must provide for the election of directors and statutory auditors through the voting list system provided under the privatization law to ensure that minority shareholders of a company are represented on its board of directors and board of statutory auditors. Accordingly, our by-laws require that members of our board of directors and our board of statutory auditors, except for the director and the statutory auditor appointed by the Italian government pursuant to its special powers, be elected on the basis of candidate lists presented either by the board of directors or by one or more shareholders, including the Treasury Ministry, representing in the aggregate at least 1% of our share capital having the right to vote at ordinary shareholders' meetings. Such candidate lists must be deposited at our registered office and published in at least three Italian newspapers having general circulation in Italy, two of which must be daily business newspapers. Publication of the candidate list presented by the board of directors must occur at least 20 days before the first call of the shareholders' meeting or 10 days in the case of candidate lists proposed by shareholders. Each shareholder may present or join in the presentation of only one candidate list and each candidate may appear on only one list.

Under our by-laws, the election of the members of the board of directors other than the director appointed by the Italian government through the exercise of its special powers, will proceed as follows:

- a) Four-fifths of the members to be elected will be drawn out from the candidate list that receives the majority of votes expressed by the shareholders in the numerical order in which they appear on the list, rounded off in the event of a fractional number to the next lower number; and
- b) The remaining board members will be drawn out from the other candidate lists.

The election of members of the board of statutory auditors is governed by the same rules, except that the board of directors may not present a candidate list for the board of statutory auditors, and that, under Italian law, if our by-laws provide that our board of statutory auditors consists of four or more members, at least two of them must be appointed by minority shareholders. Our current by-laws provide that our board of statutory auditors consists of three auditors, of which minority shareholders have the right to appoint one.

Item 7. *Taxation*

The following is a summary of certain United States federal and Italian tax matters. The summary contains a description of the principal United States federal and Italian tax consequences of the purchase, ownership and disposition of ADSs by a holder who is a citizen or resident of the United States or who otherwise will be subject to United States federal income tax on a net income basis in respect of the ADSs. This summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase ADSs. In particular, the summary deals only with beneficial owners who will hold ordinary shares or ADSs as capital assets and does not address the tax treatment of a beneficial owner who owns 10% or more of the voting shares of Enel and does not discuss the treatment of ADSs that are held in connection with a permanent establishment or fixed base through which a beneficial owner carries on or performs personal services.

The summary is based upon tax laws and practice of the United States and Italy as in effect on the date of this Annual Report. Prospective purchasers and current holders of ordinary shares or ADSs are advised to consult their own tax advisors as to the U.S., Italian or other tax consequences of the purchase, beneficial ownership and disposition of ordinary shares or ADSs, including, in particular, the effect of any state, local or national tax laws.

For purposes of the summary, beneficial owners of ADSs who are considered residents of the United States for purposes of the current income tax convention between the United States and Italy (the “Income Tax Convention”), and are not subject to an anti-treaty shopping provision that applies in limited circumstances, are referred to as “U.S. owners.” Beneficial owners who are citizens or residents of the United States, corporations organized under U.S. law, and U.S. partnerships, estates or trusts (to the extent their income is subject to U.S. tax either directly or in the hands of partners or beneficiaries) generally will be considered to be residents of the United States under the Income Tax Convention. Special rules apply to U.S. owners that are also residents of Italy. A new tax treaty to replace the current Income Tax Convention was signed on August 25, 1999, but has not yet been ratified. The new treaty would not change significantly the provisions of the current Income Tax Convention that are discussed below (except that it would clarify the availability of benefits to certain tax-exempt organizations). These laws are subject to change, possibly on a retroactive basis.

For purposes of Income Tax Convention, the current estate tax convention between the United States and Italy (the “Estate Tax Convention”) and the United States Internal Revenue Code of 1986,

holders of American Depositary Receipts evidencing ADSs will be treated as the beneficial owners of the underlying ordinary shares represented by those ADSs.

Withholding Tax on Dividends. Italian law provides for the withholding of income tax at a 27% rate on dividends paid by Italian companies to shareholders who are not residents of Italy for tax purposes. Accordingly, the amount initially made available to the Depositary for payment to U.S. owners will reflect withholding at the 27% rate.

Under domestic Italian law, a non-resident holder of shares of common stock may recover up to four-ninths of the tax withheld on dividends by presenting evidence to the Italian tax authorities that income tax has been fully paid on the dividends in the non-resident holder's country of residence in an amount at least equal to the total refund claimed. Non-resident holders seeking such payments from the Italian tax authorities have experienced extensive delays and incurred expenses.

However, the 27% withholding tax may be reduced pursuant to an income tax convention between Italy and the non-resident holder's country of residence. Italy has concluded income tax conventions with approximately 60 foreign countries, including all member states of the European Union, Argentina, Australia, Brazil, Canada, Japan, New Zealand, Norway, Switzerland, the United States and some countries in Africa, the Middle East and Asia. Generally, the treaties are not applicable if the non-resident holder is a tax-exempt entity or, with a few exceptions, a partnership.

Under current Italian law, all shares of Italian listed companies (including the ordinary shares) must be held in a centralized clearing system authorized by CONSOB. Under applicable tax provisions, if the ordinary shares are held through the centralized clearing system managed by Monte Titoli S.p.A. ("Monte Titoli") (the only such system currently authorized in Italy), no withholding tax on dividends is applied by the Company. Instead of the withholding tax a substitute tax (*imposta sostitutiva*) is applied on dividend distributions to non-resident holders of ordinary shares (or ADSs relating to such ordinary shares) at a rate equal to the withholding tax that would otherwise be due. The substitute tax is applied by the resident or non-resident intermediary with which the ordinary shares are deposited and which participates in the Monte Titoli system (directly or through a foreign centralized clearing system participating in the Monte Titoli system). The procedures to be followed by a non-resident holder in order for the intermediary with which the ordinary shares are deposited to apply a reduced rate of tax pursuant to an applicable income tax convention are as follows. The intermediary must receive (i) a declaration of the non-resident holder that contains certain data identifying the non-resident holder and indicating the existence of all the conditions necessary for the application of the relevant income tax convention and the determination of the applicable treaty rate of withholding and (ii) a certification by the tax authorities of the non-resident holder's country of residence that the holder is a resident of that country for purposes of the income tax convention and, as far as it is known to such authorities, the holder has no permanent establishment in Italy (which certificate will be effective until March 31 of the year following submission). If the ordinary shares are deposited with a non-resident intermediary, such intermediary must appoint as its fiscal representative in Italy a bank or an investment services company that is resident in Italy, or the permanent establishment in Italy of a non-resident bank or investment services company, to carry out all duties and obligations relating to the application and administration of the substitute tax.

Since the ordinary shares underlying the ADSs will be held by the custodian in the centralized clearing system managed by Monte Titoli, the substitute tax regime described above will apply to the ADSs. In order to enable eligible U.S. holders to obtain a reduction at source or a refund of withholding tax under the Treaty, the Company and the Depositary have agreed to certain procedures. According to such procedures, the Depositary will send holders of the ADSs certain instructions before the dividend payment date specifying the documentation required and the deadlines for submission. The

documentation generally will include the holder's declaration and the tax certification specified under points (i) and (ii) in the preceding paragraph. Eligible U.S. holders must obtain the documentation under point (ii) above from the U.S. Internal Revenue Service (Form 6166) with respect to each dividend payment, unless a previously filed certification will be effective on the dividend payment date and a statement whereby the U.S. holder represents to be a U.S. resident individual or corporation and does not maintain a permanent establishment or a fixed base in Italy. The time for processing requests for certification by the Internal Revenue Service normally is six to eight weeks. Accordingly, holders requiring this certification should submit their requests to the Internal Revenue Service as soon as possible after receiving instructions from the Depositary. In the case of ADSs held through a broker or other financial intermediary, the required documentation should be delivered to such financial intermediary for transmission to the Depositary. In all other cases, eligible U.S. holders should deliver the required documentation directly to the Depositary at least five business days prior to the date set for the payment of dividends.

If the documentation is not provided in the time allotted, or if the intermediary (i.e. the custodian in the case of the ADSs) determines that the documentation does not satisfy the prescribed requirements or that applicable law does not permit it to apply directly the reduced Income Tax Convention rate, the intermediary will withhold tax at the 27% rate, and eligible U.S. holders will be required to claim a Treaty refund of 12% of the dividend (representing the difference between 27% and the 15% Treaty rate) directly from the Italian tax authorities. ***U.S. residents seeking refunds from the Italian tax authorities have encountered expenses and extensive delays.***

Distributions of profits in kind will be subject to withholding tax. In that case, prior to receiving the distribution, the holder will be required to provide the Company with the funds to pay the relevant withholding tax. Distributions of additional ordinary shares issued upon capitalization of reserves to beneficial owners with respect to their ADSs that are made as part of a pro rata distribution to all shareholders of the Company generally will not be subject to Italian tax. However, such additional shares will reduce the tax basis of each single share for the calculation of the capital gains tax.

The gross amount of dividends (that is, the amount before reduction for Italian withholding tax) paid to holders of ADSs who are U.S. citizens or residents will be subject to U.S. federal income taxation as dividend income and will not be eligible for the dividends-received deduction allowed to domestic corporations. The Italian withholding tax (less any refund to which such holder is entitled under the Income Tax Convention) will be treated as a foreign income tax which such holders may elect to deduct in computing their taxable income or, subject to the limitations on foreign tax credits generally, credit against their United States federal income tax liability.

Tax on Capital Gains. Italian capital gains tax ("CGT") normally is imposed on gains with respect to the transfer or sale of shares whether held within or outside Italy. More specifically, a 27% CGT will be levied on gains realized on the disposal of a "qualified" shareholding. A "qualified" shareholding is constituted by ordinary shares or ADSs and/or rights representing more than five percent of a listed company's total share capital or more than two percent of its voting share capital. However, under domestic law, an exemption applies to gains realized on the disposal of "non-qualified" shareholdings in an Italian company of shares which are listed on a regulated market, such as the ordinary shares of Enel, even when such shareholdings are held in Italy. A "non-qualified" shareholding is constituted by an interest in Enel which does not reach the thresholds described above.

Furthermore, pursuant to the Income Tax Convention, a U.S. owner will not be subject to Italian CGT unless such U.S. owner has a permanent establishment or fixed base in Italy to which the ordinary shares or ADSs are effectively connected. To this end, U.S. residents selling ordinary shares or ADSs may be required to produce appropriate documentation establishing that the above mentioned conditions

have been met. Other countries have executed income tax conventions with Italy providing for a similar treatment of Italian CGT. No CGT will be imposed on the deposit or withdrawal of ordinary shares in return for ADSs. U.S. owners of ADSs who are United States citizens or residents will be subject to United States federal income tax on any capital gains to the same extent as on other gains from the disposition of stock.

Transfer Tax. An Italian transfer tax is normally payable on the transfer of shares in an Italian company. The transfer tax will not be payable with respect to any transfers of ordinary shares or ADSs involving non-Italian residents concluded either on a regulated market or with the intervention of a bank or an investment services company. Deposits and withdrawals of ordinary shares in return for ADSs by non-Italian residents will not be subject to this transfer tax.

Estate and Gift Tax. Italian estate and gift tax may be payable on the death of, or a gift by, a beneficial owner of ordinary shares or ADSs even if such are held outside of Italy. Under the Estate Tax Convention, a credit for the amount of any estate tax imposed by Italy and attributable to the ADSs will, subject to certain limitations, be allowed against the tax imposed in respect of the ordinary shares or ADSs by the United States on the estate of a deceased person who, at the time of death, was a national of, or domiciled in, the United States. There is currently no gift tax convention between Italy and the United States.

Item 8. *Selected Financial Data*

The following selected consolidated financial data of the Enel Group should be read in conjunction with Item 9. “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the Consolidated Financial Statements and notes thereto included herein.

The Consolidated Financial Statements and the notes thereto included herein have been prepared in accordance with the requirements of Italian GAAP. A further discussion of the accounting policies applied is included in the notes to the Consolidated Financial Statements. These standards differ in certain respects from generally accepted accounting principles in the United States. For an explanation and quantification of such differences, see note 23 and 24 to the Consolidated Financial Statements.

	Year ended December 31,					
	1995	1996	1997	1998	1999	1999(1)
					(in billions, except per share amounts)	(in millions, except per share amounts)
	(in billions, except per share amounts)					
Consolidated Statement of Income Data						
<i>Amounts in accordance with Italian GAAP:</i>						
Operating revenues	Lit. 38,320	Lit. 38,664	Lit. 39,617	Lit. 39,788	Lit. 40,584	\$ 21,107
Operating expenses:						
Depreciation and amortization	5,375	5,604	5,695	6,036	6,201	3,225
Other	24,587	24,825	25,233	24,148	23,957	12,460
Total operating expenses	29,962	30,429	30,928	30,184	30,158	15,685
Operating income	8,358	8,235	8,689	9,604	10,426	5,422
Financial income (expense).....	(3,339)	(2,516)	(2,197)	(1,480)	(1,131)	(588)
Equity losses(2)	—	—	—	—	(439)	(228)
Extraordinary income (expense)(3)	490	35	(1,107)	(907)	(1,057)	(550)
Income before taxes	5,509	5,754	5,385	7,217	7,799	4,056
Income taxes	3,283	3,528	2,058	2,931	3,258	1,694
Net income	<u>Lit. 2,226</u>	<u>Lit. 2,226</u>	<u>Lit. 3,327</u>	<u>Lit. 4,286</u>	<u>Lit. 4,541</u>	<u>\$ 2,362</u>
Earnings per share(4)	Lit. 184	Lit. 184	Lit. 274	Lit. 353	Lit. 375	\$ 0.19
Number of shares outstanding (in billions).....	12.1	12.1	12.1	12.1	12.1	12.1
<i>Amounts in accordance with U.S. GAAP(5):</i>						
Operating revenues	Lit. 38,809	Lit. 38,623	Lit. 39,603	Lit. 39,770	Lit. 40,765	\$ 21,201
Depreciation and amortization	4,520	4,868	5,166	5,724	5,933	3,086
Operating income	9,940	9,040	8,312	8,687	9,879	5,138
Income before taxes	6,949	6,898	6,435	7,253	8,187	4,258
Net income	2,984	2,858	3,177	3,531	4,446	2,312
Earnings per share(4)	Lit. 246	Lit. 236	Lit. 262	Lit. 291	Lit. 367	\$ 0.19

See notes on page 101.

	Year ended December 31,					
	1995	1996	1997	1998	1999	1999(1)
					(in billions, except per share amounts)	(in millions, except per share amounts)
(in billions, except per share amounts)						
Consolidated Balance Sheet Data						
Amounts in accordance with Italian GAAP:						
Fixed assets, net	Lit. 74,147	Lit. 75,596	Lit. 76,151	Lit. 75,687	Lit. 73,411	\$ 38,179
Current assets.....	11,063	14,518	13,570	12,633	11,160	5,804
Total assets	91,656	93,626	92,658	90,579	85,933	44,691
Current liabilities	16,144	15,598	15,645	21,832	20,904	10,871
Short-term debt(6)	3,978	3,817	5,089	10,480	6,741	3,506
Long-term debt(7).....	32,475	31,294	28,479	17,000	16,961	8,821
Shareholders' equity	25,920	30,380	32,515	35,880	34,034	17,700
Amounts in accordance with U.S. GAAP(5):						
Fixed assets, net	Lit. 70,617	Lit. 73,176	Lit. 74,996	Lit. 74,961	Lit. 73,014	\$ 37,972
Total assets	89,105	92,018	92,355	90,659	86,561	45,018
Short-term debt(6)	3,978	3,817	5,089	10,480	6,741	3,506
Long-term debt(7).....	32,475	31,294	28,479	17,000	16,961	8,821
Shareholders' equity	28,848	30,401	32,228	34,785	32,895	17,108

	Year ended December 31,					
	1995	1996	1997	1998	1999	1999(1)
	(in billions, except per share amounts)					
Consolidated Cash Flow Data						
<i>Amounts in accordance with Italian GAAP:</i>						
Net cash provided by operating activities	Lit. 6,649	Lit. 8,022	Lit. 7,993	Lit. 15,248	Lit. 13,512	\$ 7,027
Net cash used in investing activities	(6,130)	(5,670)	(5,044)	(5,760)	(4,553)	(2,368)
Net cash used in financing activities	(1,173)	(2,376)	(2,748)	(7,021)	(10,786)	(5,609)
<i>Amounts in accordance with U.S. GAAP(6):</i>						
Net cash provided by operating activities	6,998	8,396	8,301	15,365	13,573	6,973
Net cash used in investing activities	(6,479)	(6,044)	(5,352)	(5,877)	(4,614)	(2,314)
Net cash used in financing activities	(1,173)	(2,376)	(2,748)	(7,021)	(10,786)	(5,609)

As of December 31,					
	1995	1996	1997	1998	1999
Operating Data (unaudited)					
Gross installed capacity (MW).....	55,917	57,072	58,223	58,906	59,418
Generation (TWh)(8)	180.3	179.9	177.2	179.5	178.8
Sales to final customers (TWh)(9).....	211.6	213.7	219.3	226.2	230.5
Customers (millions)	28.5	28.7	29.0	29.3	29.7
Employees	97,937	95,464	88,957	84,938	78,511

See notes on page 101.

- (1) We have translated lira amounts into dollar amounts at a rate of exchange of Lit. 1,922.81 = \$1.00, the lira equivalent (calculated at the fixed lira/euro rate of Lit. 1,936.27 = €1.00) of the noon buying rate for euro on December 31, 1999 of €1.00 = \$1.0070 or \$1.00 = €0.9930.
- (2) For the year ended December 31, 1999 we began accounting for our investment in WIND under the equity method of accounting. We used the cost method of accounting in previous periods. You should read note 2 to our Consolidated Financial Statements for a discussion of our consolidation principles.
- (3) You should read note 23 to the Consolidated Financial Statements for a discussion of the different criteria used under Italian GAAP and U.S. GAAP for determining what constitutes an extraordinary item.
- (4) We calculate earnings per share by dividing our consolidated net income by the number of ordinary shares outstanding during each period. There were 12,126,150,379 ordinary shares outstanding during each period.
- (5) For information concerning differences between Italian GAAP and U.S. GAAP that are relevant to the Consolidated Financial Statements included herein, you should read notes 23 and 24 to the Consolidated Financial Statements.
- (6) Includes current portion of long-term debt.
- (7) Excludes current portion of long-term debt.
- (8) For the period beginning on January 1 of each year and ending as of such date.

Exchange Rates

The following table shows, for the periods indicated, information concerning the exchange rate between (i) the U.S. dollar and the lira and (ii) the U.S. dollar and the euro. These rates are provided solely for your convenience. We do not represent that lire could have been, or that the euro could be, converted into U.S. dollars at these rates or at any other rate.

The column of averages in the table below shows the averages of the relevant exchange rates on the last business day of each month during the relevant period. The high and low columns show the highest and lowest exchange rates on any business day during the relevant period.

	<u>End of period</u>	<u>Average</u>	<u>High</u>	<u>Low</u>
<i>Lire per U.S. dollar(1)</i>				
<u>Year ended December 31,</u>				
1995.....	1,584	1,629	1,736	1,569
1996.....	1,519	1,538	1,602	1,496
1997.....	1,769	1,712	1,841	1,516
1998.....	1,654	1,737	1,828	1,592
1999.....	1,923	1,828	1,933	1,639
2000 (through May 31)	2,076	2,043	2,178	1,874
<i>U.S. dollars per Euro(2)</i>				
1999.....	1.0070	1.0588	1.1812	1.0016
2000 (through May 31)	0.9328	0.9478	1.0335	0.8891

- (1) Based on the U.S. Federal Reserve Bank noon buying rate for the lira for 1995, 1996, 1997 and 1998. For 1999 and 2000, based on the noon buying rate for euro and then converted in lire at the fixed lira/euro conversion rate of Lit. 1,936.27 = €1.00.
- (2) Based on the U.S. Federal Reserve Bank noon buying rate for the euro on the dates indicated.

Our ordinary shares are quoted in euro on Telematico, the Italian automated screen-based trading system managed by Borsa Italiana. Our ADSs are quoted in U.S. dollars and traded on the New York Stock Exchange.

The fixed conversion rate between the euro and the lira established on December 31, 1998 was Lit.1,936.27 = €1.00.

On June 26, 2000, the noon buying rate for the euro was \$0.9382 = €1.00 and the effective noon buying rate for lire was Lit. 2,063.87 = \$1.00.

Dividends and Dividend Policy

Our shareholders are entitled to receive interim or annual dividends that our board recommends and, in the case of final dividends, that our shareholders approve. The following table shows our dividends per share based on the 12,126,150,379 ordinary shares outstanding in the years indicated; prior to our initial public offering in November 1999, the Treasury Ministry was our sole shareholder.

	Year ended December 31,				
	1995	1996	1997	1998	1999
Dividends per ordinary share (in lire)	85.0	99.0	76.0	162.0	232.0
Dividends per ordinary share (in U.S. cents)(1) .	5.5	5.8	4.3	8.6	11.3

- (1) We have translated the historical dividend amounts into U.S. dollars using the noon buying rate for lire or euro in effect on the respective payment dates. You should read “Exchange Rates” for a more detailed discussion of historical exchange rates for lire. The noon buying rate for euro may differ from the rate that may be used by the Depositary for the ADSs in order to convert lire into U.S. dollars for purposes of making payments to holders of ADSs.

At our shareholder’s meeting on September 3, 1999, the Treasury Ministry, at that time our sole shareholder, approved the distribution of an extraordinary dividend of Lit. 4,422 billion that was paid to the Treasury Ministry in October 1999.

The dividends that we declared during the period prior to our initial public offering in November 1999 reflected our status as a company wholly owned by the Italian government. You should not consider the historical amount of dividends that we paid during that period as a proportion of our earnings, or “pay-out ratio”, as indicative of our future dividend pay-out ratio.

At our annual shareholders’ meeting on May 26, 2000, the shareholders approved our board of directors’ proposal to pay an aggregate dividend of Lit. 2,813 billion, or Lit. 232 per ordinary share, in respect of the fiscal year ended December 31, 1999. The amount of the aggregate dividend was equal to approximately 62% of our consolidated net income for the year and was paid on June 22, 2000 to holders of record as of June 19, 2000.

This dividend was consistent with our current dividend policy of paying dividends in amounts that are consistent with our objective of maximizing value and return to our shareholders and maintaining a competitive dividend pay-out ratio comparable to the average pay-out ratio of other similar European electricity companies (which is, at present, approximately 50-60% of consolidated earnings).

Italian law will allow us to pay dividends only out of our statutory retained earnings, plus our distributable reserves and statutory net income for the current year, net of the amount to be allocated to the legal reserve in the subsequent year. Italian law requires companies to contribute 5% of their net income each year to the legal reserve until the aggregate amount of this reserve is equal to 20% of the aggregate par value of their issued and outstanding share capital. As the aggregate amount of our legal reserve was equal to such aggregate par value, we did not allocate any of our 1999 net income to such a

reserve. Our Board will recommend the payment of any future dividends in light of conditions then existing, including:

- Our financial performance;
- Cash and capital requirements;
- Any restrictions in financing agreements;
- Prevailing business conditions; and
- Other factors, including the pay-out ratios of other European electricity companies.

Any cash dividends which we declare on or before December 31, 2001 will be declared and paid in lire. From January 1, 2002, we will declare and pay any dividends in euro. We will pay dividends on ordinary shares represented by ADSs to the Depositary. The Depositary will convert the dividends into U.S. dollars at the prevailing rate of exchange, net of conversion expenses of the Depositary and any applicable Italian withholding tax. The amount of dividends received by holders of ADSs in U.S. dollars may be affected by fluctuations in exchange rates. You should read “—Exchange Rates” and “—Risk Factors” in Item 1 for a more detailed discussion of historical exchange rates for the lire and euro and the risks of euro/dollar exchange rate fluctuations for holders of ADSs.

Item 9. *Management’s Discussion and Analysis of Financial Condition and Results of Operations*

Overview

Tariffs, regulation and increased competition

Substantially all our operating revenue comes from the sale of electricity. The price of electricity has historically been determined by the regulator through tariffs. Our operating revenues have been dependent on those tariffs. These tariff levels are currently set by the Energy Authority, the independent government regulator for the electricity industry, which acts under the supervision of the Industry Ministry. For the periods covered by the financial statements included herein, our electricity revenues consisted of:

- Tariff revenues based upon the contracted capacity required by a consumer and on the amount of electricity the customer actually consumed; and
- Equalization Fund reimbursements related to our fuel costs, electricity purchases and other factors.

Equalization Fund reimbursements are paid through the *Cassa Conguaglio per il Settore Elettrico*, the Equalization Fund for the Electricity Industry, or the Equalization Fund. These reimbursements include reimbursements for electricity purchases that Regulation 6/92 of the *Comitato Interministeriale Prezzi*, an Italian governmental committee, requires us to make from domestic producers that use renewable resources. These producers are commonly referred to as “CIP 6 Producers”.

Tariffs remained largely unchanged over the periods covered by the financial statements that we have included herein, with the exception of tariffs for residential customers. The Italian government reduced residential tariffs by 10.6% in July 1996. As discussed in more detail below, a new tariff framework came into effect on January 1, 2000.

Effective July 1997, the Energy Authority substantially modified the system of Equalization Fund reimbursements. Before July 1997, we were reimbursed for virtually all the costs of fuel and for all the costs of electricity imports. Under the system that came into effect in July 1997, we were reimbursed for fuel costs according to an index based on weighted average industry fuel prices and a consumption index related to the efficiency of production. Under this system, although there was some variation in profits between accounting periods because of the timing of reimbursement calculations, our profit levels over time were generally unaffected by fluctuations in fuel prices or in exchange rates relating to fuel costs.

Under this system, the costs of electricity imports were also reimbursed according to the fuel reimbursement indices, based on the assumed cost of fuel that would have been used to generate the electricity being imported. In practice, however, reimbursement levels were lower than the actual costs of our imports. As a result, our operating income generated from sales of imported electricity declined.

The Energy Authority implemented a new tariff framework that took effect on January 1, 2000. We expect that the new tariff structure will result in significant reductions in our tariff revenues. These reductions will result from lower rates for generation, transmission and distribution fees in 2000, the application of price cap reductions to transmission and distribution fees after 2000 and reductions in generation fees in connection with the operation of the pool market beginning in 2001, as well as certain changes to the cost reimbursement policies discussed above. Since the introduction of the new tariffs on January 1, 2000, our tariff revenues have decreased, as compared with the comparable periods of 1999. The new tariff structure is one of a number of significant changes in the regulatory framework for the Italian electricity industry enacted over the past several years, particularly in 1999, as a result of European Union and Italian government measures designed to increase competition in the electricity market. You should read “—Overview” and “—The Enel Group”, “—Regulatory Matters” and “—Risk Factors” in Item 1 for a more detailed discussion of these changes to our business.

Economic background

The level of demand for electricity in Italy has historically been closely related to the general level of economic activity in the country. During the past decade, economic growth in Italy has been slow relative to many other countries in the European Union. From 1995 to 1999, Italy’s real gross domestic product grew at an average annual rate of 1.8%, as compared with an average annual rate of 2.2% for the European Union. However, growth in electricity demand in Italy has historically exceeded growth in gross domestic product, principally because electricity consumption has grown faster than total energy consumption.

Interest rates in Italy and the rest of Europe changed significantly over the period covered by the financial statements included herein, largely as a result of the macroeconomic measures enacted by the Italian government in order to meet the convergence criteria for participation in the first stage of European Monetary Union and Italy’s subsequent participation in the single European currency. Market long-term rates in Italy for Italian government bonds declined from an average of 6.86% in 1997 to an average of 4.73% in 1999. Short-term rates for six-month lira-denominated LIBOR declined from an average of 6.68% in 1997 to an average of 3.05% in 1999. The official discount rate of the Bank of Italy decreased from 7.50% at January 1, 1997 to 3.00% at December 31, 1999. We benefited from lower interest rates through lower financing costs.

Business segments

In 1998, we completed an internal restructuring and began operating our business in three principal segments: generation, transmission and distribution. We have completed a further restructuring required by the Bersani Decree to adopt a holding company structure and operate these segments as

separate subsidiaries within the Enel Group. Enel Produzione is the lead company of our generation segment; TERNIA is the lead company of our transmission segment; and Enel Distribuzione (sales to Non-Eligible Customers) and Enel Trade (sales to Eligible Customers) are the lead companies of our distribution segment. We have implemented a system of transfer pricing between the three segments based on management allocations that is intended to approximate arm's-length pricing. However, these prices are not representative of prices that would be charged to unaffiliated third parties and may differ from market prices. Because we operate as an integrated company and have leading positions in each of our segments in the Italian electricity market, most of our segment operating revenues and costs for the periods presented arise from sales or costs incurred within the Enel Group. After the *Gestore della Rete* and the Single Buyer begin to operate, we expect that the majority of operating revenues and costs for each segment will involve third parties. The significant changes in our business operations and tariff structure occurring as a result of the Bersani Decree may affect comparison of this information to our results in future periods.

We also have operations that include telecommunication services, research and development, information technology services, real estate management and general services, engineering management and construction and new technologies. During the periods presented, these operations did not represent a significant share of our operating revenues or costs. Our results from these operations are presented together as "Other activities".

Prior to 1998, we managed our operations on a total-utility basis, without separate identifiable business segments. Certain business units within our company provided services on a company-wide basis. These consisted primarily of information technology, research and development, construction and engineering. These business units provided almost no services to third parties, and the related assets of these business units totaled less than one percent of consolidated assets. We considered the costs of these operations to be costs of providing utility services and we included them as operating costs for purposes of determining tariffs. For these reasons, we had no separately reportable segments for 1997 or prior periods.

Accordingly, we compare herein segment information for the years ended December 31, 1998 and 1999. We compare information for the Enel Group as a whole for the years ended December 31, 1997 and 1998.

Outlook

Based on current regulatory requirements, our business will change over the next several years in ways that will materially affect our financial condition and results of operations. These include:

- The change in tariffs that took effect on January 1, 2000;
- The disposal by January 1, 2003 of 15,057 MW of our net installed capacity (equivalent to approximately 16,000 MW of gross installed capacity), through our disposition of the three generating company subsidiaries we created in 1999;
- The consolidation of distribution networks in many municipalities, including the possible sale of portions of our distribution network to municipal utilities by March 2001; and
- The remuneration of our generation activities based on competitive electricity prices rather than tariffs following the introduction of the pool market in early 2001.

You should read “—the Enel Group”, “—Regulatory Matters” and “—Risk Factors” in Item 1 for a more detailed discussion of these changes to our business.

We will seek to reduce costs significantly over the next several years to offset the impact of tariff reductions and in an effort to continue to improve operating margins. We expect that lower personnel costs arising from reductions in our workforce will be a principal source of savings and that these reductions will primarily result from attrition and early retirement. Our workforce reduction goal is for our total number of employees to decrease by over 19,500 employees by December 31, 2004, or 24.9% of our workforce of 78,511 persons at December 31, 1999 (including the effects of disposals and transfers). By comparison, our total number of employees decreased by 25,039, or 24.2%, between the end of 1994 and the end of 1999.

In addition, because of the introduction of the *Gestore della Rete* and the Single Buyer as intermediaries in the transmission of electricity under the Bersani Decree, in the future we, as a generator, will sell electricity to the Single Buyer and then, as a distributor, repurchase electricity for distribution on our distribution network. As a result, on a consolidated basis the level of our operating revenues and costs will both increase because we will record revenues from sales to the Single Buyer and to end users of electricity and have costs relating to the generation of electricity and the purchase of electricity from the Single Buyer. However, we do not expect that this proportionate increase in costs and revenues will have a significant net effect on our operating income.

As part of our required restructuring under the Bersani Decree:

- We have transferred to the *Gestore della Rete*: 614 employees, assets with an aggregate book value of Lit. 117 billion (net of technical depreciation) and liabilities in an aggregate amount of Lit. 79 billion, all relating to our transmission network. We transferred all of the shares of the *Gestore della Rete* to the Treasury Ministry without charge on April 1, 2000. The results of the *Gestore della Rete* are therefore not included in the Enel Group’s consolidated results for the year ending December 31, 1999.
- We have transferred all of our discontinued nuclear operations to SOGIN; and
- We are scheduled to transfer all of the shares of SOGIN to the Treasury Ministry free of charge before the end of 2000. As a result, SOGIN is not included in the Enel Group’s consolidated results for the year ending December 31, 1999.
- We have transferred the 15,057 MW of net installed capacity that we are required to dispose of by January 1, 2003 to three newly-formed generating company subsidiaries: Eurogen, Elettrogen and Interpower.

In connection with the formation of the generating company subsidiaries in 1999, we transferred an aggregate of approximately 5,100 employees, Lit. 8,200 billion of assets and Lit. 6,400 billion of liabilities to the three subsidiaries. We plan to complete the disposal through the sale or other disposition of shares in each of these generating companies, which sale, in the case of Eurogen, may take the form of a public offering. We estimate that in 1999 approximately 26% of our total energy produced, and 13% of our total revenues were related to the assets that we transferred to the three subsidiaries. The actual impact of our transfer of the generating companies may differ significantly from these estimates, in part because of the significant uncertainty surrounding the ultimate date of the disposals, which will be sometime prior to January 1, 2003, varying production volumes of the transferred assets in the future, and the changing tariff structure. In particular, we currently estimate the revenues of our generation activities based on a system of internal transfer pricing which may differ from market prices. However, our

operating profits will decline after the sales unless we are able to offset the decrease in volumes of our generation business in Italy through improved efficiencies, diversification of our operations or international expansion. Prior to the ultimate disposal of this generating capacity we will not operate and manage these assets differently than we have in the past and will continue to fully include the results of the three companies in our consolidated results . You should read “—The Enel Group” in Item 1 for more detail on these transfers.

Results of Operations

The following table shows certain financial data from our profit and loss account for the years ended December 31, 1997, 1998 and 1999, expressed in each case as a percentage of operating revenues:

	Year ended December 31,		
	1997	1998	1999
Operating revenues.....	100.0%	100.0%	100.0%
Operating expense:.....			
Personnel.....	(22.3)	(20.2)	(18.2)
Fuel.....	(19.3)	(16.7)	(15.5)
Purchased power.....	(15.3)	(15.8)	(16.8)
Depreciation and amortization.....	(14.4)	(15.2)	(15.3)
Other operating expenses.....	(6.8)	(8.0)	(8.5)
Total.....	<u>(78.1)</u>	<u>(75.9)</u>	<u>(74.3)</u>
Operating income.....	21.9	24.1	25.7
Financial expense.....	(5.5)	(3.7)	(2.8)
Equity losses.....	—	—	(1.1)
Extraordinary income (expense).....	(2.8)	(2.3)	(2.6)
Income before taxes.....	<u>13.6</u>	<u>18.1</u>	<u>19.2</u>
Income taxes.....	(5.2)	(7.3)	(8.0)
Net income.....	<u>8.4%</u>	<u>10.8%</u>	<u>11.2%</u>

1999 Compared with 1998

Operating revenues

The following table shows the different sources of our operating revenues for the years ended December 31, 1998 and 1999.

	Year ended December 31,	
	1998	1999
	(in billions)	
Operating revenues:		
Electricity sales:		
Tariff revenues from electricity sales	Lit. 25,681	Lit. 26,419
Equalization Fund reimbursements for:		
Fuel costs	6,951	6,324
Electricity imports and electricity purchases	5,112	5,448
Other services	540	583
Total	<u>Lit. 38,284</u>	<u>Lit. 38,774</u>
Other revenues:		
Reimbursement of costs for customer connections, inspections and repositioning services	Lit. 1,090	Lit. 1,124
Other revenues(1)	414	686
Total other revenues	<u>1,504</u>	<u>1,810</u>
Total operating revenues	<u>Lit. 39,788</u>	<u>Lit. 40,584</u>

(1) Other revenues include reimbursements for repairs to electrical equipment damaged by third parties and revenues from our real estate, electrical consulting and public lighting operations.

The following table shows our operating revenues for each of our business segments for the periods presented:

	Year ended December 31,	
	1998	1999
	(in billions)	
Generation	Lit. 19,270	Lit. 18,584
Transmission	19,010	16,157
Distribution	27,280	28,166
Other activities	4,153	3,803
Eliminations	(29,925)	(26,126)
Total	<u>Lit. 39,788</u>	<u>Lit. 40,584</u>

Operating revenues for 1999 increased by Lit. 796 billion, or 2.0%, compared to 1998. This increase was principally attributable to an increase of Lit. 738 billion, or 2.9%, in tariff sales, reflecting higher volumes sold, up 1.9%, and an improved sales mix (an increase in higher priced sales of low voltage electricity and a decrease in lower priced high voltage sales), as well as an increase in other revenues of Lit. 306 billion, or 20.3%, reflecting (i) the start of WIND's use of a fiber optic network, which generated lease and other revenues of approximately Lit. 120 billion, (ii) sundry income of approximately Lit. 120 billion, of which approximately Lit. 70 billion reflected the release of risk provisions that were no longer needed, (iii) an increase in work in progress of approximately Lit. 56 billion, and (iv) an increase of approximately Lit. 34 billion in payments from customers for network connections and related services. The positive impact of these factors on operating revenues was offset in part by a decline of Lire 291 billion, or 2.4%, in the total amount of Equalization Fund reimbursements that was primarily attributable to a decline in the average prices for fuel to which such payments are indexed.

Generation. Our operating revenues from generation are attributable to the transfer of electricity to our transmission segment and Equalization Fund reimbursements for fuel costs for electricity generation. Operating revenues for the generation segment fell by Lit. 686 billion, or 3.6%, principally

because of lower intersegment prices and of lower Equalization Fund reimbursements for fuel costs, reflecting lower average market prices of the fuels on which these reimbursements are based and the time lag between changes in fuel prices and contribution adjustments.

Transmission. Our operating revenues for transmission are attributable to:

- The transportation of electricity we produce or that is purchased by the transmission segment from CIP 6 Producers or foreign producers and transported to our distribution segment;
- Equalization Fund reimbursements for electricity purchased from CIP 6 Producers and for electricity imports; and
- For the period through September 30, 1999, the sale to our distribution segment of electricity purchased from our generation segment.

Operating revenues for the transmission segment decreased by Lit. 2,853 billion, or 15.0%, principally as a result of the new structure of the Group that became effective on October 1, 1999, following which our generation segment sells electricity directly to our distribution segment, rather than selling it through our transmission segment.

Distribution. Our operating revenues from distribution in the amount of electricity sold are principally attributable to electricity sales to final customers. Operating revenues for the distribution segment increased by Lit. 886 billion, or 3.2%. This increase was principally attributable to increases in the amount of electricity sold and in our average tariff revenue per kWh sold. Average tariff revenue increased from 113.6 Lit./kWh to 114.6 Lit./kWh, reflecting an increase in the amount of electricity sold to customers using medium and low voltage electricity, who generally pay higher tariffs than customers using high voltage electricity.

Other activities. Our operating revenues from other activities primarily consist of intersegment revenues from engineering and construction services and real estate activities. During 1998 and 1999, these operations did not represent a significant share of our operating revenues or costs.

Eliminations. Eliminations in operating revenues primarily relate to intersegment electricity sales and intersegment engineering and construction services.

Operating expenses

The following table shows a breakdown of operating expenses for each of the periods presented:

	Year ended December 31,	
	1998	1999
	(in billions)	
Operating expenses:		
Personnel.....	Lit. 8,025	Lit. 7,402
Fuel.....	6,663	6,308
Purchased power	6,306	6,831
Services and rentals	2,223	2,518
Materials and supplies.....	1,585	1,526
Provisions	815	752
Other	455	550
Capitalized expenses.....	(1,924)	(1,930)
Total.....	<u>Lit. 24,148</u>	<u>Lit. 23,957</u>

The following table shows operating expenses for each of our business segments for the periods presented:

	Year ended December 31,	
	1998	1999
	(in billions)	
Generation	Lit. 10,043	Lit. 9,758
Transmission	18,450	15,620
Distribution	20,983	20,793
Other activities	4,468	3,865
Eliminations	(29,796)	(26,079)
Total	<u>Lit. 24,148</u>	<u>Lit. 23,957</u>

Operating expenses for 1999 decreased by Lit. 191 billion, or 0.8%, compared to 1998. Expressed as a percentage of operating revenues, operating expenses decreased from 60.7% in 1998 to 59.0% in 1999. The reduction in costs was principally due to decreases in personnel, fuel and materials expenses, the positive effects of which were offset in part by increases in costs related to electric energy purchases from third parties and the use of third party assets and services, as well as other costs. Each of these items is discussed in more detail below.

Personnel costs decreased by Lit. 623 billion, or 7.8%, mainly due to the decrease in the average number of employees, which declined by 7.1%, from 86,398 in 1998 to 80,253 in 1999. The decline was attributable to early retirements spurred by incentives, as well as the transfer of employees to WIND, SOGIN and the *Gestore della Rete* in connection with the Group's restructuring.

Fuel costs decreased by Lit. 355 billion, or 5.3%, of which Lit. 161 billion reflected lower prices and Lit. 194 billion reflected the different impact in 1999 of the Group's provision for fluctuations in fuel prices. The provision, which was created with an accrual of Lit. 132 billion in 1998, is designed to offset the effect on the Group's costs of the time lag between adjustments to contributions from the Equalization Fund and changes in fuel prices. In 1999, Lit. 62 billion was withdrawn from the provision, reflecting the fact that contributions from the Equalization Fund and fuel purchases were roughly equivalent in 1999, whereas they had been out of balance by Lit. 288 billion in 1998.

Purchased power increased by Lit. 525 billion, or 8.3%, reflecting a 7.8% increase in the volume of energy purchased during the year, primarily from other national producers that qualified as CIP 6 Producers following their introduction of new power plants using renewable resources. The relatively slight increase in overall average purchase cost per unit reflected a higher proportion of energy purchased domestically.

Costs related to the services received from third parties and the use of third party assets increased by Lit. 295 billion, or 13.3%, due mainly to services supplied to the Group by WIND (approximately Lit. 200 billion) and by the *Gestore della Rete* (approximately Lit. 60 billion). These costs, which primarily relate to services that had previously been provided internally, arose for the first time in 1999 as a result of the Group's restructuring and related transfers of assets. Their overall impact on the Group is therefore partially offset by decreases in other items related to intra-Group costs.

In addition, other costs increased by Lit. 95 billion, or 20.9%, due primarily to an increase in the amount of emission taxes paid, while purchases of consumables decreased by Lit. 59 billion, or 3.7%, reflecting increased efficiencies in the use of resources.

Generation. Operating expenses for the generation segment decreased by Lit. 285 billion, or 2.8%. Operating expenses for generation primarily consist of personnel, maintenance and fuel costs for our production plants. As noted above, fuel costs decreased by Lit. 355 billion, or 5.3%, while other operating expenses increased by Lit. 70 billion, or 2.1%, primarily reflecting an increase in the amount of emission taxes paid, particularly the new carbon tax.

Transmission. Operating expenses for the transmission segment decreased by Lit. 2,830 billion, or 15.3%. Operating expenses for transmission consist of costs associated with running our transmission network, the transfer prices paid to the generation segment for electricity (for the period through September 30, 1999) and the cost of electricity purchases from CIP 6 Producers and electricity imports. As noted above, the total cost of electricity purchases from third parties increased by Lit. 525 billion, or 8.3%, primarily as a result of a 7.8% increase in the volume of energy purchased during the year. Purchases from CIP 6 Producers increased by 14.4%, while the volume of imports increased by 2.6%. The decrease in the segment's operating expenses also reflected the change in the Group's structure after September 30, 1999, particularly the fact that the transmission segment no longer buys electricity from the generation segment for sale to the distribution segment.

Distribution. Operating expenses for the distribution segment principally consist of costs associated with running our distribution network and (for the period through September 30, 1999) the transfer price paid to the transmission segment for electricity purchased from and transported by that segment. Following the restructuring described above, the distribution segment now buys electricity directly from the generation segment, with a portion of the purchase price being payable to the transmission segment for its services. Operating expenses for the distribution segment decreased by Lit. 190 billion, or 0.9%, primarily reflecting a reduction in personnel costs related to the continued decline in the segment's headcount.

Other activities. Operating expenses for other activities principally consist of costs attributable to performing corporate functions and the Group's information technology, real estate, engineering and construction, research and telecommunications services. Operating expenses for these activities decreased by Lit. 602 billion, or 13.5%. The decrease was concentrated in engineering and construction (approximately Lit. 400 billion), telecommunications (approximately Lit. 100 billion) and nuclear operations (approximately Lit. 100 billion), reflecting lower capital expenditures in 1999 and the transfer of our discontinued nuclear operations to SOGIN and that of certain telecommunications services to WIND.

Eliminations. Eliminations for operating expenses principally consist of the elimination of intersegment electricity purchases and service contracts.

Depreciation and amortization

The following table shows depreciation and amortization for each of our business segments for the periods presented:

	Year ended December 31,			
	1998		1999	
	(in billions)			
Generation.....	Lit.	2,297	Lit.	2,493
Transmission.....		385		427
Distribution.....		2,863		2,880
Other activities.....		491		401
Total.....	<u>Lit.</u>	<u>6,036</u>	<u>Lit.</u>	<u>6,201</u>

Depreciation and amortization for 1999 increased by Lit. 165 billion, or 2.7%, compared to 1998. This increase was principally attributable to an increase in depreciation related to assets acquired or entering service in 1998. Under Italian GAAP, assets are depreciated at 50% of the annual rate for the year in which they are acquired or enter service; depreciation therefore increased when the full rates become applicable to these assets in 1999.

Operating income

The following table shows operating income for each of our business segments for the periods presented:

	Year ended December 31,			
	1998		1999	
	(in billions)			
Generation.....	Lit.	6,930	Lit.	6,333
Transmission		175		110
Distribution		3,434		4,493
Other activities		(806)		(463)
Eliminations		(129)		(47)
Total.....	Lit.	9,604	Lit.	10,426

Operating income for 1999 increased by Lit. 822 billion, or 8.6%, compared to 1998, principally due to increased operating revenues and lower operating costs, which were partially offset by an increase in depreciation.

Generation. Operating income for generation fell by Lit. 597 billion, or 8.6%. The principal reasons for this decrease were an increase of Lit. 196 billion in depreciation, a decrease in intersegment sales of Lit. 195 billion, an increase in emission taxes (Lit. 70 billion) and the non-recurrence in 1999 of an excess of reimbursements for fuel costs of Lit. 288 billion recorded in 1998 as a result of the effect of the timing of the calculation of the index used by the Energy Authority to calculate those reimbursements. These negative factors were partially offset by a decrease in personnel costs of Lit. 111 billion.

Transmission. Operating income for the transmission segment fell by Lit. 65 billion, or 37.1%. The principal reason for the decrease was the change in the Group's structure effective October 1, 1999, as noted above.

Distribution. Operating income for the distribution segment increased by Lit. 1,059 billion, or 30.8%. The improvement was primarily due to higher gross margins of Lit. 782 billion earned on energy sales that reflected a 1.9% increase in volume (Lit. 490 billion), an increase in average revenue per kWh sold due to an increase in sales of higher priced low voltage electricity (Lit. 250 billion) and lower costs of intersegment energy purchases (Lit. 42 billion). The increase in operating income also reflected the

positive impact of a Lit. 310 billion reduction in personnel costs that reflected the segment's lower headcount.

Other activities. The operating loss for other activities decreased by Lit. 343 billion, or 42.6%, compared with 1998, primarily due to the decrease in operating expenses described above.

Financial expense

Net financial expense decreased by Lit. 349 billion, or 23.6% in 1999, compared with 1998, primarily as a result of the reduction in the Group's average debt outstanding, which decreased by 24.0%, from Lit. 28,121 billion in 1998 to Lit. 21,370 billion in 1999, as well as lower average market interest rates for the period. The decrease in outstanding debt reflected reductions through prepayment and payments at maturity. Long-term debt, including the current portion, decreased by 22.6%, from Lit. 26,736 billion at December 31, 1998 to Lit. 20,699 billion at December 31, 1999.

Equity losses

The Lit. 439 billion charge represents the recognition of our share of equity losses in WIND. In 1999, we began accounting for our investment in WIND under the equity method of accounting. We used the cost method of accounting in previous periods because WIND had very limited operations before 1999. You should read note 2 to our Consolidated Financial Statements for a discussion of our consolidation principles.

Extraordinary income (expense)

Net extraordinary expense increased 16.5%, from Lit. 907 billion in 1998 to Lit. 1,057 billion in 1999.

Extraordinary expenses for 1999 principally consisted of:

- A provision of Lit. 792 billion relating to two different early retirement programs made available to our employees and managers. The manager plan, which opened in May 1998 and remains open, is directed at individual managers. The employee program opened in July 1999 and will remain open until December 2001. Both programs allow for a one-time payment of a certain number of month's salary based upon the plans' formula.
- A provision of Lit. 180 billion relating to below-market swap and swap option contracts to cover interest rate risk that were restructured during 1999.
- A write-down of Lit. 172 billion to reflect the difference in the carrying value and estimated fair market value (as determined by an independent appraisal) of certain real estate assets that we transferred to Dalmazia Trieste, one of our consolidated subsidiaries, in view of their planned disposal.
- A provision of Lit. 100 billion, principally relating to a power plant construction project halted by management for which provisions had been recorded in prior years. The provision reflects the decrease in the estimated fair value of the related assets, as the probability of a sale of this project or its inclusion in a construction joint venture decreased in 1999.

- A provision of Lit. 80 billion principally relating to the write-off of our equity investments in the *Gestore della Rete* and SOGIN, which either have been or will be transferred to the Treasury Ministry at no cost.
- A provision of Lit. 59 billion for the future restructuring of engineering and research activities.

These extraordinary expenses were offset in part by extraordinary income which principally consisted of income of Lit. 214 billion arising out of a favorable judgment received in 1999 with regard to refunds of taxes and fees paid by the Group in prior years and income of Lit. 57 billion relating to a court judgment in our favor, for which we recorded a receivable.

Extraordinary expenses in 1998 principally consisted of:

- A provision of Lit. 523 billion principally to record at fair value two construction projects that were halted by management in previous years. We estimated the projects' fair values using available market prices and potential estimated sales prices to unrelated third parties. A provision was also taken on these projects in 1997. The additional provision in 1998 was based on the reduced probability of a favorable sale of these assets because of the technological change from the time these traditional plants began to be constructed. In particular, because of technological advances, CCGT plants now cost less to construct than traditional plants and they also are more efficient than traditional plants. Additionally, the economic crisis in 1998 in emerging markets, which represent the potential target for this kind of traditional technology, has reduced the probability of sales to an external party. Consequently, at the end of 1998, we reviewed the estimate of the fair value of these assets, not only using some of the above criteria, but also on the basis of potential utilization in construction joint ventures by our engineering and construction subsidiary, Enelpower;
- A provision of Lit. 386 billion relating to various voluntary early retirement programs available to employees and managers. In February and May 1998, we made two different temporary offers to managers to take voluntary early retirement. The first program was available from February 1998 through March 1998. The second program was opened in May 1998 and remains open. In April 1998, we also made a temporary offer to employees to take early retirement during May and June 1998. In total, 124 managers and 4,896 employees accepted these offers. Both programs allowed for a one-time payment calculated on the basis of the plans' formula; and
- A provision of Lit. 166 billion accrued for a one-time additional benefit to active managers. The managers and we agreed to these benefits prior to the establishment in 1998 of Fondenel, the pension fund for Enel managers.

These extraordinary expenses were offset in part by extraordinary income of Lit. 109 billion related to the reversal of a court judgment against us. A receivable was recorded for this favorable judgment, and the full amount has been subsequently collected.

You should read note 23 to the Consolidated Financial Statements for a discussion of the different criteria used under Italian GAAP and U.S. GAAP for determining what constitutes an extraordinary item.

Income taxes

The following table shows a breakdown of our income taxes for the periods indicated.

	Year ended December 31,	
	1998	1999
	(in billions)	
Income taxes:		
Current taxes.....	Lit. 2,785	Lit. 2,834
Deferred tax charge	734	986
Recognition of prior years deferred tax assets	(588)	(562)
Total.....	<u>Lit. 2,931</u>	<u>Lit. 3,258</u>

The total tax charge for the year ended 1999 was Lit. 3,258 billion, which was Lit. 327 billion or 11.2% higher than the charge for 1998. The principal reasons for this increase were:

- An increase of Lit. 582 billion, or 8.1%, in the Group's income before income taxes, which would have produced an increase in income taxes of Lit. 279 billion, or 9.5%, at the statutory tax rate; and
- A decrease in our recognition of deferred tax assets from prior years of Lit. 26 billion. Our application of new Italian accounting standard No. 25 had resulted in our recognition of a deferred tax asset of Lit 588 billion as of January 1, 1998. We had not previously recorded the full benefit of deferred tax assets, which primarily related to reserves for nuclear charges that had been recorded under Italian GAAP, due to the uncertainty of realization of the assets. During 1999, the issue of which assets and liabilities of our discontinued nuclear operations that would be transferred to our new subsidiary, SOGIN, was clarified and, as a result, Lit. 562 billion of deferred tax assets were recognized in 1999 for these items. The reorganization and eventual transfer of our discontinued nuclear operations is discussed in more detail in “—Regulatory Matters—Environmental matters—Discontinued nuclear operations” in Item 1.

Our effective tax rate was 40.6% in 1998 and 41.8% in 1999. The following table shows our tax rates as a percentage of income before taxes for the periods indicated.

	Year ended December 31,	
	1998	1999
Effective tax rate.....	40.6%	41.8%
Current tax rate	38.6%	36.3%
Deferred tax rate	10.2%	12.7%
Impact of recognition of deferred tax assets	(8.2%)	(7.2%)

Net income

Net income increased from Lit. 4,286 billion in 1998 to Lit. 4,541 billion in 1999, a 5.9% increase. This increase was principally due to increased operating income and decreased financing costs, partially offset by equity losses and higher income taxes.

1998 Compared with 1997

Operating revenues

The following table shows the different sources of our operating revenues for the years ended December 31, 1997 and 1998:

	Year ended December 31,	
	1997	1998
	(in billions)	
Operating revenues:		
Electricity sales:		
Tariff revenues from electricity sales.....	Lit. 24,999	Lit. 25,681
Equalization fund reimbursements for:		
Fuel costs.....	7,452	6,951
Electricity imports and electricity purchases.....	5,257	5,112
Other services ⁽¹⁾	535	540
Total.....	<u>Lit. 38,243</u>	<u>Lit. 38,284</u>
Other revenues:		
Reimbursement of costs for customer connections, inspections and repositioning services	Lit. 1,028	Lit. 1,090
Other revenues ⁽²⁾	<u>346</u>	<u>414</u>
Total other revenues	<u>1,374</u>	<u>1,504</u>
Total operating revenues	<u>Lit. 39,617</u>	<u>Lit. 39,788</u>

- (1) Certain items included in “other revenues” for prior years have been reclassified as “other services” in order to conform with the presentation for 1999. These reclassifications did not effect reported “total operating revenues” in any of the periods presented.
- (2) Other revenues include reimbursements for repairs to electrical equipment damaged by third parties and revenues from our real estate, electrical consulting and public lighting operations.

Operating revenues in 1998 increased by Lit. 171 billion, or 0.4%, as compared to 1997. Tariff revenues from electricity sales in 1998 increased by Lit. 682 billion, or 2.7%, as compared to 1997. The increase in tariff revenues was less than the 3.1% increase in the amount of electricity we sold because of a decrease in our average tariff revenue per kWh sold. Average tariff revenue decreased from 114.01 Lit./kWh to 113.55 Lit./kWh principally because of an increase in the amount of electricity sold to customers using medium and high voltage electricity relative to sales to customers using low voltage electricity. Customers using medium and high voltage electricity generally pay lower tariffs than customers using low voltage electricity.

The increase in tariff revenues in 1998 was offset in part by a Lit. 501 billion, or 6.7%, decrease in fuel cost reimbursements. This decrease resulted from significant reductions in fuel oil and natural gas prices during 1998. Although reimbursements for fuel costs in 1998 were less than for 1997, they exceeded actual fuel costs in 1998 by Lit. 288 billion. Fuel prices generally decreased during 1998, and because of the timing of calculation of fuel cost reimbursements, the reimbursement levels exceeded our actual costs.

Operating expenses

The following table shows a breakdown of operating expenses for each of the periods presented:

	Year ended December 31,	
	1997	1998
	(in billions)	
Operating expenses:		
Personnel.....	Lit. 8,831	Lit. 8,025
Fuel.....	7,657	6,663
Purchased power	6,073	6,306
Services and rentals	2,352	2,223
Materials and supplies.....	1,563	1,585
Provisions	328	815
Other	438	455
Capitalized expenses.....	(2,009)	(1,924)
Total.....	Lit. 25,233	Lit. 24,148

Operating expenses in 1998 decreased by Lit. 1,085 billion, or 4.3%, as compared to 1997. This decrease was principally due to a decrease in personnel and fuel costs. Personnel costs decreased by Lit. 806 billion, or 9.1%, due to:

- Approximately Lit. 430 billion in savings from a reduction in headcount of 4,399 employees in 1998;
- A Lit. 460 billion savings as a result of the elimination of payroll taxes for national health care as of January 1, 1998. You should read “—Income taxes” for a more detailed discussion of these tax changes; and
- A decrease of Lit. 100 billion due to a non-recurring provision recorded in 1997 for pension liabilities for active and retired personnel.

These reductions were offset by an increase in payroll costs relating to an increase in average per employee compensation and an increase of approximately Lit. 90 billion due to the elimination of social security contribution relief.

Fuel costs in 1998 decreased by Lit. 994 billion, or 13%, as compared to 1997 as a result of a fall in fuel oil prices in 1998 and increased use of less expensive fuels such as coal and orimulsion. These reductions were partially offset by an increase in purchased power from third parties of Lit. 233 billion, or 3.8%, in 1998 as compared to 1997. This increase comprised a 6.3% increase in purchases from CIP 6 Producers and a 1% increase in imported electricity, principally due to attractive spot prices for imports. Provisions increased by Lit. 487 billion, principally due to:

- A Lit. 200 billion provision for pension liabilities for retired managers; and
- An increase of Lit. 135 billion in provisions for bad debts.

Depreciation and amortization

Depreciation and amortization increased from Lit. 5,695 billion in 1997 to Lit. 6,036 billion in 1998, a 6.0% increase, principally as a result of additional fixed assets entering service in 1998.

Operating income

Operating income increased from Lit. 8,689 billion in 1997 to Lit. 9,604 billion in 1998, a 10.5% increase. This increase was principally attributable to reduced personnel costs, the increase in tariff revenues and, less significantly, the effect of timing in fuel cost reimbursement calculations, offset by an increase in electricity purchases, other costs and depreciation.

Financial income (expense)

Net financial expense declined from Lit. 2,197 billion in 1997 to Lit. 1,480 billion in 1998, a 32.6% decrease. This decrease was attributable to a reduction in outstanding debt through prepayment and retirement at maturity and reduced interest paid due to lower interest rates. Long-term debt (including the current portion) decreased by 17.5% from Lit. 32,393 billion at December 31, 1997 to Lit. 26,736 billion at December 31, 1998.

Extraordinary income (expense)

Net extraordinary expense decreased from Lit. 1,107 billion in 1997 to Lit. 907 billion in 1998, a 18.1% decrease. Details of our extraordinary expenses in 1998 are presented above in the comparison with those for 1999.

Extraordinary expenses in 1997 principally consisted of:

- A net provision of Lit. 440 billion principally to record at fair value the construction projects that were halted by management and which are referred to above. The provision necessary to record these assets at fair value was Lit. 614 billion. The estimate of the fair value was based on international market price comparisons to similar plants and equipment, as reported by the World Bank in an appraisal report prepared for the study of similar initiatives in China, and on various preliminary negotiations with potential acquirers based in developing countries. The total provision was offset in part by Lit. 174 billion related to a litigation reserve no longer required due to a favorable ruling on litigation against INPS. The litigation regarded social security contributions that INPS had claimed were due in respect of one-time bonus payments to our employees in connection with the renewal of labor contracts in prior years;
- A provision of Lit. 390 billion to record an allowance for doubtful accounts on a receivable from the Equalization Fund for the reimbursement of past nuclear-related charges that are in dispute. We recorded this provision after the Energy Authority clarified the reimbursement criteria for nuclear-related costs, previously under review by the Energy Authority, and excluded from reimbursement a number of items. In addition, the criteria for calculating the interest for delayed reimbursement had been altered. On that basis, the allowance for doubtful accounts was established for Lire 390 billion. In accordance with Italian GAAP, we recorded this provision in 1997, because the resolution was issued prior to the approval of the Consolidated Financial Statements for 1997 by our board of directors;
- A provision of Lit. 266 billion relating to the different voluntary early retirement programs offered to managers and employees. The manager plan was available in 1996 and was accepted by 462 individuals. In January and March 1997, we offered two different programs, which ended in February and May 1997, respectively, to employees for early retirement, and 3,195 employees accepted. All programs provided for a one-time payment calculated on the basis of the plans' formula; and

- A provision of Lit. 175 billion to write-off our investment in NERSA S.A. (“NERSA”), an electricity generation company that operated a nuclear power plant in France, in anticipation of withdrawing completely from the project in 1998. We sold our 33% interest in NERSA in July 1998. You should read “—Regulatory Matters—Environmental matters—Discontinued nuclear operations” in Item 1 for a more detailed description.

You should read note 23 to the Consolidated Financial Statements for a discussion of the different criteria used under Italian GAAP and U.S. GAAP for determining what constitutes an extraordinary item.

Income taxes

In 1998, income taxes changed in Italy when the government introduced a new tax, the regional income tax, or IRAP, in place of several taxes: the local income tax, or ILOR; tax on net equity; and payroll taxes for national health. Taxable income for IRAP is computed based on operating revenues less external third party operating costs and depreciation. The national income tax for corporations, or IRPEG, did not change during the period.

Under Italian GAAP, we recognize deferred taxes based upon timing differences between taxable income and income reported for consolidation purposes on a liability basis. We recognize deferred tax assets when there is a reasonable certainty of their realization. Our current accounting policies reflect the adoption in 1998 of new accounting standards under Italian GAAP with respect to accounting for income taxes, applicable starting from the year 1998. These changes resulted in recognition on January 1, 1998 of a deferred tax asset of Lit. 588 billion. You should read note 2 to the Consolidated Financial Statements for a more detailed discussion of these accounting changes.

The following table shows a breakdown of our income taxes for the periods indicated:

	Year ended December 31,	
	1997	1998
	(in billions)	
Income taxes:		
Current taxes	Lit. 2,096	Lit. 2,785
Deferred tax charge	993	734
Reversal of deferred tax liabilities and recognition of deferred tax assets	(1,031)	(588)
Total	<u>Lit. 2,058</u>	<u>Lit. 2,931</u>

Income taxes in 1998 increased by Lit. 873 billion, or 42.4%, as compared to 1997. This increase was principally attributable to an increase of Lit. 689 billion in current taxes due to increased income for 1998.

	Year ended December 31,	
	1997	1998
Effective tax rate	38.2%	40.6%
Current taxation tax rate	38.9%	38.6%
Deferred taxation tax rate	(0.7) %	2.0%

Net income

Net income increased from Lit. 3,327 billion in 1997 to Lit. 4,286 billion in 1998, a 28.8% increase. This increase was principally due to increased operating income and decreased financing costs, partially offset by higher income taxes.

Inflation

The tariff in effect over the periods covered by the financial statements included herein was not adjusted for inflation. Inflation in Italy was 1.7% in 1997, 1.9% in 1998 and 1.7% in 1999. As a result, the real value of tariffs decreased over time due to inflation.

U.S. GAAP Reconciliation

We have prepared our Consolidated Financial Statements in accordance with Italian GAAP, which differ in certain respects from U.S. GAAP. The significant differences between Italian GAAP and U.S. GAAP, as applied to our Consolidated Financial Statements, are as follows:

- Restated fixed assets and the related depreciation;
- Capitalized interest and the related depreciation;
- Write-down of fixed assets;
- Unbilled revenues;
- Pension and employee termination accounting;
- Other post retirement benefits accounting;
- Social Security withholdings and contribution;
- Derivatives;
- Effect of U.S. GAAP adjustments on WIND equity;
- Restructuring reserve;
- Accounting for income taxes; and
- Extraordinary income and expenses.

You should read note 23 to our Consolidated Financial Statements for a more detailed discussion of the principal differences between Italian GAAP and U.S. GAAP that affect our Consolidated Financial Statements, and note 24 to our Consolidated Financial Statements for a reconciliation of net income and shareholders' equity between Italian GAAP and U.S. GAAP.

Our consolidated net income under U.S. GAAP was approximately Lit. 3,177 billion in 1997, Lit. 3,531 billion in 1998 and Lit. 4,446 billion in 1999, as compared to consolidated net income under Italian GAAP of Lit. 3,327 billion in 1997, Lit. 4,286 billion in 1998 and Lit. 4,541 billion in 1999. Our shareholders' equity under U.S. GAAP was Lit. 34,785 billion at December 31, 1998 and Lit. 32,895 billion at December 31, 1999, compared with shareholders' equity under Italian GAAP of Lit. 35,880 billion at December 31, 1998 and Lit. 34,034 billion at December 31, 1999.

The differences between U.S. GAAP and Italian GAAP also have an impact on operating income at the segment level. The differences result primarily from the property related adjustments and the different classifications of extraordinary expenses. Operating income by segment for 1998 under U.S. GAAP approximates Lit. 6,093 billion from generation, Lit. 228 billion from transmission and Lit. 3,317 billion from distribution, as compared to 1998 operating income under Italian GAAP of Lit. 6,930 billion from generation, Lit. 175 billion from transmission and Lit. 3,434 billion from distribution. Operating income by segment for 1999 under U.S. GAAP approximates Lit. 5,897 billion from generation, Lit. 90 billion from transmission and Lit. 4,256 billion from distribution, as compared to 1999 operating income under Italian GAAP of Lit. 6,333 billion from generation, Lit. 110 billion from transmission and Lit. 4,493 billion from distribution.

Under the Italian government's budget for the year 2000, we are required to pay approximately Lit. 1,500 billion to the national pension system in each of 2000, 2001 and 2002 in connection with the termination of the national electricity pension fund. The relevant legislation provides the Group with the option to expense these payments proportionately over the twenty-year period between 2000 and 2019 or to record them in each of the three years they are actually paid. We have chosen to use the twenty-year option for Italian GAAP purposes. For U.S. GAAP purposes, however, we will be required to expense these amounts in each of 2000, 2001 and 2002, as the contributions are paid. This difference between the treatment of these payments under Italian GAAP and U.S. GAAP will therefore have a significant negative effect on our U.S. GAAP results in each of those three years. You should read "—Employees—Employee benefits" in Item 1, and our Consolidated Financial Statements contained herein for a more detailed description of the reform of the electricity pension fund and a discussion of its impact on the reconciliation of our results under U.S. GAAP.

Liquidity and Capital Resources

Liquidity

Our primary source of liquidity is cash generated from operations. Net cash provided by operating activities was Lit. 13,512 billion in 1999, as compared to Lit. 15,248 billion in 1998. The decrease is attributable to a significant decrease in net current receivables from the Equalization Fund from Lit. 3,433 billion in 1998 to only Lit. 765 billion in 1999, which reflected the completion in early 1999 of the delayed collection of thermal generation grants for previous years. Net of these receivables, cash flow from operations was Lit. 12,747 billion in 1999, as compared to Lit. 11,815 billion in 1998, with the increase being almost entirely due to the increase in the Group's net income. A decrease in the level of the Group's working capital reflected the drawdown of approximately Lit. 200 billion in inventories as a result of increased fuel prices in the second half of the year.

Cash used in investing activities decreased from Lit. 5,760 billion in 1998 to Lit. 4,553 billion in 1999. The difference reflected a decrease in capital expenditures of Lit. 218 billion, as explained in more detail below, as well as the positive contribution to cash flow of an increase in payments received from the Equalization Fund for nuclear-related costs of approximately Lit. 1,100 billion, which were offset in part by negative cash flows relating to investments in financial assets (Lit. 243 billion) and the disposal of fixed assets (Lit. 223 billion).

Cash used in financing activities increased from Lit. 7,021 billion in 1998 to Lit. 10,786 billion in 1999, principally because of the extraordinary dividend of Lit. 4,422 billion paid to the Treasury Ministry and the extraordinary distribution of Lit. 1,445 billion from the employee termination indemnity provision to enable employees to purchase shares in our initial public offering. These extraordinary items were offset in part by debt repayments or prepayments. In total, we repaid Lit. 5,958 billion of medium and

long-term debt in 1999 (Lit. 5,657 billion in 1998); our short-term debt increased by Lit. 3,002 billion during 1999.

Capital resources

At December 31, 1999, our outstanding medium and long-term debt was Lit. 16,961 billion and our short-term debt, including the current portion of long-term debt, was Lit. 6,741 billion. Financial expense totaled Lit. 1,131 billion for the year ended 1999.

We maintain committed lines of credit with maximum borrowing limits aggregating approximately Lit. 3,000 billion and uncommitted lines of credit and other short-term borrowing agreements with banks in Italy with maximum borrowing limits aggregating approximately Lit. 4,591 billion as of the end of 1999. The average interest rate on short-term borrowings was approximately 3.5% as of December 31, 1999. We believe that our bank facilities, together with our portfolio of cash and cash equivalents, are sufficient to meet our present working capital needs and requirements for capital expenditures.

At December 31, 1999, only 2.7% of our long-term debt was denominated in currencies of countries that are not participating in the euro and 34.0% of our long-term debt was guaranteed as to principal and interest by the Italian government. At December 31, 1999, 62.2% of our long-term debt bore interest at floating rates and 37.8% bore interest at fixed rates. To improve our mix of floating and fixed-rate obligations, we have entered into certain interest rate hedging contracts, particularly interest rate swaps and collars. Taking these hedging positions into account using the nominal values of interest rate collars, we have estimated that we are exposed to interest rate fluctuations with respect to approximately 31% of our outstanding debt. You should read "Price risk management and market risk information" in Item 9A for a discussion of those contracts. Without giving effect to these arrangements, the average interest rate on our outstanding long-term debt as of December 31, 1999 was approximately 4.6%.

Capital Expenditures

The table below sets out the capital expenditures by type of plant for the periods indicated:

	Year ended December 31,		
	1997	1998	1999
	(in billions)		
Distribution network.....	Lit. 3,092	Lit. 3,007	Lit. 3,246
Transmission network.....	659	594	436
Generation plants.....	2,322	1,869	1,578
Other	393	401	393
	<u>Lit. 6,466</u>	<u>Lit. 5,871</u>	<u>Lit. 5,653</u>

Capital expenditures have been decreasing in recent years due to reductions in the unit cost of construction supplies and the standardization of components. The reductions in generation reflected the fact that expenditures to bring thermal plants into line with current environmental regulations neared completion during 1998, and benefited from a more efficient investment program that we implemented in 1997.

Commitments

Although the actual amount of our capital expenditures in future periods will depend on various factors that cannot presently be foreseen, we expect to make capital expenditures of Lit. 5,500 billion in 2000, and approximately Lit. 25,000 billion in the 2001-2004 period. The expenditures are scheduled to be primarily concentrated in the distribution business segment, for the upgrading of the network and the development of new activities, and in the generation segment, principally for the conversion of plants to CCGT technology.

We have entered into various fuel supply contracts primarily for the purchase of fuel oil and natural gas. We expect that our expenditures related to these commitments will approximate an aggregate of Lit. 17,215 billion for the five-year period ending December 31, 2004.

We also have unconditional purchase obligations for electric power. Our aggregate expenditures related to these commitments are expected to approximate Lit. 45,675 billion for the five-year period ending December 31, 2004. Once the Single Buyer becomes operational, we will no longer be required to purchase electricity from domestic CIP 6 Producers. In addition, we may be required to transfer all or part of our long-term import contracts to the Single Buyer.

Year 2000 Compliance

The Year 2000 issue refers to the risk that systems, products and equipment having date-sensitive components will not recognize the year 2000, resulting in potential system failures or miscalculations that could cause disruption of operations. We have implemented those procedures that we deemed necessary to safeguard our operations from computer-related issues associated with adverse effects as a result of improperly recognizing the millennial data change. As a result of these Year 2000 preparation efforts, the Enel Group has experienced no significant Year 2000-related failures to date.

We plan to continue monitoring our systems and contingency plans are available in the event that a Year 2000 failure should occur. These contingency plans were designed to mitigate the impact on our business if its Year 2000 compliance efforts were not successful. The total cost of our Year 2000 Project, covering both IT and non-IT systems, was Lit. 88 billion, which we charged as current expenses to 1999 income.

However, there can be no assurance that the Group's systems do not contain undetected Year 2000 defects or errors. Known or unknown errors or defects in our systems may result in delay or loss of revenue, diversion of development resources, damage to our reputation, or increased service or warranty costs. The occurrence of any of the foregoing could have a material adverse effect on our results of operations and financial condition.

European Single Currency

The European Economic and Monetary Union introduced the euro on January 1, 1999. On that date, 11 member states of the European Union, including Italy, adopted the euro as their local currency. Italy's national currency and that of the other ten countries participating in the euro became components of the euro on that day. The euro is now available only for currency trading on currency exchanges and non-cash (banking) transactions. Bills and coins denominated in the former national currencies, or legacy currencies, will remain legal tender through January 1, 2002. Beginning on January 1, 2002, euro-denominated bills and coins will be issued for cash transactions. For a period of up to six months from that date, bills and coins denominated in both legacy currencies and the euro will be legal tender. On or

before July 1, 2002, the participating countries will withdraw all bills and coins denominated in legacy currencies and use the euro exclusively.

Operational impact

We expect to adopt the euro as our reporting currency and to declare all dividends in euro for all periods ending after December 31, 2001. Our shares have been quoted on the Italian Stock Exchange in euro from the date of their initial listing.

The introduction of the euro will require changes in our information technology and other systems in order to accommodate the use of the euro in our corporate transactions and financial reporting. For example, we will be required to make changes to our information systems in order to be able to produce bills for our customers in euro. As this transition is an integral part of our implementation of a new Group-wide management information system, we are not able to specifically identify that portion of our information technology and other systems in connection specifically related to the introduction of the euro.

Business and competitive implications

We believe that the euro will not have a material impact on our revenues because virtually all our revenues are generated within Italy and as a result do not vary with exchange rate fluctuations. Most of our non-fuel costs, particularly labor costs, are incurred within Italy. Most of our fuel costs are denominated in dollars and should not be significantly affected by the introduction of the euro. However, there can be no assurance whether and to what extent the introduction of the euro will affect our business, financial condition and results of operations, particularly if the geographic diversification of our operations increases.

Item 9A. *Quantitative and Qualitative Disclosures About Market Risk*

Price risk management and market risk information

We purchase electricity from outside Italy and also purchase fuel in the international oil and natural gas market. As a consequence, we are subject to market risks from changes in foreign exchange rates and commodity prices. We are also subject to interest rate risks because of our medium and long-term debt positions.

The tariff structure that has been in place during the periods covered in our Consolidated Financial Statements has reduced our commodity price and exchange rate risks from fuel purchases and imports of electricity. The tariff structure includes a reimbursement component for fuel costs and imports that is based on, among other things, an index to the price of a basket of fuels on international markets. This index is adjusted so that changes in fuel costs and exchange rate fluctuations are reflected in the levels of tariffs and reimbursements. As a result, our residual commodity price and exchange rate exposures for fuel purchases have been:

- exchange rate exposure on our accounts payable for fuel purchases. We actively manage this exchange rate exposure; and
- commodity price and exchange rate exposure related to the time delay between incurrence of fuel costs and reimbursement calculations. We believe that this risk, which is attributable to variation in profits between periods because of reimbursement calculations, is limited and our profit levels over the long run have generally been unaffected by fluctuations in fuel prices or

exchange rates relating to fuel costs. Notwithstanding the above, due to the increased volatility of the oil market in 2000, we have begun systematically to hedge this exposure through Enel.FTL.

Our exchange rate exposure for electricity imports is principally limited to imports denominated in Swiss francs. In 1999, approximately 63.0% of our electricity imports by value were denominated in Swiss francs. The balance of our electricity imports are denominated in euro, and we do not have an exchange rate risk on these imports as a result. We actively manage the exchange rate exposure on our accounts payable in Swiss francs.

Almost all of our long-term debt is denominated in the currencies of countries participating in the euro and as a result is not subject to exchange rate risk. Exchange rate risk on most of our long-term debt that is denominated in non-euro currencies is covered by the Republic of Italy either entirely or within a 2% or 5% band. The Republic of Italy covers these risks pursuant to a program for eligible companies that were financing new industrial investments as an incentive for economic development. At December 31, 1999, we were fully exposed to exchange rate risk on only Lit. 249 billion out of Lit. 20,699 billion in long-term debt outstanding.

For the three years ended December 31, 1997, 1998 and 1999, the net foreign exchange losses covered by the Italian government under the special incentive laws, and therefore not included in the Consolidated Financial Statements, totaled approximately Lit. 237 billion, Lit. 156 billion and Lit. 153 billion, respectively.

In early 1999, we rearranged our risk management organization. We assigned responsibility for analyzing, monitoring and controlling risk management activities to a risk controller and for executing financial operations to a risk manager, both of whom are part of our finance department. Senior management provides the risk manager with instructions about the strategic position of the debt portfolio, such as the balance between fixed and floating rate debt and the amount of the unhedged portion of our debt denominated in foreign currencies.

Our treasury department acts under operating limits regarding losses from financial instruments and currency net exposures. Our calculation and measurement techniques are generally consistent with international banking standards established by the Basle Committee. However, our policies regarding risk levels are generally significantly more conservative than those established by the Basle Committee. Our risk controller is responsible for measuring actual risk levels on the portfolio of financial instruments and monitoring compliance with our policies.

We currently do not buy and sell derivative financial instruments for trading purposes. In the future, however, Enel Trade may possibly engage in derivatives trading as part of its broader mandate.

We have estimated our market risk exposure using sensitivity analysis. Market risk exposure represents the change in fair value of financial instruments, including financial and commodity derivatives, resulting from an assumed 10% adverse change in market prices or rates. We determined fair value using pricing models that measure the effect of changes in market prices according to market practice for each category of financial instrument.

We have used sensitivity analysis to determine the market risk exposure associated with our debt and with our foreign exchange, interest rate and commodity derivatives. We have summarized the results of this sensitivity analysis in the following paragraphs. Actual changes in market prices or rates may differ from hypothetical changes.

The notional value of a derivative is the contractual amount on the basis of which the differentials are exchanged. This amount can be expressed either on a value basis or on a physical quantities basis such as tons. Amounts expressed in a foreign currency are converted into lire by applying the exchange rate at end of the relevant period. Amounts expressed in the currency of a participant in the EMU are translated using the fixed exchange rate for that currency in euro.

Foreign exchange risk

As explained above, our principal foreign exchange risk relates to fuel costs and electricity imports. At December 31, 1999, we also had foreign exchange risk exposure on Lit. 249 billion in debt denominated in non-euro currencies, which represented approximately 1.2% of our total long-term debt outstanding. Our exposure to foreign currency exchange rates is primarily in respect of U.S. dollars because of fuel purchases and in respect of Swiss francs because of electricity imports.

We use forward exchange contracts and currency options in managing our foreign exchange risk. At December 31, 1999, we had forward exchange contracts and options outstanding with an aggregate notional amount of Lit. 1,549 billion. Assuming a 10% depreciation of the euro against all the other currencies to which we have exchange rate exposure, the fair market value of these financial instruments, including long-term debt exposed to exchange rate risk, would have declined by Lit. 41 billion. The net foreign exchange gains (losses) were Lit. (40) billion, Lit. 13 billion and Lit.(16) billion for the years ended December 31, 1997, 1998 and 1999, respectively. The foreign exchange losses in 1997 and 1999 mainly reflect negative year-end adjustments related to long-term debt denominated in foreign currencies because of depreciation of the Italian lira.

Interest rate risk

Our outstanding total medium and long-term debt at December 31, 1999 amounted to Lit. 20,699 billion, of which Lit. 12,878 billion, or 62.2%, was floating rate, principally based on Euribor, and Lit. 7,821 billion, or 37.8%, was fixed rate. To improve the mix of our fixed and floating rate exposures, we have entered into interest rate hedging contracts, particularly interest rate swaps and collars.

In interest rate swaps, we agree with other parties to exchange, at specified intervals, the difference between interest amounts calculated by reference to the notional principal amount and the fixed or floating interest rates that we have agreed with the other parties.

An interest rate collar is a combination of options that enable us to lock our debt cost into a predetermined interest rate range. We use primarily zero-cost collars that do not require payment of an option premium.

At December 31, 1999, we had arranged interest rate derivatives with a notional amount of Lit. 11,391 billion. The fair value of these derivatives was negative by Lit. 197 billion at December 31, 1999. The fair value of our medium and long-term debt was Lit. 20,733 billion at December 31, 1999. As a result, the aggregate fair value of our interest rate derivatives and long-term debt was Lit. 20,930 billion.

Based on the results of our sensitivity analysis, at December 31, 1999, a 10% decrease in interest rates would have increased the net negative fair value of our portfolio of financial instruments (including long-term debt and interest rate derivatives) by Lit. 261 billion. However, we do not consider such an increase in net negative fair value to be a significant risk, because it would impact earnings and cash flows only if we were to reacquire all or a portion of these instruments in the open market prior to their maturity.

The effective interest rate risk is dependent on the likelihood that interest rates will increase. Because our revenues are not directly linked to interest rates, our principal interest rate risk is that a general rise in interest rates will result in a higher interest expense on the unhedged portion of floating-rate debt. If interest rates were to increase by 10% over December 31, 1999 levels, our consolidated interest expense, including with respect to long-term debt and interest rate derivatives, would increase by a total of approximately Lit. 13 billion per year.

Commodity price risk

In 1999, we entered into commodity-based derivative contracts on a limited basis to fix the benefit associated with futures prices that are below expected fuel cost reimbursements. Our commodity-based derivative contracts consist mainly of over-the-counter market swaps related to fuel oil products.

At December 31, 1999, the notional amount of these open contracts related to 30,000 tons of fuel oil, the fair value of which was not material. At December 31, 1998, the contracts had related to 1,190 million tons of fuel oil, and the fair value on these positions was Lit. 9 billion.

Item 10. *Directors and Officers of the Registrant*

Our board of directors is responsible for the management of Enel. It has the power to take all actions consistent with the corporate purpose described in our by-laws, except for actions that by law or under our by-laws may only be taken by our shareholders at the general meeting. Our board is elected for a term of up to three years. Members are eligible for re-election. The board must consist of not less than three and not more than nine members. The board currently consists of seven members whose three-year terms are scheduled to expire in 2002.

The chairman and chief executive officer are our legal representatives. The chief executive officer generally has the power to represent Enel within the scope of the functions delegated to him. For specific actions or categories of actions, the power to represent us can be delegated by the holder of such power to one of our employees or to third parties.

The quorum for board meetings is a majority of the members in charge. Resolutions are adopted by a majority of votes of those present. A board meeting may be called by the chairman on his or her own initiative, must be called upon a request of the majority of the board's members or upon request of the board of statutory auditors (or at least two of its members) and must be called upon a request for a meeting for specific purposes of two directors (or one director when the board is composed of three members).

The board has the power to delegate certain of its powers to one of its members, and determines the powers and the functions delegated to such person. Under applicable law and our by-laws, the board may not delegate certain of its responsibilities, such as the approval of the financial statements or proposals of increases or reductions of our capital.

The names of the seven members of our board, their current position and the year when each was initially appointed as director are set forth in the following table. The term of appointment of the current board will expire on 2002.

<u>Name</u>	<u>Position</u>	<u>Year Initially Appointed</u>
Enrico Testa	Chairman	1996
Francesco Tatò	Director and Chief Executive Officer	1996
Carlo Angelici.....	Director	1999
Vittorio Grilli	Director	1996
Franco Morganti.....	Director	1999
Lorenzo Pelliccioli.....	Director	1999
Claudio Poggi.....	Director	1999

In January 2000, our board of directors has established a compensation committee. This committee is composed of three members with no delegated powers. Current members of this committee include Carlo Angelici, Lorenzo Pelliccioli and Claudio Poggi. The compensation committee submits to the board of directors proposals of resolution concerning the compensation of the chief executive officer, the directors to which certain powers have been delegated, and senior executives.

In January 2000, our board of directors has also established an internal audit committee. This committee is composed of three members with no delegated powers: Vittorio Grilli, Franco Morganti and Enrico Testa. Such committee has the authority to evaluate the activity and the periodical reports of both the internal and external auditors.

The Treasury Ministry has confirmed that as long as it remains our majority shareholder, it intends to continue to participate in the nomination and election of our board in order to protect its investment as a shareholder. Under current law, as long as the Treasury Ministry remains our majority shareholder, the Court of Accounts, which was established to exercise a degree of supervision in respect of financial management of government-owned entities such as Enel, will exercise certain powers to protect the financial interests of the Italian government. The Court of Accounts has the right to inspect our financial statements, and regularly reports its findings to the President of each of the Senate and the Chamber of Deputies. In addition, during this period, a non-voting representative of the Court of Accounts may attend the meetings of our board of directors and our board of statutory auditors.

The table below sets forth our executive officers, their positions within Enel, the year they were appointed to such positions and their ages (as of June 1, 2000):

<u>Name</u>	<u>Age</u>	<u>Management Position</u>	<u>Year Joined Enel</u>	<u>Year Appointed to Current Position</u>
Corporate Managers:				
Mario Barozzi.....	37	Strategic Affairs	1997	1998
Alessandro Bufacchi.....	53	E-Business Development	2000	2000
Antonio Cardani.....	50	Audit	2000	2000
Salvatore Cardillo	50	Legal Affairs	2000	2000
Giuseppe Carta.....	64	Regulatory Relations	1961	1991
Fulvio Conti.....	52	Chief Financial Officer	1999	1999
Mario Dal Co	50	Information and Communication	1997	1999
Angelo Delfino.....	60	Personnel	1997	1999
Stefano Lucchini.....	38	Press and External Communications	1997	1999
Massimo Romano.....	41	Institutional Relations	1997	1997
Claudio Sartorelli.....	55	Corporate Affairs	1970	1995
Luciana Tarozzi.....	56	Accounting	1965	1997
General Managers:		Subsidiary		
Lorenzo Bronzi.....	56	Enel.FTL S.p.A.	1970	2000
Vincenzo Cannatelli.....	47	Eurogen S.p.A., Elettrogen S.p.A., Interpower S.p.A.	1999	1999
Antonino Craparotta	54	Enel Produzione S.p.A.	1999	1999
Gianluigi Di Francesco.....	50	Enel.it S.p.A.	1999	1999
Rocco Failla	54	Enel.Hydro S.p.A.	1998	1999
Roberto Formigoni.....	54	Enel Trade S.p.A.	1998	1999
Luigi Giuffrida	52	Enelpower S.p.A., Elettroambiente S.p.A.	1998	1999
Renato Iodice	58	Enel Distribuzione S.p.A.	1998	1999
Salvatore Machi	63	Cesi S.p.A.	1965	1999
Francesco Massa	56	Sei S.p.A.	1967	1997
Sergio Mobili	59	T.E.R.N.A. S.p.A.	1967	1999
Roberto Muscogiuri.....	50	Enel.re S.p.A.	1981	2000
Giuseppe Novello	54	CONPHOEBUS S.p.A.	1970	1999
Giuseppe Nucci.....	48	So.l.e. S.p.A.	1998	1998
Francesco Parvis.....	54	Sfera S.c.p.a.	1999	1999
Paolo Pietrogrande.....	43	E.R.G.A. S.p.A., CISE S.r.l.	1999	1999
Tommaso Pompei.....	58	WIND Telecomunicazioni S.p.A.	1996	1997
Franco Seripa	65	Enel.si S.p.A.	1964	2000

Board of Statutory Auditors

Pursuant to the Italian Civil Code, in addition to electing the board, our shareholders also elect a board of statutory auditors.

Statutory auditors remain in office for a three-year term and may be re-elected for consecutive terms or substituted automatically by an alternate auditor if they resign or are unable to complete their term. Statutory auditors may be removed only for cause and with the approval of an Italian court.

The board of statutory auditors is responsible for reviewing our management and financial reporting and financial condition. In conducting this review the board of statutory auditors has a duty to the shareholders, to whom it reports, and to us. The role of the board of statutory auditors includes reviewing our management, and, in particular, ensuring compliance with applicable law and our by-laws. Furthermore, the statutory auditors must ensure that we maintain adequate organizational structure, internal controls and administrative and accounting systems.

Our current board of statutory auditors was appointed in 1998. The term of its members will expire in 2001. At that time, new members will be appointed by the shareholders. The names of the current members, their positions and the year during which each was initially appointed are set forth in the following table.

<u>Name</u>	<u>Position</u>	<u>Year Initially Appointed</u>
Bruno De Leo ⁽¹⁾	Chairman	1992
Gustavo Minervini.....	Auditor	1992
Oreste Piemontese	Auditor	1995
Umberto Aprea.....	Alternate Auditor	1998
Francesco Bilotti.....	Alternate Auditor	1995

(1) Employee of the Italian Ministry of Treasury.

Item 11. *Compensation of Directors and Officers*

Applicable Italian regulations (Article 78 of CONSOB Regulation No. 11971, issued on May 14, 1999) require Enel to publicly disclose the following information regarding the compensation for 1999 of each of the directors and statutory auditors identified in Item 10 in reports filed with CONSOB. The following amounts include compensation paid by our subsidiaries in certain cases.

<u>Name</u>	<u>Position(s) Held</u>	<u>Base Compensation</u> ⁽¹⁾	<u>Bonuses and Other Incentives</u> ⁽²⁾	<u>Other Compensation</u>	<u>Pension, Retirement and other Similar Benefits</u> ⁽³⁾
Fees (in thousands of Lire)					
Enrico Testa	Chairman of the Board of Enel, Chairman of the Board of Elettroambiente S.p.A.	529,852	825,000	8,400	6,799
Francesco Tatò	Chief Executive Officer of Enel, Chairman of the Board of Cesi S.p.A. and Enel.Hydro S.p.A., Director of Elettroambiente S.p.A.	1,376,575	2,250,000	7,200	—
Alfonso Limbruno ⁽⁴⁾	Vice President of Enel	81,183	—	1,800	—
Claudio Poggi	Director of Enel and SEI S.p.A.	89,144	—	6,600	—
Alberto Giovannini ⁽⁵⁾	Director of Enel	81,941	—	4,800	—
Carlo Angelici	Director of Enel	30,000	—	1,800	2,014
Vittorio Grilli	Director of Enel	112,100	—	6,900	—
Franco Morganti	Director of Enel	4,516	—	300	—
Lorenzo Pelliccioli	Director of Enel	—	—	—	—
Bruno De Leo	Chairman of the Board of Statutory Auditors of Enel, SOGIN and <i>Gestore della Rete</i>	131,483	—	11,400	9,049
Gustavo Minervini	Statutory Auditor of Enel, SOGIN and <i>Gestore della Rete</i>	97,483	—	7,800	—
Oreste Piemontese	Statutory Auditor of Enel, SOGIN and <i>Gestore della Rete</i>	98,683	—	10,200	—

(1) Represents the combined annual compensation for posts held at Enel and certain of its subsidiaries.

(2) Represents a special bonus in connection with Enel's initial public offering granted by the board of directors on March 3, 2000.

(3) Represents an amount contributed by the Company in respect of pension and termination benefits on behalf of the individuals listed above.

(4) Until May 1999.

(5) Until October 1999.

The Company does not disclose to its shareholders or otherwise make available public information as to the compensation of its executive officers.

The aggregate compensation paid by the Company and its subsidiaries to all of its directors, executive officers and statutory auditors identified in Item 10, excluding pension, retirement or similar benefits, for the year ended December 31, 1999 was approximately Lit. 18,550,000,000. The aggregate amount paid or accrued for pension, retirement or similar benefits for directors, statutory auditors and executive officers for the year ended December 31, 1999 was approximately Lit. 578,000,000.

Item 12. Options to Purchase Securities from Registrant or Subsidiaries

In December 1999, the shareholders of Enel S.p.A. authorized the board of directors to increase Enel's outstanding share capital by an amount not to exceed Lit. 121,261,500,000 in order to permit the issuance (in one or more tranches over a five-year period ending December 2004) of a maximum of 121,261,500 new ordinary shares. These new ordinary shares are to be reserved for issuance upon the exercise of options granted to certain of the Group's senior managers (as identified by the board of directors at the time of the grant) under the terms of the executive stock option incentive plan approved by the board of directors in March 2000 (the "Plan").

The Plan distinguishes between options that, once vested, may be exercised after the first anniversary of the grant date ("One Year Options") and those that, once vested, may be exercised only after the third anniversary of the grant date ("Three Year Options" and, together with the One Year Options, the "Options"). Of the Options granted to each individual participant in any single year, 20% are One Year Options and the remaining 80% are Three Year Options.

Options vest if the average reference price of Enel shares on the Italian stock exchange over the last three months of the year of the grant is higher than a target price determined by the board of directors in the year of the grant (the "Target Price"). The board sets the Target Price with reference to securities analysts' estimates of the future price of Enel shares. The Target Price for the Options granted in 2000 was set at €4.70. If the Target Price is not met in a given year, all of the One Year Options and 30% of the Three Year Options granted in that year do not vest and expire. However, the remaining 70% of the Three Year Options granted in the year (56% of the Options) may still vest if (i) the price of Enel shares on the Italian stock exchange during the year of the grant outperforms a specified reference index over the same period and (ii) the actual growth in value of our business during the year of the grant (as determined using a proprietary formula) exceeds the expected growth for that year, as determined by the board of directors at the beginning of the year. If these conditions are not met, the remaining 70% of Three Year Options may also vest if the average reference price of Enel shares on the Italian stock exchange over the last three months of the second year following the grant is higher than the Target Price for the year of the grant, as adjusted for the expected positive variation of the price of Enel shares in the following two years, as determined by the board of directors each year.

One Year Options, if vested, may be exercised from the first to the fourth year following the grant. Three Year Options, if vested, may be exercised in the third and fourth year following the grant. In all cases, the Options may only be exercised within fifteen trading days following the shareholders' approval of the financial statements for the preceding fiscal year. The strike price of the Options is set by the board of directors at a date no later than the date of the grant and cannot be lower than the average reference price of Enel shares on the Italian stock exchange during the month preceding the grant (the strike price of Options granted in 2000 was set at €4.30 per share). Options are not transferable, except in certain cases.

In March 2000, our board of directors granted an aggregate of 19,690,000 Options (in respect of an equal number of ordinary shares) under the Plan. The number of Options granted to participating managers has been determined pursuant to a formula based on the participant's gross salary for the year in question and the board of directors' judgment on his or her individual contribution to the appreciation in value of our ordinary shares. Of the total of 19,690,000 Options that have been granted, 9,320,000 are held by the directors and executive officers named in item 10. Other than the foregoing, none of our directors, statutory auditors or executive officers mentioned above owns or controls any Options.

Item 13. *Interest of Management in Certain Transactions*

Not applicable.

PART II

Item 14. *Description of Securities to be Registered*

Not applicable.

PART III

Item 15. *Defaults upon Senior Securities*

None.

Item 16. *Changes in Securities and Changes in Security for Registered Securities*

None.

Item 17. *Financial Statements*

Reference is made to Item 19(a) for a list of all financial statements filed as part of this Annual Report.

Item 18. *Index to Financial Statements and Exhibits*

(a) Index to Consolidated Financial Statements

Pages

Report of Independent Auditors with respect to the Consolidated Financial Statements	F-2
Consolidated Balance Sheets as of December 31, 1998 and 1999	F-3
Consolidated Statements of Income for the years ended December 31, 1997, 1998 and 1999	F-5
Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 1997, 1998 and 1999	F-6
Consolidated Statements of Cash Flows for the years ended December 31, 1997, 1998 and 1999..	F-7
Notes to the Consolidated Financial Statements	F-8

(b) Index to Exhibits

1.1	By-laws of Enel S.p.A., as amended and restated as of May 26, 2000
-----	--

SIGNATURES

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant certifies that it meets all of the requirements of filing on Form 20-F and has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

ENEL S.P.A.

(Registrant)

S/ FULVIO CONTI

FULVIO CONTI
CHIEF FINANCIAL OFFICER

Dated: June 30, 2000

ENEL S.p.A. AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

	<u>Pages</u>
Report of Independent Auditors with respect to the Consolidated Financial Statements	F-2
Consolidated Balance Sheets as of December 31, 1998 and 1999	F-3
Consolidated Statements of Income for the years ended December 31, 1997, 1998 and 1999	F-5
Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 1997, 1998 and 1999	F-6
Consolidated Statements of Cash Flows for the years ended December 31, 1997, 1998 and 1999.....	F-7
Notes to Consolidated Financial Statements	F-8

REPORT OF INDEPENDENT AUDITORS

To the Shareholders of
ENEL S.p.A.:

We have audited the accompanying consolidated balance sheets of ENEL S.p.A. (an Italian corporation) and subsidiaries (the “Company”) as of December 31, 1998 and 1999, and the related consolidated statements of income, changes in shareholders’ equity and cash flows for each of the three years in the period ended December 31, 1999. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ENEL S.p.A. and subsidiaries as of December 31, 1998 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with generally accepted accounting principles in Italy.

As discussed in Note 20, effective January 1, 1998, the Company changed its method of accounting for deferred income taxes.

The accounting practices used by the Company in preparing the accompanying consolidated financial statements conform with generally accepted accounting principles in Italy, but do not conform with generally accepted accounting principles in the United States (“U.S. GAAP”). A description of these differences and a reconciliation of net income and shareholders’ equity to U.S. GAAP are set forth in Notes 23 and 24 of the Notes to the Consolidated Financial Statements.

ARTHUR ANDERSEN S.p.A.

Rome, Italy,
May 2, 2000.

ENEL S.p.A. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 1998 AND 1999

	<u>1998</u>	<u>1999</u>	<u>1999</u>
	(billions of lire)		(millions of U.S. dollars)
ASSETS			
Current assets:			
Cash and cash equivalents (Note 2)	2,854	1,027	534
Receivables (Note 4):			
Customers	5,084	5,504	2,862
Other	1,290	2,134	1,110
Equalization fund receivable (Note 5)	1,998	360	187
Inventories (Notes 2 and 6)	1,105	1,944	1,011
Accrued income, prepayments and other	302	191	100
	-----	-----	-----
	12,633	11,160	5,804
	-----	-----	-----
Utility plant (Notes 2 and 7)	146,965	148,624	77,295
Accumulated depreciation (Notes 2 and 7)	(79,020)	(81,969)	(42,630)
	-----	-----	-----
	67,945	66,655	34,665
	-----	-----	-----
Construction work in progress and advance payments	7,742	6,756	3,514
	-----	-----	-----
	75,687	73,411	38,179
	-----	-----	-----
Other non-current assets:			
Equalization fund receivable for nuclear- related costs (Notes 8 and 21)	817	-	-
Social security relief receivable (Note 8)	362	181	94
Investments (Notes 2 and 9)	319	467	243
Other	761	714	371
	-----	-----	-----
	2,259	1,362	708
	-----	-----	-----
Total Assets	90,579	85,933	44,691
	=====	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

ENEL S.p.A. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AS OF DECEMBER 31, 1998 AND 1999

	<u>1998</u>	<u>1999</u>	<u>1999</u>
	(billions of lire)		(millions of U.S. dollars)
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Current maturities of long-term debt (Note 10)	9,736	3,738	1,944
Short-term debt (Note 10)	744	3,003	1,562
Trade accounts payable	4,836	6,089	3,167
Taxes payable	1,375	2,272	1,181
Advances from customers	1,886	1,704	886
Accrued expenses and other current liabilities	3,255	4,098	2,131
	-----	-----	-----
	21,832	20,904	10,871
	-----	-----	-----
Long-term debt (Note 10)	17,000	16,961	8,821
	-----	-----	-----
Other non-current liabilities:			
Reserves for pensions and similar obligations (Note 11)	2,015	2,041	1,062
Reserves for employee termination indemnities	4,439	2,996	1,558
Reserves for decommissioning of nuclear plant and for disposal of nuclear fuel	1,548	-	-
Deferred income taxes (Note 20)	4,544	4,974	2,587
	3,321	4,023	2,092
	-----	-----	-----
Other (Notes 12 and 21)	15,867	14,034	7,299
	-----	-----	-----
Shareholders' equity (Note 13):			
Share capital, lire 1,000 par value per share (12,126,150,379 shares authorized, issued and outstanding)	12,126	12,126	6,306
Legal reserve	251	2,425	1,261
Law 292/93 reserve	10,607	6,036	3,139
Other reserves	1,978	56	29
Retained earnings	6,632	8,850	4,603
Net income	4,286	4,541	2,362
	-----	-----	-----
	35,880	34,034	17,700
	-----	-----	-----
Total Liabilities and Shareholders' Equity	90,579	85,933	44,691
	=====	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

ENEL S.p.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

FOR THE YEARS ENDED DECEMBER 31, 1997, 1998 AND 1999

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1999</u> (millions of U.S. dollars)
	(billions of lire)			
Operating revenues (Notes 2 and 14):				
Sales and services	38,243	38,284	38,774	20,165
Other	1,374	1,504	1,810	942
	-----	-----	-----	-----
	39,617	39,788	40,584	21,107
Operating expenses:				
Personnel (Note 15)	8,831	8,025	7,402	3,850
Fuel (Note 16)	7,657	6,663	6,308	3,280
Purchased power (Note 16)	6,073	6,306	6,831	3,553
Depreciation and amortization (Note 2)	5,695	6,036	6,201	3,225
Services and rentals (Note 17)	2,352	2,223	2,518	1,310
Materials and supplies (Note 16)	1,563	1,585	1,526	794
Provisions.....	328	815	752	391
Other	438	455	550	286
Capitalized expenses (Note 2)	(2,009)	(1,924)	(1,930)	(1,004)
	-----	-----	-----	-----
	30,928	30,184	30,158	15,685
	-----	-----	-----	-----
Operating income	8,689	9,604	10,426	5,422
	-----	-----	-----	-----
Financial income (expense) (Note 18):				
Financial income	424	524	356	185
Financial expense	(2,621)	(2,004)	(1,487)	(773)
	-----	-----	-----	-----
	(2,197)	(1,480)	(1,131)	(588)
	-----	-----	-----	-----
Equity losses.....	-	-	(439)	(228)
Extraordinary income (expense) (Note 19)	(1,107)	(907)	(1,057)	(550)
	-----	-----	-----	-----
Income before income taxes	5,385	7,217	7,799	4,056
	-----	-----	-----	-----
Income taxes (Notes 2 and 20)	2,058	2,931	3,258	1,694
	-----	-----	-----	-----
Net Income	3,327	4,286	4,541	2,362
	=====	=====	=====	=====

The accompanying notes are an integral part of these consolidated financial statements.

ENEL S.p.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 1997, 1998 AND 1999

	<u>Share Capital</u>	<u>Legal Reserve</u>	<u>Law 292/93 Reserve</u>	<u>Other Reserves</u> (billions of lire)	<u>Retained Earnings</u>	<u>Net income</u>	<u>Total</u>
Balance at January 1, 1997	12,126	138	10,607	1,978	3,313	2,226	30,388
Allocation of 1996 net income							
to reserves	-	64	-	-	962	(1,026)	-
Dividends	-	-	-	-	-	(1,200)	(1,200)
Net income for 1997	-	-	-	-	-	3,327	3,327
Balance at December 31, 1997	12,126	202	10,607	1,978	4,275	3,327	32,515
Allocation of 1997 net income							
to reserves	-	48	-	-	2,357	(2,405)	-
Other	-	1	-	-	-	-	1
Dividends	-	-	-	-	-	(922)	(922)
Net income for 1998	-	-	-	-	-	4,286	4,286
Balance at December 31, 1998	12,126	251	10,607	1,978	6,632	4,286	35,880
Allocation of 1998 net income							
to reserves	-	103	-	-	2,218	(2,321)	-
Transfer to reserves	-	2,071	(2,071)	-	-	-	-
Reserves distribution	-	-	(2,500)	(1,922)	-	-	(4,422)
Dividends	-	-	-	-	-	(1,965)	(1,965)
Net income for 1999	-	-	-	-	-	4,541	4,541
Balance at December 31, 1999	12,126	2,425	6,036	56	8,850	4,541	34,034
(millions of U.S. dollars)							
Balance at December 31, 1999	6,306	1,261	3,139	29	4,603	2,362	17,700

=====

The accompanying notes are an integral part of these consolidated financial statements.

ENEL S.p.A. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 1997, 1998 AND 1999

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1999</u>
		(billions of lire)		(millions of U.S. dollars)
CASH FLOW FROM OPERATING ACTIVITIES:				
Net income	3,327	4,286	4,541	2,362
Depreciation and amortization	5,695	6,036	6,201	3,225
Writedowns (revaluations), net	307	19	804	418
Net changes in reserves for employee termination indemnities	(237)	162	279	145
Net changes in other reserves	199	570	99	52
Loss (gain) on disposal of assets, net	51	51	94	49
Interest income	(424)	(524)	(356)	(185)
Interest expense	2,621	2,004	1,487	773
Income taxes	2,166	2,931	3,258	1,694
Cash generated from operating income before working capital changes	13,705	15,535	16,407	8,533
(Increase) decrease:				
- Inventories	532	611	(217)	(113)
- Accounts receivable	(214)	18	(1,349)	(702)
- Accrued income, prepayments and other	671	(937)	39	20
- Equalization fund receivables	(118)	3,433	765	398
- Trade accounts payables	(1,159)	775	1,877	976
- Accrued expenses and other current liabilities	(59)	160	84	44
Cash generated from operations	13,358	19,595	17,606	9,156
Interest received	59	144	356	185
Interest paid	(2,581)	(2,264)	(1,842)	(958)
Income taxes paid	(2,843)	(2,227)	(2,608)	(1,356)
Net cash provided by operating activities	7,993	15,248	13,512	7,027
CASH FLOWS FROM INVESTING ACTIVITIES:				
Investments:				
- Fixed assets	(6,466)	(5,871)	(5,653)	(2,940)
- Financing receivables and other net	1,360	146	(97)	(51)
- Change in investments	(6)	(302)	1,153	600
	(5,112)	(6,027)	(4,597)	(2,391)
Disposals:				
- Fixed assets	68	267	44	23
Net cash used in investing activities	(5,044)	(5,760)	(4,553)	(2,368)
CASH FLOWS FROM FINANCING ACTIVITIES:				
Change in long-term debt	(1,976)	(5,657)	(5,958)	(3,098)
Change in short-term debt	433	(431)	3,002	1,561
	(1,543)	(6,088)	(2,956)	(1,537)
Reserves distribution and dividends paid	(1,200)	(922)	(6,387)	(3,322)
Other	(5)	(11)	(1,443)	(750)
Net cash used in financing activities	(2,748)	(7,021)	(10,786)	(5,609)
NET CASH FLOW FOR THE YEAR	201	2,467	(1,827)	(950)
CASH BALANCE AT BEGINNING OF THE YEAR	186	387	2,854	1,484
CASH BALANCE AT END OF THE YEAR	387	2,854	1,027	534

The accompanying notes are an integral part of these consolidated financial statements.

ENEL S.p.A. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) GENERAL

ENEL S.p.A. (the “Parent”) and its subsidiaries (the “Subsidiaries” or the “Subsidiary Companies”), (collectively the “Company”, “ENEL” or the “ENEL Group”) are involved in the generation, transmission and distribution of electricity and related activities, providing the majority of the electric service in Italy.

At December 31, 1999, approximately 68.3% of the share capital of the Parent is owned by the Ministry of the Treasury (the “Treasury Ministry”) of the Republic of Italy. The Company is the successor entity to Ente Nazionale per l’Energia Elettrica, which was established as a public statutory body by the Italian Parliament in 1962 when the Treasury Ministry nationalized approximately 1,250 private electric companies. In July 1992, the public statutory body was converted into a joint stock company in accordance with Law No. 359 of August 8, 1992 which provided for the privatization of the ENEL Group.

ENEL’s privatization was launched in 1999 with a total of 3,848,802,000 ordinary shares, representing 31.74% of its capital stock, being placed on the market.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING AND REPORTING POLICIES

Basis of Presentation

The Company’s consolidated financial statements were prepared from the accounts of the Parent and the individual financial statements of the Company’s subsidiaries (whether directly or indirectly controlled), in accordance with accounting principles prescribed by Italian law and supplemented by the accounting principles issued by the Consiglio Nazionale dei Dottori Commercialisti e dei Ragionieri (“Italian GAAP”). The financial statements have been reformatted from the original Italian consolidated financial statement presentation and include certain financial statement reclassifications and additional disclosures in order to conform more closely with the form and content of financial statements required by the United States Securities and Exchange Commission. The reclassifications did not affect reported consolidated net income or shareholders’ equity.

Certain prior year balances have been reclassified to conform with the 1999 presentation. These reclassifications did not affect reported consolidated net income or shareholders’ equity.

Differences between the Company’s accounting principles and Generally Accepted Accounting Principles in the United States (“U.S. GAAP”) and their effects on consolidated shareholders’ equity as of December 31, 1998 and 1999 and on consolidated net income for each of the three years in the period ended December 31, 1999, are set forth in Notes 23 and 24.

These financial statements are presented in Italian lire (“lire”) and, for 1999, are also presented in U.S. dollars, solely for the convenience of the reader, at the exchange rate of lire 1,922.81 = U.S. \$1.00, using the noon buying rate in the City of New York for cable transfers of foreign currencies as announced by the U.S. Federal Reserve Bank of New York for custom purposes on December 31, 1999. This rate is computed using the

December 31, 1999 rate of U.S. \$ 1.007 = euro 1.00 and the fixed euro/lire exchange rate of lire 1,936.27 = euro 1.00 established on December 31, 1998. No representation is made that lire or euro amounts have been, could have been, or could be converted into U.S. dollars at that or any other rate of exchange.

Consolidation Principles

The Company's consolidated financial statements include the Parent's statutory accounts and the accounts of companies controlled by ENEL S.p.A., directly or indirectly, either by holding the majority of the voting rights or sufficient votes to enable it to exercise control at ordinary shareholders' meetings. Control is defined as the ability to govern the financial and operating policies of the enterprise so as to obtain benefits from the activities. The statutory financial statements reflect certain tax-basis amounts. Adjustments are made in consolidation to eliminate the effect of the tax-basis reporting and to eliminate all significant intercompany balances and transactions, including any unrealized gains and losses on such transactions.

The companies whose financial statements are consolidated with the Company's financial statements are as follows:

	<u>Percentage of direct And indirect ownership</u>
CESI Spa - Centro Elettrotecnico Sperimentale Italiano Giacinto Motta S.p.A.	65.03%
CONPHOEBUS S.p.A.	100.00
Dalmazia Trieste S.p.A.	100.00
ElettroAmbiente S.p.A.	100.00
Elettrogen S.p.A.	100.00
Enel Distribuzione S.p.A.	100.00
Enel Hydro S.p.A. (ex Ismes)	100.00
Enel Produzione S.p.A.	100.00
Enel Trade S.p.A.	100.00
E.R.G.A. S.p.A.	100.00
Eurogen S.p.A.	100.00
Interpower S.p.A.	100.00
SEI S.p.A.	100.00
So.l.e. S.p.A.	100.00
T.E.R.N.A. S.p.A.	100.00

Insignificant subsidiaries are not consolidated. Investments in entities that are not consolidated, when the Company has a 20% to 50% investment, if material, are accounted for under the equity method. Other investments are recorded at cost, and adjusted if a permanent impairment in value is present. The primary unconsolidated subsidiaries are as follows:

	As of December		<u>Ownership</u>	
	<u>1998</u>	31, <u>1999</u>	<u>Percentage</u>	
	(billions of lire)			
Wind Telecomunicazioni S.p.A.	306.0	453.9	51.00%	(a)
CISE Tecnologie Innovative Srl	1.2	1.2	100.00	(b)
Enel F.T.L. S.p.A.	-	0.2	100.00	(c)
Enel.it. S.p.A.	-	0.2	100.00	(c)
Enel POWER S.p.A.	-	0.2	100.00	(c)
Gestore della rete di trasmissione nazionale S.p.A.	-	-	100.00	(d)
Se.m.e. - Servizi manutenzione elettrica S.p.A.	-	1.7	100.00	(b)
Sfera – S.c.p.a.	-	0.1	100.00	(c)
S.o.g.i.n. – Società Gestione Impianti Nucleari per azioni ("Sogin")	-	-	100.00	(d)
Consorzio Siciltech	0.1	0.1	99.00	(b)
Enelpower UK Ltd	-	0.1	100.00	(c)

- (a) Beginning in 1999, the Company accounts for its investment in Wind Telecomunicazioni S.p.A. ("WIND") under the equity method of accounting in view of the limitations to the exercise of control contained in the company's by-laws. In the previous year, WIND had been accounted for using the cost method due its limited operations.
- (b) The results of operations of these companies have been excluded from the December 31, 1999 consolidated financial statements, due to the limited scale of their operations during the year.
- (c) The Parent's initial capital contributions for these companies have been reflected in the consolidated financial statements. However, the results of operations of these subsidiaries have been excluded from the December 31, 1999 consolidated financial statements, since these recently established companies were not operating during 1999.
- (d) These companies have been excluded from the consolidated financial statements since, pursuant to the Bersani Decree, the shares in such companies will have to be transferred free of charge to the Italian Treasury, consequently the book values of both companies have been completely wrote-down as of December 31, 1999.

Cash and Cash Equivalents

Cash equivalents are comprised of highly liquid temporary investments with original maturities of three months or less.

Inventories

Inventories are stated at purchase cost, calculated on the basis of the weighted average cost and primarily include fuel stock and other materials.

The obsolete or slow moving inventories are written down to their estimated realizable value.

“Contract work in progress” is stated on the basis of the contracted amounts due, if those amounts can be calculated with reasonable certainty on a percentage-of-completion method.

Utility Plant

Utility plant is stated at cost as adjusted by revaluations in accordance with various Italian laws.

Revaluations prior to 1993 increased the consolidated and statutory net book value of utility plant. Increases in utility plant of the Parent were credited to retained earnings in the statutory and consolidated financial statements. Revaluations that increased net assets of the Subsidiary Companies were reflected as an increase in the “Other reserves” in the accompanying consolidated financial statements.

The application of Law No. 292 of August 9, 1993 resulted in a restatement of the net book value of the Parent’s utility plant in its statutory books to a valuation based upon a projected economic return. Such revaluation increased the gross book value of utility plant and created a distributable reserve in the statutory accounts that is reflected in the “Law 292/93 Reserve” in the accompanying consolidated financial statements. At the date of the revaluation, the total restated net book value in the statutory accounts approximated the total net book value balance reflected in the consolidated accounts. The consolidated financial statements reflect corresponding increases in both the gross book value and accumulated depreciation of utility plant to bring the gross book value stated in the statutory and consolidated accounts in line.

Costs directly associated with improvements are capitalized while routine maintenance and repairs are expensed. Interest prior to 1989 was capitalized; however no amounts have been capitalized since.

If management believes that there has been a permanent impairment in the net value of any specific asset, a write-down will be recorded accordingly. The original value of the asset, net of depreciation, may be reinstated if the reasons for such a write-down subsequently cease to exist.

Replaced or retired property is removed from the utility plant accounts, along with the related accumulated depreciation. The aggregate gains and losses resulting from asset retirements were not material for any of the three years in the period ended December 31, 1999.

Grants received to finance specific construction projects, the value of which is recorded among tangible assets, are recognized once the legal right to such grants has been acquired and their amount is reasonably determinable. These amounts are amortized over the life of the asset.

Depreciation

The consolidated financial statements reflect depreciation of utility plant on a straight line basis, using rates reflecting the economic useful life (“economic depreciation”) of the related assets. The statutory financial statements of the Parent and Subsidiary Companies, as permitted by Italian law, depreciate utility plant over prescribed tax lives (“fiscal depreciation”) which are shorter than the economic useful lives and doubles the

fiscal depreciation in the first three years an asset is placed in service. The excess amount of depreciation in the statutory accounts is eliminated in the consolidated financial statements, taking into consideration the contributions from customers for new connections, accordingly, such contributions are amortized over the useful life of the related assets.

Depreciation expense in the accompanying consolidated financial statements was based on the following estimated economic useful lives:

<u>Plant categories</u>	<u>Average years of estimated Economic useful life</u>
Buildings and associated land.....	40
Generating plant:	
Hydroelectric	40
Thermal	20
Geothermal	12
Other renewable sources	20
Transmission lines	35
Distribution:	
Transformer and substations	20
Lines.....	18-20

Other Non-Current Assets

Other non-current assets primarily include interest bearing long-term receivables stated at nominal value. Other non-current assets also include intangible fixed assets, stated at purchase or production cost, and are written down if a decline in value is other than temporary. Such assets are amortized on a straight-line basis over the period they are expected to benefit, which in the case of charges relating to the development of software is three years. Law No. 662 of December 23, 1996, required the Company to pay a “solidarity contribution” for pensions and welfare contributions relating to the period from 1985 to 1991. The law also allows the Company to pay this contribution during 1997 through 1999, and the amounts are expensed as paid over this deferred payment period.

Reserve for Employee Termination Indemnities and Other Employee Benefits

The Company’s employees are eligible for severance pay pursuant to Italian law. The Company accrues a reserve for such employee termination liabilities, net of applicable advances, over the employees’ service periods.

The Company also contributes to a management retirement plan that pays pension benefits, in accordance with Italian law and by agreements with the Trade Unions, to managers who retired prior to April 1, 1998. With the establishment of the FONDENEL Fund, the liabilities related to managers employed as of April 1, 1998 were transferred to the FONDENEL Fund. As more fully described in Note 11, the FONDENEL Fund is managed externally and subject to the regulations governed by Decree No. 14 on April 21, 1993.

Accordingly, the pension benefits liability as of December 31, 1999 relates solely to those individuals who were retired as of April 1, 1998. The reserve also includes amounts to be paid to existing employees who have worked at least 35 years with the Company, in accordance with the collective labor contract and current union agreements.

In addition, the Company makes contributions to certain employee associations that provide medical and various other employee benefits to both current and retired employees. These plans are not administered by the Company, and contributions are determined in accordance with the provisions of negotiated contracts with the Trade Unions. The Company expenses its contributions to these plans when they are paid. Such amounts totaled , lire 170 billion, lire 161 billion and lire 163 billion for the years ended December 31, 1997, 1998 and 1999, respectively.

As established by the Collective Labor Agreement signed between the ENEL Group and the employees' Trade Union, the Company grants to its employees hired before July 1, 1996 (working, retired or to their surviving spouses) an 80% reduction on electricity tariffs (excluding taxes and duties) within certain limits of consumption per year. These discounts are primarily presented as a reduction in operating revenues in the accompanying consolidated financial statements.

In March 1999, the Company and the managers' union signed an agreement which replaced the managers' benefit from the discounted tariff rates with a monthly bonus paid during their working life and a one-time bonus paid at their retirement date.

In November 1999, 70,303 of the Company's employees (about 87% of those eligible), purchased approximately 1.5% of the Company's stock during the privatization (see Note 1). No discount was provided to the employees, with the exception of a bonus share in a ratio of 11 shares for every 200 shares held for a period of at least one year (for other participants in the Italian retail offering, the allocation was 10 shares for every 200 shares held at least one year). The Company's employees were allowed to take advances against the provision for termination indemnities for this purchase of the Company's shares. The total amount of the advances was lire 1,445 billion.

Operating Revenues

Revenues from the sale of electricity are recorded when the customer is billed or the meter is read prior to year-end. Revenues from the supply of electricity provided after the last meter reading prior to year-end are recognized in the subsequent period when billed. Pricing is based on the tariff structure, in effect for the period, as established by law and the Electrical Energy and Gas Authority (the "Energy Authority"). Revenues from other services are recognized when the service is provided and consist primarily of connections, inspections, and repositioning services.

The Company's revenues currently also include amounts for the reimbursement of fuel costs and electricity purchases, through a contribution from the Equalization Fund (see Notes 3 and 5). Revenues received from the Equalization Fund as a reimbursement of fuel used for thermal production are recognized in the period when electricity is produced and consequently the fuel is consumed. Revenues received as a reimbursement of purchased power are recognized when electricity is supplied to the transmission network.

Other operating revenues are recognized in the period in which the service has been performed.

Statements of Cash Flows

The consolidated statements of cash flows are prepared using the indirect method and are in accordance with Standard No. 7, issued by the International Accounting Standard Committee, as well as Italian GAAP.

During 1997, 1998 and 1999, the Company transferred the current liabilities for employee termination payments to accounts payable of lire 69 billion, lire 289 billion and lire 226 billion respectively. During 1998, the Company also transferred the current liability for the FONDENEL Fund (see Note 1) of lire 690 billion to accounts payable. These non-cash activities have been excluded from the consolidated statements of cash flows.

The extraordinary distribution of funds from the reserve for employee termination indemnities to employees for the purchase of the Company's shares in 1999, for a total of lire 1,445 billion, is included in the consolidated statements of cash flows from financing activities in the item "other".

Vacation Pay

Vacation pay is provided in accordance with Italian law. The related liabilities were lire 143 billion and lire 164 billion as of December 31, 1998 and 1999, respectively, and are included in "Accrued expenses and other current liabilities" in the accompanying consolidated balance sheets.

Income Taxes

In connection with the issuance by the Italian Accounting Profession of Italian Accounting Standard No. 25 in 1998, the Company revised its accounting policy for income taxes.

Deferred tax assets and liabilities are recognized for differences between the financial reporting and tax bases of assets and liabilities at each reporting period. Certain reserves within shareholders' equity, totaling lire 500 billion, are subject to taxation upon utilization. Deferred tax liabilities on such reserves are provided to the extent that such taxation will result from expected future distributions or other taxable events. Deferred tax assets, including tax loss carryforwards, are recognized when there is a reasonable certainty of their realization.

Research and Development

Research and development activities, primarily relating to various studies involving technological innovation, improvements to plant efficiency, reliability, safety, environmental protection, service quality, and use of energy resources, are charged to operating expenses as incurred. Amounts charged to operating expenses were lire 410 billion, lire 350 billion, and lire 280 billion for the years ended December 31, 1997, 1998 and 1999, respectively.

Foreign Currency

Transactions denominated in foreign currencies are translated to lire at the exchange rate in effect on the date of the transaction. At December 31, 1999, assets and liabilities denominated in foreign currencies have been translated into lire at the exchange rate on the balance sheet date. Foreign currency exchange gains and losses, both realized and unrealized, are included in income in the period they arise, net of any amounts absorbed by the Italian government (see Note 10). The only exception to this is for foreign currency exchange gains that exceed foreign currency exchange losses related to long-term assets or liabilities, which are recorded only when realized. For the years ended December 31, 1997, 1998 and 1999, there were no such unrealized net gains.

Assets and liabilities expressed in one of the currencies of the European Economic and Monetary Union Members as of December 31, 1999 are translated into lire using the appropriate fixed exchange rates in euro.

Financial Derivatives

With respect to interest rate, foreign exchange and price risks, the Company enters into derivative transactions to hedge specific transactions as well as to hedge general risk.

The interest differentials to be received or paid on interest rate swaps, as well as interest differentials on interest rate collars, are accrued over the life of the contract. The interest differentials on forward rate agreements are recognized at the date of settlement of the contract and accrued over the period hedged. Such interest rate differentials are recorded in “Accrued income, prepayments and other” or “Accrued expenses and other current liabilities” as applicable in the consolidated balance sheets. When recognized in the statements of income, the amounts are classified as “Financial income (expense)”.

Foreign exchange forwards are valued at the spot rate at year-end and the related gains and losses are recorded as “Financial income (expense)”. Costs for options are recognized at the expiry date of the option. Premiums or discounts are accrued over the life of the contract, and also classified as “Financial income (expense)”. With reference to options, the premiums paid are recorded in the item “Accrued income, prepayments and other”, depending on the maturity of the contract.

Extraordinary Income and Expenses

The Company records items as extraordinary income and expenses if they relate to gains or losses on activities which impact the corporate structure of the Company (such as business reorganization costs, mergers and acquisitions, reconversions and reorganization of production cycle); extraordinary write-downs of fixed assets and related restatement of original value when the reasons for asset write-downs subsequently cease to exist; contingent assets or liabilities from events or transactions that would not reasonably be expected to recur in the foreseeable future, such as theft or shortage, natural events or litigation related to non-operating areas (e.g., mergers and acquisitions); and items regarding previous fiscal years, like adjustments of income/costs due to incorrect entries, adjustments due to incorrect applications of accounting principles and the recognition of capital grants related to previous fiscal years.

(3) REGULATION AND RATES

The Company is subject to regulation by the Industry Ministry and the Energy Authority.

The Historical Regulatory Framework

For the periods presented in the accompanying consolidated financial statements, the Company was regulated under the “Historical Regulatory Framework”. This regulatory framework existed until April 1, 1999, while the tariff structure under the Historical Regulatory Framework remained in place until December 31, 1999.

Electricity sales were regulated by tariffs which consisted of two main components:

1. A fixed component based on capacity; and
2. A variable component covering the following elements:
 - a) Fixed, operating and maintenance costs (excluding fuel and electricity import costs); it also covered specific and/or temporary reimbursement elements (e.g., accrued credits in respect

of the previous years' fuel costs, one-time costs relating to nuclear production and contributions for incentivized production from renewable and assimilated sources); and

- b) Variable energy costs (including fuel and electricity import costs).

The tariff relating to b) above was reviewed by the Energy Authority in July 1997 (Decree No. 70 of June 26, 1997), which set the following rules:

- i. Fuel costs for thermal production were to be reimbursed on a standard basis instead of on an actual cost basis. In this respect a standard heat rate and a standard basket of fuel were fixed by the Energy Authority;
- ii. Every two months the tariff was changed as determined by price fluctuations in the standard basket of fuels and variances in exchange rates;
- iii. An incentive element to be included for any decrease in thermal production and electricity imports (as compared with the average of the corresponding two months period of the previous three years) and to encourage hydro and geothermal production; and
- iv. Electricity imports to be reimbursed on the same basis as thermal production.

The New Regulatory Framework

On April 1, 1999, Legislative Decree No. 79/1999 (the "Bersani Decree"), implementing the principles contained in the Electricity Directive issued in 1997 by the European Union, became effective. The Bersani Decree has commenced the transformation of the electricity sector from a highly regulated industry to one where energy prices charged by generators will be eventually determined by competitive bidding. The Bersani Decree also mandates the consolidation of electricity distribution activities in urban areas. It also provides for a gradual liberalization of the electricity market so that customers whose annual consumption exceeds specified amounts, together with distributors and wholesalers (all defined as "Eligible Customers") will be able to contract freely with power generation companies to buy electric power.

The Bersani Decree establishes a general regulatory framework for the Italian electricity industry that gradually introduces free competition in power generation and sales to Eligible Customers while maintaining a monopoly structure for power transmission and physical distribution to Non-Eligible Customers. In particular, the Bersani Decree and subsequent implementing regulations:

- Liberalized, as of April 1, 1999, the generation, import, export, purchase and sale of electricity;
- Provide that after January 1, 2003 no electricity company will be allowed to produce or import more than 50% of the total of imported and domestically-produced electricity in Italy and, in connection with this limit, mandate that the Company sells not less than 15,000 MW of its generating capacity by January 1, 2003 to reduce its market share and increase competition in power generation;
- Distinguished between Eligible Customers, which may negotiate supply agreements directly with any domestic or foreign producer, wholesaler or distributor of electricity, and Non-eligible Customers, which must purchase electricity from the distributor that serves the area in which they are located and pay tariffs determined by the Energy Authority;

- Provided for the establishment of the Single Buyer, a central purchaser of electricity from producers on behalf of all Non-eligible Customers;
- Provide for the creation of a Borsa dell'Energia Elettrica, ("Pool Market") for electricity, by January 1, 2001, in which producers, importers, wholesalers, distributors, other Eligible Customers and the Single Buyer will participate, with prices being determined through a competitive bidding process;
- Provide for the creation during 2000 of the Gestore del Mercato, ("Market Operator"), charged with managing the pool market;
- Provide that the transmission and distribution of electricity is reserved to the Italian government;
- Provide that management and operation of the national transmission network is licensed to an independent system operator, the Gestore della Rete, ("System Operator") while owners of the transmission network (including the Enel Group) retain ownership of the network assets; and
- Establish a new licensing regime for electricity distribution and require that distributors servicing the same municipality consolidate their networks.

Restructuring of the ENEL Group

The Bersani Decree contains provisions mandating a significant restructuring of the Enel Group. As a result of the decree:

- The Company adopted a holding company structure, with separate subsidiaries that conduct its power generation, transmission, distribution and electricity supply and other businesses (see Note 2); and
- The Company has transferred its assets and liabilities relating to its discontinued nuclear power generation operations to Sogin, a wholly owned subsidiary. The Bersani Decree provides that the Company must transfer in the future the shares of this subsidiary to the Treasury Ministry at no cost (see Note 2).

Generation

The Bersani Decree liberalized the regime of generation of electric power. In order to increase the level of competition in the market, the Bersani Decree provides that, by January 1, 2003:

- The ENEL Group, like any other company, will not be allowed to produce or import more than 50% of the total amount of electricity provided or imported in Italy; and
- The Company will be required to sell not less than 15,000 MW of its approximately 59,418 MW of gross installed capacity. To comply with this requirement, the Company developed a plan to dispose of 15,057 MW of net installed capacity, or approximately 16,000 MW of gross installed capacity, which the Company submitted to the Council of Ministers and which the Council approved in August 1999. These specific generating assets have been contributed to Eurogen S.p.A., Elettrogen S.p.A. and Interpower S.p.A. in 1999. The January 1, 2003 deadline is extendible for one year if market conditions require, as determined by the Antitrust Authority after consulting with the Energy Authority.

The Bersani Decree also requires the Italian government to adopt by April 1, 2000 streamlined authorization procedures relating to the installation of new power generation plants and the renovation and expansion of existing plants.

Transmission

The Bersani Decree delegates the management and operation of the Italian electricity transmission network to the System Operator. The Bersani Decree requires the owners of assets included in the national electricity transmission network to transfer to the System Operator the right to manage and operate those assets. The decree does not otherwise affect the ownership of those assets. The Company transferred the rights to manage and operate its transmission assets to the System Operator in 1999, at which time the System Operator was still a subsidiary of the Company. In April 2000, pursuant to the Bersani Decree, the Company transferred its ownership of the System Operator to the Treasury Ministry at no cost.

The System Operator has responsibility for the planning, operation and control of the national electricity transmission network, with the mandate to ensure the efficiency, adequacy and safety of electricity supply. The System Operator is expected to perform its duties to ensure equal access to the network of all producers and consumers of electricity. The System Operator must give priority to electricity generated from renewable sources and co-generation in accordance with guidelines to be issued by the Energy Authority.

Distribution

The principal effects of the Bersani Decree on distribution are:

- The formal adoption of a licensing regime applicable to the distribution of electricity; and
- The promotion of the consolidation of electricity distribution activities.

The Bersani Decree requires the Industry Ministry to issue, not later than March 31, 2001, licenses for electricity distribution to the entities that were engaged in the distribution of electricity on April 1, 1999. These licenses, which will run until December 31, 2030, will regulate the operation, maintenance and development of electricity distribution networks as well as the interconnections among them. There is no limit to the number of licenses that one distributor can hold. The licenses will promote an increase in the efficiency of energy use pursuant to criteria established by the Industry and Environment Ministries.

The Bersani Decree seeks to cause the consolidation of the Italian electricity distribution industry. It permits only one distribution license to be issued within each municipality. It establishes procedures intended to promote consolidation of distribution activities under a single operator in municipalities where both the ENEL Group and a local distribution company are engaged in electricity distribution. The Decree asks operators with overlapping operations to submit joint consolidation proposals to the Industry Ministry by March 31, 2000; these proposals are considered approved unless the Industry Ministry objects within 60 days. If a joint consolidation proposal is not submitted, or is not approved by the Industry Ministry, a local distribution company owned or jointly owned by a municipality that serves at least 20% of the electricity customers of a municipality may request that the Company sell to them, by March 31, 2001, its distribution assets in that municipality at a price to be determined by agreement between the ENEL Group and that local distribution company.

If the parties do not agree on a price by September 30, 2000, then an arbitration panel will determine that sale price by reference to accepted valuation methodologies which take into account market prices. The panel will

consist of one person nominated by each of the parties and a third person nominated by the President of the Court having jurisdiction over the geographic area in which the local distribution company is located. Local distribution companies owned or jointly owned by a municipality that serve at least 100,000 customers may also request an authorization from the Industry Ministry to use the same procedure to purchase the electricity distribution businesses of adjoining municipalities.

New Tariff Structure

The new tariffs set by the Energy Authority took effect on January 1, 2000. This new tariff structure regulates the price paid by Non-eligible Customers for electricity. Eligible Customers will pay the market price for electricity, as well as regulated transmission fees and system charges set by the Energy Authority. In addition, the Energy Authority has established a mechanism for the recovery of a significant portion of the Company's stranded costs.

The Company expects that the new tariff structure will result in reductions in its tariff revenues. These reductions will result from lower rates in 2000 for generation, transmission and distribution fees, the application of price cap reductions to transmission and distribution fees after 2000 and reductions in generation fees in connection with the operation of the pool market beginning in 2001.

Tariffs for Non-eligible Customers

Under the new structure, tariffs are the maximum prices net of taxes that distributors may charge Non-eligible Customers. The Energy Authority has announced that it intends to set tariffs so as to cover:

- The costs of supplying electricity, including both:
 - Operating costs of the generation, transmission and distribution activities, procurement costs and amortization and depreciation. These costs must be actually incurred by the electricity companies and recognized by the Energy Authority; and
 - Appropriate return on invested capital, covering both equity and debt financing; and
- The costs associated with system charges, which involve the costs of the System Operator, Market Operator and Single Buyer and of complying with public policy requirements for the Italian electricity system.

Charges Applicable to Eligible Customers

Eligible Customers purchase electricity directly from generators or from wholesalers and as a result may pay rates that differ from the generation fees paid by Non-eligible Customers. In general, Eligible Customers will only pay transmission and distribution fees and system charges, which they will pay directly to wholesalers or distributors that will in turn pay the fees to the System Operator.

Stranded Costs

Stranded costs are current costs deriving from contractual commitments or investment decisions that electricity companies:

- Undertook for reasons of public policy;

- Undertook at a time when the electricity markets were not yet open to competition; and
- Could have been recovered in a monopoly regime but could not be recovered under a regime of competitive electricity pricing.

To facilitate the transition to open electricity markets, the European Commission has stated that electricity companies should be refunded their stranded costs provided that:

- They minimize the impact of those costs (and, hence, the amount of the refund) on their future operations; and
- They present an industrial plan showing a long-term profitability of the activity that is charged with stranded costs.

The Company's stranded costs mainly consist of costs resulting from the requirements that were imposed in the past on the Company's generation plants. In particular, because of governmental policies, the Company built most of its plants to ensure high flexibility in the type of fuel that could be used.

The Industry Ministry and the Treasury Ministry have determined which costs are to be considered as stranded costs and established a system to recover them.

Commitments for investments the Company undertook prior to February 19, 1997 in generating plants currently in service as stranded costs, except for investments in plants that benefit from the CIP6 regime. The Energy Authority has developed a program to allow the Company to recover a significant portion of our stranded costs between 2000 and 2006. The Energy Authority has assigned a recognized cost to each of the Company's plants. During the recovery period the Energy Authority will compare the recognized cost for each plant to the actual or reference generation costs for that plant established by the Energy Authority from time to time. If recognized costs are higher in the aggregate than actual or reference costs, the Company will be entitled to recover an amount equal to this aggregate amount.

If a plant for which stranded costs have been recognized is sold, the purchaser is entitled to recover those costs on the same terms established for the seller.

The Company's contractual obligations in connection with its imports of liquified natural gas from Nigeria are also regarded as stranded costs. These stranded costs will be recovered over a ten-year period, which may be extended if certain conditions are satisfied.

The maximum amount the Company may recover for stranded costs is lire 15,000 billion. The plan for the recovery of stranded costs must be submitted to the Italian Government for approval by the European Union's rules on governmental assistance to private businesses.

(4) RECEIVABLES

Receivables are stated at their net realizable value and relate primarily to amounts due for the supply of electricity and services, and also include amounts to be billed. The following table shows a breakdown of receivables as of December 31, 1998 and 1999:

	<u>1998</u>	<u>1999</u>
	(billions of lire)	
Electricity and services	5,536	5,914
Allowance for doubtful accounts:		
Ordinary provisions	(326)	(302)
Provision for overdue interests	(126)	(108)
	-----	-----
	5,084	5,504
Other	1,290	2,134
	-----	-----
	6,374	7,638
	=====	=====

The increase in receivables from electricity and services compared with December 31, 1998 is primarily due to higher sales in the second half of 1999, while the increase in other receivables is mainly due to lire 516 billion billed in advance by Electricit  de France for the fixed portion of electricity to be supplied in 2000. At December 31, 1998, a similar advanced billing was present, but for only one month. In 1999, tax receivables amounting to approximately lire 500 billion for indirect tax reimbursements and for a valued added tax receivable are also included in other receivables.

(5) EQUALIZATION FUND RECEIVABLE

The purpose of the Cassa Conguaglio per il Settore Elettrico (the "Equalization Fund") is to ensure that the cost of fuel and electricity purchased by the electricity companies are generally transferred to customers by a component of the tariff. The tariff also provides incentives for the generation of electricity from renewable sources.

These incentives are collected from the customers by the utility companies and then remitted to the Equalization Fund, which in turn distributes these amounts in the form of Equalization Fund contributions to the electricity generating companies. Historically, the Equalization Fund has provided for the reimbursement of certain nuclear-related costs.

As of December 31, 1998 and 1999, the Equalization Fund receivable was as follows:

	<u>1998</u>	<u>1999</u>
	(billions of lire)	
Equalization Fund receivable	3,559	2,828
Current portion of Equalization Fund		
receivable for nuclear-related costs	970	96
Equalization Fund payable, related to		
amounts collected from customers	(2,531)	(2,564)
	-----	-----
	1,998	360
	=====	=====

The decrease from December 31, 1998 was due to the recovery of the prior year thermal surcharge and to the recovery of nuclear related costs through a specific portion of the electricity tariff.

(6) INVENTORIES

Inventories as of December 31, 1998 and 1999 were as follows:

	<u>1998</u>	<u>1999</u>
	(billions of lire)	
Fuel	657	876
Materials, supplies and other stocks	414	380
Civil buildings held for disposal.....	-	622
Work in progress and advances	34	66
	-----	-----
	1,105	1,944
	=====	=====

The increase in the value of fuel is due to higher international oil prices.

The carrying value of inventories is slightly lower than its market value as of December 31, 1999.

“Civil buildings held for disposal” refer to the buildings transferred to the subsidiary Dalmazia Trieste S.p.A. An independent appraisal was performed on these assets in 1999.

(7) UTILITY PLANT

Net utility plant as of December 31, 1998 and 1999 consisted of the following:

	<u>1998</u>	<u>1999</u>
	(billions of lire)	
Generation	33,663	33,469
Transmission	5,652	6,405
Distribution	20,423	20,267
Real estate and other	8,207	6,514
	-----	-----
Net utility plant	67,945	66,655
Construction work in progress and advance payments	7,742	6,756
	-----	-----
	75,687	73,411
	=====	=====

The Company's utility plant under Italian GAAP, broken down by plant categories, is as follows:

	1998	1999
	(billions of lire)	
Utility plant, gross:		
Generating Plant:		
Hydroelectric.....	17,207	17,378
Thermal.....	41,346	42,719
Geothermal and renewable sources.....	2,440	2,978
Transmission Line.....	10,039	11,494
Distribution Network.....	61,195	62,697
Land and Buildings.....	7,412	6,508
Other.....	7,326	4,850
...		
Construction in progress.....	7,742	6,756
	-----	-----
Total.....	154,707	155,380
...	=====	=====

Accumulated Depreciation:

Generating Plant:		
Hydroelectric.....	5,943	6,364
Thermal.....	20,173	21,882
Geothermal and renewable sources.....	1,214	1,360
Transmission Line.....	4,387	5,089
Distribution Network.....	40,772	42,430
Land and Buildings.....	1,429	1,372
Other.....	5,102	3,472
...		
Construction in progress.....	-	-
	-----	-----
Total.....	79,020	81,969
...		

Utility plant, net:

Generating Plant:		
Hydroelectric.....	11,264	11,014
Thermal.....	21,173	20,837
Geothermal and renewable sources.....	1,226	1,618
Transmission Line.....	5,652	6,405
Distribution Network.....	20,423	20,267
Land and Buildings.....	5,983	5,136
Other.....	2,224	1,378
Construction in progress.....	7,742	6,756
	-----	-----
Total.....	75,687	73,411
	=====	=====

Hydroelectric plants include assets to be relinquished with a net book value of approximately lire 6,000 billion. Italian laws (Decree 79/99 applying European Commission Directive 92/62 regarding the electricity market) established the expiry date for concessions relating to large reservoirs managed and operated by the Company. The concessions will run out thirty years after the decree becomes effective, thus in 2029. At such date, all water catchment plant, control equipment, high pressure pipes and drainage pipes must be transferred to the State in good working order if the concession is not renewed.

The following reflects changes in utility plant (billions of lire):

	December 31, 1997				December 31, 1998				December 31, 1999	
	Net book value	Addition	Depreciation	Reclassification and retirements	Net book value	Addition	Depreciation	Reclassification and retirements	Net book value	
Generating plant:										
Hydroelectric.....	10,966	205	(482)	575	11,264	145	(490)	95	11,014	
Thermal.....	18,793	1,248	(1,617)	2,749	21,173	739	(1,788)	713	20,837	
Geothermal and other renewables	1,094	78	(127)	181	1,226	51	(153)	494	1,618	
Transmission line.....	5,021	295	(355)	691	5,652	142	(408)	1,019	6,405	
Distribution network.....	20,066	2,496	(2,763)	624	20,423	2,720	(2,780)	(96)	20,267	
Land and buildings.....	6,297	44	(177)	(181)	5,983	68	(179)	(736)	5,136	
...										
Other.....	2,297	239	(469)	157	2,224	169	(351)	(664)	1,378	
Construction in progress.....	11,617	1,266	-	(5,141)	7,742	1,619	-	(2,605)	6,756	
	-----	-----	-----	-----	-----	-----	-----	-----	-----	
Total.....	76,151	5,871	(5,990)	(345)	75,687	5,653	(6,149)	(1,780)	73,411	
	=====	=====	=====	=====	=====	=====	=====	=====	=====	

Included in the December 31, 1999 reclassifications and retirements is lire 642 billion of assets transferred to WIND, Sogin and the System Operator. Additionally, lire 622 billion of assets were transferred to Dalmazia Trieste S.p.A., and have been classified as civil buildings held for sale (see Note 6).

Estimated liabilities and charges resulting from the eventual abandonment of currently suspended construction projects are covered by the provisions for litigation and contingent liabilities.

(8) OTHER NON-CURRENT ASSETS

Equalization Fund Receivable for Nuclear Related Costs

The amount of the non-current portion of the Equalization Fund receivable for nuclear –related cost at December 31, 1998 has been transferred to Sogin during 1999, together with the other assets and liabilities related to the discontinued nuclear operations (principally the reserves for decommissioning of nuclear plant and for disposal of nuclear fuel). Sogin shares will be transferred to the Minister of Treasury free of charge, in accordance with the “Bersani Decree” (see Note 3).

Social Security Relief Receivable

In 1993, the Constitutional Court of Italy ruled that a portion of the Parent’s social security contributions for the period 1968 through 1991 was collected under a law that was unconstitutional. The Court ordered the Istituto Nazionale della Previdenza Sociale (“INPS”) to reimburse the Company for such social security contributions. The amount is being reimbursed in ten installments, without interest, and is due annually through 2001.

The amount as of December 31, 1999, totaling lire 362 billion, of which lire 181 billion is the current portion, reflects the present value of the residual amount to be reimbursed.

(9) INVESTMENTS

Investments as of December 31, 1998 and 1999 are as follows:

	<u>1998</u>	<u>1999</u>
	(billions of lire)	
Investments in unconsolidated subsidiaries	309	458
.....		
Investments in affiliates	2	2
.....		
Investments in other companies	8	7
.....		
	----	----
	319	467
	====	====

The investments in unconsolidated subsidiaries are mainly related to WIND, a joint venture established with France Telecom and Deutsche Telekom, that provides integrated fixed and mobile telephone services.

The increase from December 31, 1998 is primarily due to the contribution of the telecommunications business to WIND, lire 587 billion, offset by the write-down of the Company’s share of WIND’s equity losses, amounting to lire 439 billion.

Other unconsolidated investments primarily include minor investments in entities involved in various technological, environmental, and other utility-related research and development areas.

(10) DEBT

Long-Term Debt

The Company's consolidated long-term debt balances, including current maturities, as of December 31, 1998 and 1999, and the related maturity schedules are as follows:

Summary by Type of Debt Instrument	Maturity Range	Balance at 12/31/199 8	Balance at 12/31/199 9	Current Maturity 2000	Long-term Maturity					
					2001	2002	2003	2004	After	Total
					(billions of lire)					
Loans, guaranteed by The Republic of Italy	2000-2009	2,114	1,693	418	407	349	164	99	256	1,275
Loans, not guaranteed by the Republic of Italy.....	2000-2006	7,686	4,926	943	581	808	1,292	757	545	3,983
Zero coupon bonds, guaranteed by the Republic of Italy...	2000-2020	11,008	5,339	2,258	524	153	147	118	2,139	3,081
Bonds not guaranteed by the Republic of Italy.....	2001-2019	5,786	8,470	-	2,324	500	500	1,936	3,210	8,470
Loans of subsidiaries...	2000-2014	142	271	119	3	2	2	14	131	152
Total long-term debt...		26,736	20,699	3,738	3,839	1,812	2,105	2,924	6,281	16,961

Summary by Type of Debt Instrument	Maturity Range	Balance at 12/31/199 8	Balance at 12/31/199 9	Current Maturity 2000	Long-term Maturity					
					2001	2002	2003	2004	After	Total
					(billions of lire)					
Fixed – rate listed bonds	2003-2008	3,943	4,872	-	-	500	500	1,936	1,936	4,872
Floating - rate listed bonds	2000-2001	7,861	4,785	2,081	2,704	-	-	-	-	2,704
Fixed - rate bonds not listed.....	2005	148	85	-	-	-	-	-	85	85
Floating - rate bonds not listed.....	2001-2020	3,822	3,230	-	32	43	35	40	3,080	3,230
Fixed – rate bond EU...	2000-2010	954	781	168	104	102	103	73	231	613
Floating - rate bonds EU	2003-2009	65	56	9	8	8	9	5	17	47
Fixed – rate bank loans.....	2000-2006	155	150	7	109	8	9	8	9	143
Floating - rate bank loans.....	2000-2006	6,684	4,164	808	252	702	1,202	666	534	3,356
Fixed – rate EU. Loans..	2000-2009	2,511	1,933	570	535	354	152	88	234	1,363
Floating rate EU. Loans	2004-2014	593	643	95	95	95	95	108	155	548

Total	26,736	20,699	3,738	3,839	1,812	2,105	2,924	6,281	16,961
	=====	=====	=====	=====	=====	=====	=====	=====	=====

Bonds aggregating lire 5,339 billion are guaranteed by the Republic of Italy (lire 11,008 billion at December 31, 1998). The remaining portion at December 31, 1999, or lire 8,470 billion, continues to benefit from the implicit Italian State guarantee, per article 2362 of the Italian civil code, when the Italian government was the sole shareholder.

The increase since December 31, 1998, in bonds not guaranteed by the Republic of Italy is due to two new bonds issues on the international market, totalling lire 4,260 billion. The first new bond issue was a fixed rate (4.5% annual) Eurobond worth 1 billion Euro due on October 5, 2004. The second bond issue was a floating rate Eurobond worth 1.2 billion Euro due on October 5, 2001. These bonds are listed on the Luxembourg and Milan Stock Exchanges.

Long-term debt, including maturities and average interest rates, by currency, is as follows:

<u>Currency</u>	<u>Maturity</u>	<u>Average Interest rate</u>	<u>At December 31, 1998</u> (billions of lire)	<u>Average Interest rate</u>	<u>At December 31, 1999</u> (billions of lire)
Italian lira	2000-2020	5.13%	22,264	4.27%	12,398
.....					
Euro	2000-2010	6.08%	2,889	4.68%	7,147
.....					
Deutsche Mark	2000-2010	7.67%	246	7.77%	163
.....					
French Franc	2000-2005	9.82%	165	9.86%	91
.....					
Belgian Franc	2000-2008	9.07%	194	9.05%	148
.....					
Netherlands Guilders ...	2000-2010	8.45%	253	8.41%	187
Austrian Shilling		7.60%	1	-	-
.....					
EMU Currency		5.35%	26,012	4.55%	20,134
.....					
U.S. Dollar	2000-2008	9.23%	126	9.02%	79
.....					
British Pound	2000-2007	9.95%	80	10.05%	60
.....					
Swiss Franc	2000-2009	6.61%	222	6.82%	179
.....					
Denmark Krone	2002	10.55%	12	10.55%	9
.....					
Japanese Yen	2000-2010	6.14%	284	5.67%	238
.....					
Non - EMU Currency		7.32%	724	7.04%	565
...					
Total Long - Term Debt		5.40%	26,736	4.62%	20,699
		=====	=====	=====	=====

Pursuant to special incentive laws, the Republic of Italy provided eligible State and non-State owned companies with assistance in financing new industrial investments as an incentive for economic development, bearing the cost of foreign exchange gains and losses on certain borrowings from European Union institutions. In the case of the Company, the Republic of Italy covers all foreign exchange gains and losses on approximately lire 459 billion (6% of the long-term debt denominated in foreign currencies as of December 31, 1999). Additionally, the Republic of Italy covers foreign exchange gains or losses greater than 2% or 5% on another lire 382 billion (5% of the long-term debt denominated in foreign currencies as of December 31, 1999). Of the remaining lire 7,459 billion, lire 7,210 billion are denominated in euro or in EMU currencies (and therefore no longer subject to exchange rate risk). Therefore, only lire 249 billion (about 1% of total long-term debt, maturity rate 2000-2009, average residual life less than 4 years) is fully exposed to exchange rate risk.

For the three years ended December 31, 1997, 1998 and 1999, the net foreign exchange losses covered by the Italian government under the special incentive laws, and therefore not included in the consolidated financial statements, totaled approximately lire 237 billion, lire 156 billion and lire 153 billion, respectively.

In the normal course of business, the Company utilizes financial hedging transactions to reduce risks arising from interest rate and foreign currency exchange rate fluctuations, both for long-term and short-term debt (see Note 21).

Short-term Debt

The Company maintains committed lines of credit with maximum borrowing limits aggregating lire 3,000 billion and uncommitted lines of credit and other short-term borrowing agreements with banks in Italy with maximum borrowing limits aggregating approximately lire 4,591 billion at December 31, 1999. The Company had average outstanding short-term borrowing agreements of approximately lire 500 billion and lire 857 billion during 1998 and 1999, respectively.

As of December 31, 1998 and 1999, the Company had outstanding borrowings from banks of lire 744 billion and lire 3,003 billion, respectively. These agreements provide for interest charges based on prevailing market conditions. As of December 31, 1998 and 1999, the average interest rate on short-term borrowings was approximately 3.68 % and 3.50%, respectively.

(11) RESERVE FOR PENSIONS AND SIMILAR OBLIGATIONS

An amount of lire 1,961 billion principally represents the present value of future liabilities connected with trade union agreements regarding a supplemental pension fund for managers participating in the program. Since April 1, 1998, the reserve relates only to retired managers. Those managers currently employed, are covered by the FONDENEL Fund.

The remaining reserve of lire 80 billion covers payments in lieu of notice at the time of the retirement, to existing employees who have, among other conditions, worked at least 35 years, in accordance with collective labor contracts and current union agreements.

The agreement between the ENEL Group and FNDAI (National Federation of Industrial Managers), signed on January 23, 1998, led to the establishment of a Company-sponsored pension fund known as FONDENEL, which is managed externally. It differs from the previous pension plan, which was based on defined benefits, in that it is now a defined-contribution plan. Following the transfer of the accumulated contributions of active managers to FONDENEL, the Company is liable to pay FONDENEL a sum equal to the provisions accrued to March 31, 1998. The amount payable to the FONDENEL Fund as of December 31, 1999, totaling lire 419 billion (of which lire 208 billion represents the current obligation reflected in "Accrued expenses and other current liabilities" in the accompanying consolidated balance sheets), is to be paid in six semi-annual installments of equal amounts.

(12) OTHER NON - CURRENT LIABILITIES

The amounts included in the caption “Other” in “Other non-current liabilities” in the accompanying consolidated balance sheets as of December 31, 1998 and 1999 were as follows:

	<u>1998</u>	<u>1999</u>
	(billions of lire)	
Litigation and contingent liabilities reserves...	2,187	2,588
Interest and other charges on bonds payable at maturity of principal	285	7
.....		
Due to Local Authorities	90	288
Due to FONDENEL Fund.....	519	211
Reserve for early retirement.....	32	563
Advances.....	84	246
Other	124	120
	-----	-----
	3,321	4,023
	=====	=====

The “Litigation and contingent liabilities reserves” covers uncertainties, contingencies and potential liabilities from current legal proceedings (primarily relating to supply contracts, labor disputes and plant operations) of a determinate nature that, according to the Parent’s internal and external legal advisors are reasonably estimable and which the Company believes the unfavorable outcome to be probable. The reserve does not take into account the effects of proceedings in which a favorable outcome is expected or those in which an adverse outcome cannot be reasonably estimated. For contingencies assessed to be less than probable the potential range of loss is disclosed if it is available. Further information regarding litigation and contingent liabilities is provided in Note 21.

The reserve also includes 1998 and 1999 provisions to record two construction projects at a fair value. These projects were halted by management in prior years. The provisions of lire 523 billion in 1998 and lire 100 billion in 1999 were, in view of the nature of the related liabilities, charged to “Extraordinary income (expense)” in the accompanying consolidated financial statements (see Note 19). The reserve also covers additional estimated liabilities and charges for litigation and other matters, for which further provisions of lire 401 billion and lire 572 billion were made during 1998 and 1999, respectively.

The reserve for early retirement consists of accruals relating to the cost of the temporary offer made to employees as an incentive for early retirement as part of the Company’s reorganization following the resolution taken on April 30, 1999 by the Parent (see Note 19).

(13) SHAREHOLDERS’ EQUITY

Share Capital

In connection with the conversion of the Parent into a joint stock corporation in July 1992, substantially all of the existing reserves at that time were converted into share capital.

The Parent has 12,126,150,379 ordinary shares of lire 1,000 par value per share.

In November 1999, the Company placed its shares through an Initial Public Offering in Italy and in the United States of America. As a result of the offering, 8,277,348,379 shares, representing 68.3% of the share capital, are owned by the Italian Treasury, while the remaining 31.7% has been placed on the market.

Shareholders' Equity Reserves

The "Legal reserve" represents earnings restricted from the payment of dividends pursuant to the Italian Civil Code (the "Civil Code"). Under the Civil Code, with respect to income of any year, an amount equal to 5% of the Company's statutory income must be set aside until the cumulative legal reserve is equal to one-fifth of the par value of the Company's issued and outstanding share capital. Such dividend restriction also applies to each Italian subsidiary of the Company, the legal reserve of which is not material. In 1999, lire 2,071 billion were transferred to the legal reserve from the "Law 292/93 reserve" in order to bring the former in line with 20% of the Group's holding company share capital, as resolved by the Shareholders' Meeting held on September 3, 1999.

The "Law 292/93 reserve" at December 31, 1999, reflects the write-up of assets of the Parent pursuant to Law No. 292. As discussed in Note 2, revaluation reserves of the Parent prior to 1993 have been credited to retained earnings in the accompanying consolidated financial statements.

The "Law 292/93 reserve" was first established in the amount of lire 7,335 billion, authorized by the Treasury Minister with the Decree of January 19, 1995. In 1996, a further provision of lire 3,272 billion was transferred from deferred income taxes, representing the residual equalization tax accrued in 1993 and 1994 and no longer due, following the Finance Ministry's clarification of the tax status of the reserve in question. This reserve was decreased by lire 4,571 billion in 1999 following the distribution of lire 2,500 billion and the transfer to the legal reserve of lire 2,071 billion, as resolved by the sole shareholder of the Company at the Shareholders' Meeting held on September 3, 1999.

At December 31, 1998 "Other reserves" included amounts received from the Treasury Ministry to reimburse the Company for principal payments on loans obtained and bonds issued in prior years which, under Italian finance laws at that time (Law No. 41/86 and Law No. 910/86), were obligations of the Republic of Italy. These reimbursements were equivalent to capital contributions and, therefore, were included in shareholders' equity. Since 1995, the Republic of Italy is not required to make any additional reimbursements on outstanding loans of this nature. In October 1999, these "other reserves" on loans were distributed for lire 1,922 billion, following the resolution of the Shareholders' Meeting held on September 3, 1999, as mentioned above.

Retained Earnings

As provided by Italian law, dividends may only be paid out of the statutory retained earnings, plus its distributable reserves and statutory net income for the current year, net of the amount to be allocated to the legal reserve in the subsequent year.

Approximately lire 9,800 billion was available for dividends at December 31, 1999.

Reconciliation of Parent's Statutory Net Income and Shareholders' Equity to Consolidated Net Income and Shareholders' Equity

The Parent's statutory financial statements reflect certain tax-basis amounts and do not reflect the consolidation of the Subsidiary Companies.

Adjustments are made in consolidating the accounts of the Parent and the Subsidiary Companies to reflect the consolidation principles described in Note 2. In addition, adjustments are made to eliminate the effect of certain tax-basis reporting applied by the Parent and the Subsidiary Companies in their respective statutory accounts.

The reconciliation of shareholders' equity and net income as reported in the statutory financial statements to those reported in the consolidated financial statements, is as follows:

	Net Income			Shareholders' Equity		
	-----			-----		

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>
	(billions of lire)					
Per Parent Statutory financial statements	976	2,072	3,052	26,536	27,686	24,352
.....						
Deferred taxes.....	924	829	(829)	924	829	-
Items reported by Parent solely for tax purposes (additional depreciation and reserve for capital grants)	1,433	1,393	900	5,032	7,349	-
.....						
Effects of consolidating the financial statements of the Subsidiary Companies and other	(6)	(8)	1,418	23	16	9,641
	-----	-----	-----	-----	-----	-----
Per consolidated financial statements	3,327	4,286	4,541	32,515	35,880	34,034
.....	=====	=====	=====	=====	=====	=====

Starting from 1999, the Company began to record deferred tax assets also in the statutory financial statements.

Changes in tax-related items of the Parent are due to the contribution of businesses at book value (represented in the case of assets by their gross value, net of ordinary and additional depreciation charges), in a neutral tax regime. The mentioned tax items have therefore been transferred to the subsidiaries receiving the contribution, and have been included among the "effects of the consolidation of the financial statements of subsidiaries" at December 31, 1999.

(14) OPERATING REVENUES

Operating revenues for the years ended December 31, 1997, 1998 and 1999 were as follows:

	<u>1997</u>	<u>1998</u>	<u>1999</u>
	-	-	-
	(billions of lire)		
Tariff revenues.....	24,999	25,681	26,419
Equalization Fund contributions	12,709	12,063	11,772
Other services	535	540	583
	-----	-----	-----
Sale and Services	38,243	38,284	38,774
	-----	-----	-----
Connections, inspections and repositioning services	1,028	1,090	1,124
Other operating revenues.....	346	414	686
	-----	-----	-----
Other	1,374	1,504	1,810
	-----	-----	-----
	39,617	39,788	40,584
	=====	=====	=====

With the exception of electricity sold to foreign distributors, totaling lire 20 billion, the above revenues are earned entirely in Italy.

The amounts included in Equalization Fund contributions for the years ended December 31, 1997, 1998 and 1999 were as follows:

	<u>1997</u>	<u>1998</u>	<u>1999</u>
	-	-	-
	(billions of lire)		
Contributions for cost of fuels	7,452	6,951	6,324
Contributions for purchase of electricity and incentives for renewable energy sources.....	5,257	5,112	5,448
...			
	-----	-----	-----
	12,709	12,063	11,772
	=====	=====	=====

Contributions for cost of fuels are lower in 1999 as a result of lower average prices of fuels to which these are indexed as compared with 1998, as a result of the lag between changes in fuel prices and contribution adjustments.

Contributions for purchase of electricity and incentives for renewable energy sources increased due to higher energy purchased and produced.

(15) PERSONNEL EXPENSES

Personnel expenses for the years ended December 31, 1997, 1998 and 1999 were as follows:

	<u>1997</u>	<u>1998</u>	<u>1999</u>
	-		
	(billions of lire)		
Wages and salaries	5,546	5,411	5,076
.....			
Social security contributions	2,180	1,732	1,552
.....			
Employee termination indemnities	502	484	462
.....			
Employee pension and similar obligations	335	138	55
Other costs	268	260	257
.....			
	-----	-----	-----
	8,831	8,025	7,402
	=====	=====	=====

The decrease from December 31, 1998 is a result of the reduction in the average headcount.

(16) MATERIALS AND CONSUMABLES

Materials and energy for the years ended December 31, 1997, 1998 and 1999 were as follows:

	<u>1997</u>	<u>1998</u>	<u>1999</u>
	-	-	
	(billions of lire)		
Electricity purchased	6,073	6,306	6,831
.....			
Fuel consumption.....	7,657	6,663	6,308
	-----	-----	-----
Total fuel and energy	13,730	12,969	13,139
.....			
Materials purchased	1,304	1,321	1,492
.....			
Net change in inventory	259	264	34
.....			
	-----	-----	-----
Total materials	1,563	1,585	1,526
.....			
	-----	-----	-----
	15,293	14,554	14,665
	=====	=====	=====

The increase in cost of electricity purchased is linked primarily to the greater quantity of subsidized electricity bought from domestic producers, as shown in the following table:

	1997		1998		1999	
	Billions of lire	Millions of kWh	Billions of lire	Millions of kWh	Billions of lire	Millions of kWh
		(Unaudited)		(Unaudited)		(Unaudited)
Domestic purchase.....	3,342	26,623	3,553	31,445	4,039	35,978
Overseas import.....	2,617	38,698	2,642	40,565	2,707	41,630
Total	5,959	65,321	6,195	72,010	6,746	77,608
Electricity purchased on an exchange basis	114		111		85	
	6,073		6,306		6,831	

During 1999, 50.2% of the fuel purchased was fuel oil, 36.8% was natural gas, 9.2% coal and the remaining 3.8% was other types of fuel (diesel, orimulsion and coke-oven gas). The decline in the consumption of fuel was due to lower consumption costs (lire 161 billion) and to the impact of the provision for fluctuations in fuel prices, accrued in 1998 for lire 132 billion, from which lire 62 billion has been reduced in 1999. The provision allowed to offset the impact of the time lag between the adjustment to the contribution from the Equalization Fund and changes in fuel prices.

(17) SERVICES AND RENTALS

Services and rentals for the years ended December 31, 1997, 1998 and 1999 were as follows:

	1997	1998	1999
		(billions of lire)	
Maintenance and repairs	728	594	570
Telephone, postage and telegraph	255	262	260
Staff canteens	149	140	121
Data processing, legal and other consultants fees ..	179	188	255
Security, cleaning and other general services	137	126	183
Travel expenses	59	62	58
Expenses and services linked to customers	50	49	40
Services from WIND.....	-	-	192
Services from the Independent System Operator....	-	-	63

Other	371	325	264
.....	-----	-----	-----
Total Services	1,928	1,746	2,006
.....	-----	-----	-----
Rentals and Leases	424	477	512
.....	-----	-----	-----
	2,352	2,223	2,518
	=====	=====	=====

Services supplied by WIND and by the Independent System Operator began in 1999 following the formations of the businesses and are offset by decreases in other items due to the fact that such services were previously provided internally. The increase in data processing charges is due to the Y2K activities and to a SAP implementation. Security, cleaning and other general services increased in 1999 following the outsourcing of these activities.

(18) FINANCIAL INCOME AND EXPENSES

Financial income for the years ended December 31, 1997, 1998 and 1999 was as follows:

	<u>1997</u>	<u>1998</u>	<u>1999</u>
		(billions of lire)	
Interest on Equalization Fund receivable for nuclear-related charges	198	105	58
.....			
Interest on overdue receivables from customers	89	74	56
....			
Interest on bank account	24	116	26
.....			
Interest on social security relief receivables	75	63	49
.....			
Other	38	166	167
.....			
	424	524	356
	===	===	===

The decrease in interest on amounts due from the Equalization Fund for nuclear-related charges results from the gradual collection of amounts due (see Note 5) and the reduction in the applicable interest rate.

Financial expense for the years ended December 31, 1997, 1998 and 1999 was as follows:

	<u>1997</u>	<u>1998</u>	<u>1999</u>
		(billions of lire)	
Interest and other charges on bonds	1,267	984	725
.....			
Interest and other charges on loans from banks and other financial institutions	1,209	870	433
.....			
Interest on short term debt from banks and			

other financial institutions	70	35	23
.....			
Other	75	115	306
.....			
	-----	-----	-----
	2,621	2,004	1,487
	=====	=====	=====

The interest paid on long and short-term borrowings decreased from December 31, 1998 due to the reduction in borrowings.

(19) EXTRAORDINARY INCOME AND EXPENSES

Extraordinary expenses in 1999 primarily included:

- A provision of lire 792 billion relating to two different early retirement programs available for employees and managers. The manager plan was opened in May 1998 and was directed at individual managers. The employee program is open between July 1999 and December 2001. Both programs allowed for a one-time payment of salary for a certain number of months based upon the plans' formula;
- A write-down of lire 172 billion to reflect certain real estate assets, that were transferred to a consolidated subsidiary at their estimated fair values in view of their planned disposal. An appraisal report was prepared in 1999 to determine these fair values;
- A provision of lire 180 billion relating to below-market swap and swap-option contracts, to cover interest rate risk, that were restructured during 1999;
- A provision of lire 100 billion principally for a construction project halted by management and for which provisions have been recorded in prior years. Because the probability of a sale of this project or its utilization in construction joint ventures has decreased in 1999, the provision was recorded for the corresponding decrease in the fair value of the assets;
- A provision of lire 80 billion principally to write-off the investments in Sogin and Gestore della Rete di Trasmissione Nazionale S.p.A. prior to the transfer of these subsidiaries to the Treasury Ministry at no cost; and
- A provision of lire 59 billion for the future restructuring of Engineering and Research activities.

These extraordinary expenses were offset in part by:

- Income of lire 214 billion related to a favorable judgment received in 1999 regarding prior year taxes and fees;
- Income of lire 57 billion related to a favorable court judgment for the Company in 1999. A receivable was recorded for this judgment.

Extraordinary expenses in 1998 primarily included:

- A provision of lire 523 billion principally to record at fair value two construction projects that were halted by management in previous years. The projects' fair values have been estimated

using available market prices, and potential estimated sales prices to unrelated third parties. A provision was also taken on these projects in 1997. The additional provision in 1998 was based on the reduced probability of a favorable sale of these assets because of the technological change from the time these traditional plants began to be constructed. In particular, because of technological advances, combined cycle gas turbine plants now cost less to construct than traditional plants and they also are more efficient than traditional plants. Additionally, the economic crisis in 1998 in emerging markets, which represent the potential target for this kind of traditional technology, has reduced the probability of sales to an external party. Consequently, at the end of 1998, the Company reviewed the estimate of the fair value of these assets, not only using some of the above criteria, but also on the basis of potential utilization in construction joint ventures by the Company's engineering and construction subsidiary, EnelPower S.p.A.;

- A provision of lire 386 billion relating to various voluntary early retirement programs available for employees and managers. In February and May 1998, the Company issued two different temporary offers to managers to accept voluntary early retirement. The first program was open from February 1998 through March 1998, while the second program was open in May 1998. In April 1998, the Company issued a temporary offer to employees to accept early retirement during May and June 1998. In total, 124 managers and 4,896 employees accepted these packages. Both programs allowed for a one-time payment of salary for a certain number of months based upon the plans' formula;
- A provision of lire 166 billion accrued for a one-time additional benefit to active managers. These benefits were agreed upon between the managers and the Company prior to the establishment of FONDENEL Fund in 1998.

These expenses were offset in part by income of lire 109 billion related to the reversal of a court judgment against the Company. A receivable was recorded for this favorable judgment, and the amount has been subsequently collected.

Extraordinary expenses in 1997 primarily included:

- A net provision of lire 440 billion principally to record at fair value the construction projects that were halted by management and which are referred to above. The provision necessary to record these assets at fair value was lire 614 billion. The estimate of the fair value was based on international market price comparisons to similar plants and equipment, as reported by the World Bank in an appraisal report prepared for the study of similar initiatives in China, and on various preliminary negotiations with potential acquirers based in developing countries. The total provision was offset in part by lire 174 billion related to a litigation reserve no longer required due to a favorable ruling on litigation against INPS. This litigation related to social security contributions that INPS had claimed were due in respect of one-time bonus payments to the Company's employees in conjunction with the renewal of labor contracts in prior years;
- A provision of lire 390 billion to record an allowance for doubtful accounts on a receivable from the Equalization Fund for the reimbursement of past nuclear-related charges that are in dispute. This provision was recorded after the Energy Authority clarified the reimbursement criteria for nuclear-related costs, previously under review by the Energy Authority and excluded from reimbursement a number of items. In particular, certain types of charges were not considered reimbursable, and the criteria for calculating the interest for delayed reimbursement had been altered. On the basis of the above exceptions, the allowance for doubtful accounts was

established for lire 390 billion. In accordance with Italian GAAP, the Company recorded this provision in 1997, because the resolution was issued prior to the approval of the consolidated financial statements for 1997 by the Company's Board of Directors;

- A provision of lire 266 billion relating to the different voluntary early retirement programs ongoing for managers and employees. The manager plan was opened in 1996 and had 462 individuals accept this program. In January and March 1997, the Company opened two different programs, which ended in February and May 1997, respectively, to employees for the option to accept early retirement, and 3,195 employees accepted. All programs provided for a one-time payment equivalent to salary for a certain number of months based upon the plans' formula; and
- A provision of lire 175 billion to write-off the Company's investment in NERSA in anticipation of withdrawing completely from the project in 1998. The Company sold its 33% interest in NERSA in July 1998.

(20) INCOME TAXES

The provision for income taxes for the years ended December 31, 1997, 1998 and 1999, were as follows:

	<u>1997</u>	<u>1998</u>	<u>1999</u>
Current	2,096	2,785	2,834
.....			
Deferred	(38)	146	424
.....			
	-----	-----	-----
	2,058	2,931	3,258
	=====	=====	=====

Italian income taxes were revised starting January 1, 1998 when IRAP was introduced. IRAP is a regional tax on business activities. The tax has a rate of 4.25% calculated on the net value of production created on the Italian territory (as described below). Following the introduction of IRAP, the following taxes have been abolished:

- ILOR (local income tax);
- Tax on the net assets of business;
- ICIAP (city tax on the conduct of arts, professions and business); and
- National Health System contribution.

Prior to this reform, income taxes were calculated at a statutory rate of 53.2% of income before income taxes (37.0% for IRPEG and 16.2% for ILOR). Following this tax reform, income taxes are calculated at 37.0% of income before income taxes for IRPEG and for IRAP the calculation will be based on a different formula (4.25% times (operating income plus personnel costs, provisions and valuation accounts and reserves)). By using this different basis to calculate IRAP, an equivalent statutory rate for IRAP would be approximately 11.0% of income before income taxes. This equivalent rate for IRAP combined with IRPEG gives the Company a statutory rate in 1998 and 1999 of approximately 48.0% of income before income taxes.

Application of new Italian Accounting Standard No. 25 resulted in the recognition of a deferred tax asset as of January 1, 1998, of lire 588 billion.

The statutory tax rate of 48% for 1998 and 1999 has been determined considering the differing bases on which IRPEG and IRAP are calculated. The difference between the statutory and effective tax rate for the years ended December 31, 1997, 1998 and 1999 is due to the following factors:

	<u>1997</u>	<u>1998</u>	<u>1999</u>
Statutory tax rate	53.2%	48.0%	48.0%
Tax on the net assets of business.....	3.5	-	-
Deferred income taxes for the year calculated at the new tax rates	(5.3)	-	-
Tax assets on timing differences	3.9	-	-
Reversal of deferred tax liabilities no longer required following the Italian tax reform	(18.0)	-	-
Deferred tax assets from prior years.....	-	-	(7.4)
Initial application of new accounting standard related to accounting for income taxes	-	(8.2)	-
Permanent differences and other.....	0.9	0.8	1.2
	-----	-----	-----
Effective tax rate	38.2%	40.6%	41.8%
	=====	=====	=====

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

In 1999, deferred tax assets from prior years were recognized for lire 562 billion. The Company had not previously recorded the full benefits of these deferred tax assets, which primarily related to reserves for nuclear charges that had been recorded under Italian GAAP, due to the uncertainty of realization of the assets. During 1999, it has been clarified which assets and liabilities of the Company's discontinued nuclear operation would be transferred to Sogin. The Company was entitled to recognize the full benefit of the deferred assets at the time of transfer in 1999. Because the deferred tax asset has now been realized, the Company recorded the related benefit in 1999.

Significant components of the net deferred income tax liabilities are as follows as of December 31, 1998 and 1999:

	<u>1998</u>	<u>1999</u>
	(billions of lire)	
Deferred income tax liabilities:		
.....		
Accelerated depreciation	5,373	6,206
.....		
Deferred income tax assets:		
.....		
Accruals and reserves	(829)	(1,232)
.....		
Net deferred income tax liabilities	----- 4,544	----- 4,974
.....	=====	=====

At December 31, 1999, all tax years prior to 1994 have been settled, for direct taxes, with Italian tax authorities by the Company.

(21) COMMITMENTS AND CONTINGENCIES

Financial Derivatives

The Company, in its operations of generation, transmission and distribution of electricity, purchases fuel power in the international oil and natural gas market and also purchases electricity from outside of Italy. The Company is therefore subject to exposure to foreign exchange rates and commodity price risks.

Considering its medium and long-term debt positions, the Company is also subject to interest rate risk. Derivative instruments are utilized by the Company to reduce these risks.

Notional Amounts and Credit Exposures of Derivatives

The notional value of a derivative is the contractual amount on the basis of which the differentials are exchanged; this amount can be expressed either on a value basis or on a physical quantities basis (such as tons). The amounts expressed in foreign currency are converted into lire applying the exchange rate at year-end. The amounts expressed in one of the currencies of European Economic and Monetary Union members are translated using the fixed exchange rates in the euro.

The notional amounts of derivatives summarized below do not represent amounts exchanged by the parties and, thus, are not a measure of the credit exposure of the Company.

Although the Company is exposed to credit-related losses in the event of non-performance by counterparties to derivative financial instruments, given the high credit standing of the counterparties, the Company does not expect any failure in meeting their obligations.

Interest Rate Risk Management

The Company enters into various types of interest rate contracts in managing its interest rate risk. The financial instruments utilized as of December 31, 1998 and 1999 were as follows:

	1998	1999
	-----	-----
	--	---
	<u>Notional amount</u>	
	-	
	(billions of lire)	
Interest rate swaps	5,050	7,461
.....		
Forward rate agreements	2,500	-
.....		
Interest rate collars	3,400	3,930
.....		
	-----	-----
	10,950	11,391
	=====	=====

The Company enters into interest rate derivatives, particularly interest rate swaps, with the purpose to decrease the amount of debt subject to interest rate fluctuations and to lower funding costs. Under interest rate swaps, the Company agrees with other parties to exchange, at specified intervals, the difference between interest amounts calculated by reference to an agreed notional principal amount and an agreed fixed or floating interest rate.

Forward rate agreements are generally used by the Company to offset changes in the rates of short-term debt and the current maturity of long-term floating-rate debt. Forward rate agreements settle in cash at a specified future date based on the differential between agreed interest rates applied to a notional amount.

The Company also enters into interest rate collar contracts to reduce the potential impact of increases in interest rates on floating-rate long-term debt. These agreements are normally entered into when the fixed rate available under interest rate swaps are considered too high with respect to the Company's view about the level of future interest rates. The Company normally uses zero-cost collars that do not require payment of an option premium.

Foreign Exchange Rate Risk Management

The Company enters into various types of foreign exchange contracts in managing its foreign exchange risk. The foreign exchange contracts utilized as of December 31, 1998 and 1999, were as follows:

	1998	1999
	-----	-----
	--	---
	<u>Notional amount</u>	
	-	
	(billions of lire)	
Forward exchange contracts	458	510
.....		

Options	1,389	1,039
.....	-----	-----
	1,847	1,549
	=====	=====

The Company uses forward exchange contracts and currency options primarily to hedge expenses denominated in foreign currencies. The accounts payable in non-EMU currencies are denominated mainly in U.S. dollars and Swiss francs. Both buy and sell amounts of such contracts are indicated at the notional value. Currency options, traded in the over-the-counter market, provide the Company with the right or the obligation to buy or sell agreed amounts of currency at a specified exchange rate at the end of a specified period, never exceeding one year. Also, the maturity of forward exchange contracts never exceed one year.

The previous table excludes an outstanding forward exchange contract for a nominal amount of 1,000 million ECU/lire put in place to hedge the 1 billion euro bond issued in October 1998. On October 13, 1998, the Company sold 1,000 million ECU at 1,942.85 (the exchange rate at which the bond was written on the balance sheet), then on January 13, 1999, the Company bought 1,000 ECU-euro at 1,946.05 and the swap points were considered as financial charges on the bonds.

Commodity Risk Management

Over-the-counter market swaps are primarily used by the Company to minimize commodity price volatility in order to conform costs to revenues. Swap agreements do not contain margin requirements and are subject to the creditworthiness of counterparts, which are principally major financial institutions. As of December 31, 1999, the notional amount of open contracts is related to 30,000 tons of fuel oil (1,190 million tons as of December 31, 1998).

Purchase Commitments

The Company has entered into fuel supply contracts, primarily for the purchase of fuel oil and natural gas. Expenditures related to these commitments are expected to approximate lire 17,215 billion for the years ending December 31, 2000 through 2004.

The Company also has unconditional purchase obligations for electric power. Such commitments, will approximate lire 45,675 billion for the years ending December 31, 2000 through 2004.

Leases

The Company has entered into various operating leases, primarily related to offices, automobiles and office equipment, used in the normal course of business. The original lease terms generally do not exceed six years in accordance with Italian law, but may be renewed at expiration. Rent expense for significant leases totaled approximated lire 116 billion, lire 149 billion and lire 174 billion for the years ended December 31, 1997, 1998 and 1999, respectively, and are included in "Services and Rentals" in the accompanying consolidated statements of income. Future rental payments for the years 2000 through 2004 are estimated to be lire 236 billion, lire 238 billion, lire 233 billion, lire 216 billion and lire 213 billion, respectively.

Capital Expenditures

Although the actual amount of the Company's capital expenditures in future periods will depend on various factors that cannot presently be foreseen, the Company is expected to make capital expenditures of approximately lire 5,500 billion in 2000, and approximately lire 25,000 billion in the 2001-2004 period. The expenditures are scheduled to be primarily concentrated in the distribution business division, for the upgrading of the network and the development of new activities, and in the generation division, principally for the conversion of plants to combined cycle gas turbine plants.

Insurance

The Company maintains third-party insurance related to its past operations of nuclear plants. The Company also maintains third-party insurance to cover property liabilities, and other risks in the normal course of business in amounts that the Company's management believes are adequate. The Company contracts with various companies for the storage and disposal of spent nuclear fuel. In addition, the Company maintains casualty and liability insurance against risks of its business to the extent management considers appropriate. The level of this insurance is generally in line with that maintained by other state-owned entities in Italy.

Environmental Matters

The Company's electricity operations are subject to extensive environmental regulation, including laws adopted by the Italian parliament or government to implement regulations and directives adopted by the European Union and international agreements on the environment.

Environmental regulation affecting the Company's business primarily relates to air emissions, water pollution, waste disposal and electromagnetic fields. The principal objective of the Company's environmental policy is to comply with all relevant legislation and to seek to reduce adverse effects that the Company's activities may have on the environment.

The principal waste products of fossil-fueled electricity generation are sulfur dioxide ("SO₂"), nitrogen oxides ("NO_x"), carbon dioxide ("CO₂") and particulate matters such as dust and ash. The primary focus of environmental regulation applicable to the Company's business is to reduce these emissions.

Principal EU legislation and international treaties regarding SO₂ and NO_x

The principal EU directive on air emissions affecting the electricity industry is the large combustion plants directive (the "LCPD"). The LCPD requires each EU member state to establish and implement a program of progressive reduction of total SO₂ emissions and total NO_x emissions from generation plants licensed before July 1, 1988 and to establish emission limits for SO₂, NO_x and particulate matter from individual generation plants licensed after July 1, 1988. The European Union commission is currently reviewing the LCPD and may issue a new directive in 2000.

Italy is a member of the Helsinki Protocol and the Oslo Protocol, which require signatory countries to reduce SO₂ emissions, and the Sophia Protocol, which requires signatories to reduce NO_x emissions. The requirements under these protocols have been reflected in Italian law.

Principal Italian legislation regarding SO₂ and NO_x

Italy implemented the LCPD by a ministerial decree in 1989 by establishing strict limits on emissions from new plants and requiring the gradual reduction of aggregate emissions from plants licensed prior to July 1, 1988. In some cases the Italian limits are stricter than those imposed by the protocols and the LCPD.

In 1990, Italy established a regulation limiting emissions of polluting substances from thermal plants licensed before July 1, 1998 that is stricter than the LCPD and covers a much broader range of pollutants. This regulation requires that individual existing thermal plants in Italy reduce emissions to levels similar to those established under the LCPD for individual plants licensed after July 1, 1998. This regulation also provides a time schedule for the implementation of environmental compliance measures at existing plants.

In response to this regulation, the Company implemented in 1990 a significant program of environmental measures that affect the Company's entire thermal operations. The Company submitted this program to the relevant ministries of the Italian government, including those for industry, environment and health. This program provides for modifications to both physical plant and operating practices.

In 1997, the Italian parliament imposed a tax on total SO₂ and NO_x emissions from thermal plants that have a nominal capacity of greater than 50 MWth. These plants are the same plants as those regulated under the LCPD.

CO₂ emissions

Both the European Union and Italy are signatories to the Kyoto Protocol, which was signed under the United Nations Framework Convention on Climate Change. With respect to Italy, the Kyoto Protocol establishes emission reduction targets for the reduction of emissions of CO₂ and other greenhouse gases ("GHGs") in the 2008-2012 period by 6.5% of their 1990 levels.

On November 19, 1998, the Italian interministerial committee for economic planning issued the guidelines for Italian policies and measures for the reduction of greenhouse gas emissions in order to implement the Kyoto Protocol. These guidelines set targets for CO₂ emissions to be achieved through measures concerning various sectors of the Italian economy, including reduction of carbon produced in thermal electricity generation, increased use of electricity generation from renewable resources and demand side management to increase efficiency of energy use.

To comply with the Italian government's guidelines regarding the Company's obligation to reduce CO₂ emissions as a result of the Kyoto Protocol, the Company is finalizing a voluntary agreement with the environment and industry ministries. The Company expects that the agreement will include a number of measures to reduce GHGs emissions. These measures will include employing high-efficiency technologies, such as combined cycle gas turbine plants, promoting the use of renewable resources and developing innovative generation technologies using biomass and other wastes. The Company also expects to take advantage of the flexibility provided under the Kyoto Protocol for reducing GHGs emissions through joint projects in industrialized and developing countries and national or international carbon credits trading.

In January 1999, Italy introduced the "carbon tax", a tax on fossil fuel consumption that also applies to fuels for electricity generation. The carbon tax will progressively increase until 2005. The amount of the carbon tax is not proportional to the level of CO₂ emissions by a producer. For example, with respect to thermal power plants, the carbon tax on emissions from coal is almost four times higher than the tax on emissions from natural gas, although the levels of CO₂ emissions from these two fuels are similar. Implementation of the tax

increases scheduled after 2000 will take into account whether and how carbon taxes are implemented in the European Union member states. Based on the current implementation schedule, the Company expects to gradually decrease its use of coal. The Company expects that electricity produced by coal will represent only 1% of its total thermal production in 2004.

Water pollution prevention

The Company is subject to environmental laws and regulations limiting thermal discharges of water from its thermal plants and liquid waste from our hydroelectric plants. In May 1999, the Italian parliament adopted a new law for the prevention of the pollution of fresh and sea waters. The rules concerning thermal discharges from power plants into rivers and coastal waters have not changed and do not affect the operation of the Company's plants. In addition, the water treatment plants already operating in our generation plants are in line with the new requirements on liquid waste.

Solid waste management

In February 1997, the Italian government issued a legislative decree implementing the EU directives on solid waste management. In accordance with this decree, the Company has increased the level of recycling of its waste. The Company has implemented specific measures concerning fuels derived from waste, which the Company intends to use in dedicated plants or together with coal at its thermal generation plants.

Electromagnetic fields

In 1992, the Italian government adopted a regulation relating to exposure to electromagnetic fields. The government supplemented the regulation by an additional decree in 1995. The regulation applies to the extremely low frequency (50Hz) used for the transmission, distribution and consumption of electricity. This regulation sets:

- Maximum levels of exposure to electromagnetic fields from new and existing transmission and distribution lines and distribution substations. Compliance with maximum exposure limits for already installed lines generally involves increasing the height of towers carrying lines where necessary. The Company expects to complete implementation of compliance measures relating to these maximum exposure limits by 2004, as required under the regulation; and
- Minimum distances between transmission or high-voltage distribution lines and residential buildings, office buildings and similar areas for lines built after the adoption of the 1992 regulation.

The minimum distance requirements for transmission and distribution lines or substations installed after the enactment of the 1992 law result in distance set-offs for these lines that exceed what would be required to comply with the maximum exposure levels. The Company has designed all new lines to comply with the minimum distance requirements.

Under a restrictive interpretation of the regulation, a portion of the Company's substations located within buildings may be regarded as non-compliant with the requirements concerning minimum distances between these substations and residences and other occupied buildings. The Company believes that this restrictive interpretation is not correct and that it complies with existing regulation.

Italian regulation of electromagnetic exposure complies with the maximum exposure limits set by international organizations such as the International Radiation Protection Association, the International Non-Ionizing

Radiation Committee and the International Commission on Non-Ionizing Radiation Protection, and those set by a European Union recommendation issued on July 12, 1999.

The level of expression of public concern about the potential effects of exposure to electromagnetic fields has increased significantly in recent years within Italy. The growing level of concern in Italy about the possible effects of electromagnetic fields has significantly increased the possibility of more stringent regulation of electricity transmission and distribution related to these fields.

In 1998, the Italian government submitted to the Italian parliament a bill which would replace then current legislation regarding electromagnetic fields. The proposed legislation, which the parliament is currently considering, would impose new maximum exposure levels and environmental quality targets. The new measures would cover both low-frequency infrastructure, such as electricity transmission and distribution lines and distribution substations, and high-frequency infrastructure, such as telephony, including mobile telephone services. The maximum exposure levels and minimum distance requirements for 50Hz frequency that may result from the current version of the pending legislation may be stricter than those imposed under current law and regulation. These requirements may make it more difficult for the Company to install new transmission and distribution lines and substations in the future.

The pending legislation also provides for a twelve-year program to restructure the Italian electricity grid and bring it into compliance with the new electromagnetic exposure limits and minimum distance requirements. This program may require the Company to move existing transmission and distribution lines and substations.

As a result, if the bill is enacted in its current form, the Company would incur significant capital expenditures to comply with the bill's requirements and this may have an adverse impact on the Company's business.

The current version of the bill would require the Energy Authority to set the criteria, terms and conditions for the recovery, through tariffs, of the costs which the owners of the electricity transmission and distribution lines and substations would bear in implementing the restructuring plan. The Company expects that it would be reimbursed for most of the expenditures that it would incur to comply with the pending legislation through this recovery mechanism

Site clearance

The Company may incur liabilities in respect of sites that are found to be contaminated. Site values could also be affected by contamination. Under new law, sites located in certain industrial and other areas must be inspected to determine whether there is any serious ground contamination. If so, under the law the Italian government may provide financial support for restoration of the contaminated site. Based on the Company's environmental compliance practices and the current regulatory regime, the Company does not expect to have significant liabilities associated with contamination of sites being inspected.

Landscape safeguard

The Company has taken the following actions to reduce the environmental impact of its transmission and distribution lines:

- Re-using routes of previous power lines wherever possible;
- Soliciting internationally proposals for the design of new towers for its transmission lines aimed at reducing the environmental and aesthetic impact of towers in non-urban areas of particular landscape value;

- Acting to reduce the impact of lines in environmentally sensitive or protected areas;
- For medium-voltage lines, placing underground cables in urban areas and aerial cables with low environmental impact in other areas with specific environmental value; and
- Using aerial insulated cables or underground cables in low voltage networks (at present, the Company has built approximately two-thirds of its network in this way).

Environmental certifications and authorizations

The Company has joined a European Union initiative to implement a voluntary environmental management and certification system (“EMAS”), which seeks to improve the level of environmental efficiency and disclosure of European industrial companies. The Company is committed under the initiative to obtain EMAS certification for 26 of its generation plants, representing 50% of its installed capacity, by 2000. In July 1999, two plants obtained the EMAS certification. The Company is implementing measures at the other 24 plants in connection with the certification process.

The Italian government and parliament are considering a bill to implement the 1996 EU directive on the prevention and reduction of pollution (the “IPPC directive”). This directive requires all industrial plants to operate under a new integrated environmental license by 2007 and make use of state of the art technologies for the prevention and reduction of pollution. The new license will set pollution limits and will be reviewed every five years or at any time plants undergo significant renovation. The Company believes that the EMAS certification will simplify these licensing procedures.

Discontinued nuclear operations

The Company produced electricity from four nuclear power plants until 1988. The Company’s four nuclear plants had an aggregate net installed capacity of 1,500 MW.

In addition to the Company’s nuclear power plants, it owned a 33% stake in NERSA, an electricity generation company that operated a nuclear power plant located in France. French and German utilities owned the balance of NERSA. In July 1998, the Company sold its stake in NERSA. However, the Company retained ownership and responsibility for the decommissioning of its share of the nuclear fuel in the plant.

Following a national referendum in 1987, the Italian Parliament imposed a moratorium on the development and production of nuclear power in Italy. As a result, the Company shut down its nuclear plants, wrote-off related assets and wrote-down fuel stock to their net realizable values. Under Italian law, the Company was reimbursed for its costs related to this moratorium.

Pursuant to the Bersani Decree, the Company has transferred its discontinued nuclear operations to Sogin, a wholly owned subsidiary.

The principal activity of Sogin will be the decommissioning of the nuclear plants, including disposal of nuclear fuel and nuclear waste. The plan for decommissioning of each plant is divided in three phases:

- The first phase includes defuelling of the plant’s reactor and the off-site shipment of irradiated fresh fuel, treatment and conditioning of operational waste and confinement and containment of the residual radioactivity in specific buildings within the plant.

- The second phase, known as “passive safe storage”, involves only surveillance of the plant while the residual radioactivity undergoes natural decay.
- The third phase involves final dismantlement of the plant and abandonment of the site.

The defuelling of the plants’ reactors has been completed. According to a plan the Company had developed before the Bersani Decree was enacted, the expectation is that all four of the nuclear plants transferred to Sogin will enter into the second phase by the year 2010 and that the third phase will be completed by 2050.

The Bersani Decree provides that the Company will transfer to the Treasury Ministry all the shares of Sogin at no cost at a yet to be determined future date.

Nuclear liability

Italy is a party to the 1960 Paris Convention on Third Party Liability in the Field of Nuclear Energy and the 1963 Brussels Supplementary Convention (1963). Italian law in implementing the conventions imposes a strict liability for claims relating to nuclear plants and the transportation and storage of nuclear matter. Strict liability under Italian law means that someone does not need to be negligent in order to be found liable. The law imposes all liability for nuclear accidents solely to the subject that is operator of the plant at the time of the accident. Consequently, the Company will not be liable for any accident occurring after the transfer to the Treasury Ministry of the shares in Sogin even if the cause of those accidents predated the transfer. However, the Company will remain liable for any accident that occurred before the transfer, even if the damage, or the accident itself, is discovered after the transfer. Italian law in implementing the conventions imposes a maximum period of ten years from the date of the accident in which someone claiming damages must bring claims.

The Company’s direct liability arising from nuclear liability claims is limited to five million International Monetary Fund Special Drawing Rights, or SDRs, per accident. To the extent any claim exceeds five million SDRs, under Italian law, someone claiming damages may sue the Company for only five million SDRs and must sue the Italian government for the excess liability up to 175 million SDRs. If the claim is in excess of 175 million SDRs, that person must sue the signatories to the conventions, but then only up to 300 million SDRs. However, the Italian government can claim reimbursement from the Company for any sums it may have to pay because of a nuclear accident arising from negligence on our part.

A provision of the Italian law implementing the conventions states that when damage has been caused concurrently by a nuclear accident and the emission of ionizing radiation, the liability of the person that caused this radiation is not subject to the limitations described above. This provision does not fully conform to the conventions because it does not specify that the ionizing radiation must not independently qualify as a nuclear accident in order to give rise to unlimited liability. The Company, however, believes that the correct interpretation of Italian law implementing the conventions is that only radiation not classified as a nuclear accident gives rise to liability outside the limitations described above. The Company believes all emissions of radiation originating from within nuclear plants would qualify as nuclear accidents. As a consequence, because the Company holds nuclear material inside its plants, it could only be liable outside the limitations described above under remote circumstances.

Litigation

The Company is a defendant in a number of legal proceedings incidental to the generation, transmission and distribution of electricity. Because of the nature of these proceedings, it is not possible to predict the ultimate outcomes of certain of those matters, some of which may be unfavorable to the Company. However, the Company does not expect the outcome of such proceedings, either individually or in the aggregate, to have a

material adverse effect upon its financial position or results of operations. However, provisions are made in the accompanying consolidated financial statements for all significant liabilities that are expected to materialize.

A number of disputes are pending in relation to urban planning, landscape and environmental matters linked to the construction and operation of several generating plants and power lines. The examination of such disputes, also on the basis of legal advice, leads the Company to believe that unfavorable outcomes would be a remote possibility. While the possibility is remote, the risk that a limited number of cases might have unfavorable outcomes cannot be ruled out, and whose consequences could entail, in addition to the payment of damages. At the present time, such charges are not predictable and therefore, the Company has not accrued any liabilities for these disputes.

Nuclear charges

The Company appealed to the administrative tribunal of Lombardy on July 27, 1998 against the resolution of June 12, 1998, n. 58 of the Energy Authority. With this resolution, the Energy Authority commenced an investigation on the criteria previously adopted by the CIP to reimburse the Company, via the electricity tariffs, for the costs accruing from the decision to cease nuclear energy generation. The Energy Authority found that all the reimbursements to the Company were proper, with the exception of certain items for an overall value of lire 390 billion (see Note 19). The Company, in turn, appealed against this cutback and at the same time allocated an equivalent amount to the allowance for doubtful accounts.

The public administrative tribunal of Lombardy, with sentence n. 612 on February 18, 1999, granted most of the requests made by the Company, recognizing the Company's right to receive most of the amount cut back from its reimbursements, amounting to lire 278 billion.

The Company has appealed to the superior public administrative tribunal (Consiglio di Stato) to obtain full recognition of reimbursement, including the residual amount of lire 112 billion, that the Company was not being allowed to recover, and has requested a rapid proceeding for this matter. In view of the uncertainty regarding the legal proceedings and the appeal process, the Company has not adjusted the lire 390 billion allowance for doubtful accounts.

Legal proceedings on tariffs

Some companies with very high levels of energy consumption and consumer associations have challenged before the competent regional administrative courts, and also occasionally petitioning the Head of State, either wholly or in part the validity of the measures with which the CIP and the Energy Authority has, over time, defined the electricity tariffs. Thus far, all court decisions have rejected such challenges.

While the annulment of one of the measures objected to, could generate a series of requests for reimbursement by certain companies, the Company does not view this as a significant risk. Any such annulment would be followed by a new measure, issued by the Energy Authority, which would, through the tariff system, provide ways to reimburse the charges to which the Company is entitled.

ATEL arbitration

By virtue of three long-term supply contracts, the Company has been in contractual relations with the Swiss company ATEL since 1986. With the devaluation of the lire, subsequent to the stipulation of the contract, the decision by the Energy Authority to fix limits on reimbursements for long-standing contracts to guarantee supply and the gradual liberalization of the electricity market in Italy, the Company considers that the relations between the two parties are no longer equitable. For these reasons it has requested that the two parties renegotiate the contractual terms in order to obtain the reciprocally equitable conditions that the contracts themselves set out to obtain.

As ATEL's proposals were viewed by the Company to be insufficient to address the imbalance between the parties in the manner prescribed by the contracts, the Company is seeking an arbitral settlement in Geneva in application of the rules of the International Chamber of Trade of Paris. The Company is principally requesting the rescission of all contracts still in force with ATEL and that ATEL pay the price differences since 1997 resulting from the new conditions fixed by the arbitration board. Alternatively, the Company is seeking such changes to the contracts as to make them equitable for both parties, together with the ruling that ATEL pay the difference in price from March 1997 on the basis of the new conditions fixed by the arbitration board.

The arbitration is only at a preliminary phase and, in any case, the Company cannot currently predict the outcome.

WIND – Deutsche Telekom

The Company, together with France Tèlècom S.A. and WIND, has initiated legal action in the Court of Rome to obtain an injunction against Deutsche Telekom AG. The injunction is necessary to safeguard the interests and contractual position of the Company as party to the agreements reached in May 1998, whereby the parties undertook to observe conditions of exclusivity, non-competition and secrecy. The Company maintains that Deutsche Telekom violated these obligations by negotiating and stipulating a Business Combination Agreement with WIND's principal competitor Telecom Italia S.p.A..

On July 12, 1999, the Rome Court recognized that Deutsche Telekom had failed to observe the undertakings in respect of non-competition and exclusivity contained in the agreements to which it was a party. In the meantime, the Company, in conformity to the arbitration clause in the agreements, has filed an arbitration proceeding to be held in Geneva on the basis of the rules of the International Chamber of Trade of Paris in order to obtain compensation for the damage sustained. The Company's claims relate to the recognition of Deutsche Telekom's breach of WIND's shareholder agreements and the resulting right on the part of the Company to acquire Deutsche Telekom's share in WIND, according to the terms and conditions described in the shareholder agreements. Deutsche Telekom will in any case be requested to pay the Company damages estimated at lire 1,700 billion.

Environmental litigation

The Company has exposure for environmental contingencies as a result of the installation and operation of electrical equipment. The most important environmental issues are those relating to the effect of exposure to electric and magnetic fields generated by the equipment installed.

ENEL Distribuzione S.p.A. and T.E.R.N.A. S.p.A. are named in a number of civil and administrative legal proceedings in which the relocation or change in operating procedures for electrical lines is requested on the basis of their alleged harmfulness, despite the fact that the equipment has been installed in accordance with current standards.

A limited number of cases, which included claims for health related damages due to electromagnetic fields, have been filed against the Company, and only a few have resulted in unfavorable rulings against the ENEL Group. All of these have been appealed so at the present time there have been no final sentences against ENEL.

(22) RELATED PARTY TRANSACTIONS

As the entity primarily responsible for electricity generation, transmission and distribution in Italy, the Company provides service to many other State-owned entities. In the vast majority of situations the rates charged are comparable to the tariffed rates charged to similar commercial organizations with the primary exception being the State-operated rail road system (Ferrovie dello Stato) and Acciai Speciali Terni S.p.A., which are entitled to favorable rates under Italian law. Total revenues from all State-owned companies were approximately 2 percent of total revenues for each of the three years ended December 31, 1999.

The Company purchases fuel for generation from ENI S.p.A. ("ENI"), an Italian oil and gas company, whose largest shareholder is the Treasury Ministry (also 63.7% owned by the public as of December 31, 1999). Total purchases from ENI were approximately 7 percent of total operating expenses for each of the three years ended December 31, 1999. Sales to ENI and the railroad Company makeup the majority of sales to State-owned companies. Total purchases from State-owned companies were approximately 10 percent of total operating expenses for each of the three years in the period ended December 31, 1999.

(23) SUMMARY OF SIGNIFICANT DIFFERENCES BETWEEN ITALIAN GAAP AND U.S. GAAP

The consolidated financial statements are prepared in accordance with Italian GAAP, as described in Note 2, which differs in certain respects from U.S. GAAP. The significant differences are as follows:

Restated Fixed Assets and Related Depreciation

In accordance with various Italian laws, certain utility plant balances have been restated. Under U.S. GAAP, such restatements are not permitted. The adjustments shown in the reconciliations below include the elimination of these restatements and the related accumulated depreciation and the effect of the recomputation of the depreciation expense on a historical cost basis.

Capitalized Interest and Related Depreciation

Under U.S. GAAP, interest is required to be capitalized as part of the cost of constructing an asset in accordance with Statement of Financial Accounting Standards ("SFAS") No. 34, "Capitalization of Interest Cost". Under Italian GAAP, interest capitalization is permitted, but not required. For Italian purposes, the Company has not capitalized any interest since December 31, 1988. The reconciliations below include adjustments to reflect capitalization of interest on assets, to the extent those assets qualify for interest capitalization in accordance with SFAS No. 34, and the related effect on depreciation.

Write-down of Fixed Assets

In 1994, the Company wrote-up the value of certain machinery which had been previously written down. In 1997, the Company reversed the above mentioned write-up in its Italian financial statements. Under U.S. GAAP, if a write-down occurs, a new cost basis is established and subsequent write-ups in value are not permitted. The reconciliations below include the adjustment needed to reverse this write-down in 1997, since it had been previously reflected for U.S. GAAP purposes.

Unbilled Revenues

As discussed in Note 2, the Company records revenues for electric services rendered when the electrical meter is read or when a customer is billed based on estimated consumption. Revenues for the supply of electricity provided after the last meter reading prior to year-end, as well as differences between estimated and actual consumption, are recognized in the subsequent period when billed. Under U.S. GAAP, revenues are recorded for all services provided through the end of the accounting period. The reconciliations presented below include adjustments to recognize the net impact on revenues for all services provided during each fiscal period, even if amounts are not billed at the period end.

Pension and Employee Termination Accounting

As discussed in Note 2, the Company grants certain pension and other benefits to its employees, as required by Italian law and under labor contracts. In particular, the Company's employees are covered by a plan required under Italian law and labor contracts which grants a termination indemnity based on compensation and years of service. The Company has accrued the amount due to each employee as of the respective year-end, based on such factors and dates. In addition, the Company is required, by agreements with Trade Unions, to provide certain additional employee termination benefits. The reserve for these termination benefits is accrued on a current liability basis at the end of each year and accordingly is not actuarially computed.

SFAS No. 87, "Employers' Accounting for Pensions," requires the provision for pension and other benefits to be recognized over the employees' employment period based on actuarially determined calculations. Additionally, in determining the employee termination liability for U.S. GAAP purposes, the Company has applied Approach 2 of Emerging Issues Task Force ("EITF") No. 88-1. This approach determines the actuarial present value of the vested benefit obligation the employee is entitled to at separation based on the employee's expected date of separation or retirement. The reconciliations below include adjustments to recognize the pension and other benefits in accordance with SFAS No. 87 and EITF No. 88-1.

Other Postretirement Benefits Accounting

As discussed in Note 2, the Company grants certain postretirement benefits to its employees, mainly related to a reduction on electricity tariffs and contributions to certain employee programs that provide medical benefits. The related costs are expensed as incurred under Italian GAAP.

SFAS No. 106, "Accounting for Postretirement Benefits Other than Pensions", requires the provision for various employee benefit arrangements to be recognized over the employees' employment period based on actuarially determined calculations. The reconciliations presented below include adjustments to recognize the other postretirement benefits in accordance with SFAS No. 106.

Social Security Withholdings and Contribution ("Solidarity Contribution")

As discussed in Note 2, the Company was required to pay approximately lire 126 billion for social security withholdings and contributions (relating to the period from September 1, 1985 to June 30, 1991), during 1997 through 1999. In the accompanying consolidated financial statements, the amounts are expensed as paid over the deferred payment period. U.S. GAAP requires the recognition of a liability on an accrual basis, when it is probable and reasonably estimated. The reconciliations below include adjustments to reflect the liabilities on an accrual basis.

Derivatives

The Company enters into derivatives for general and specific hedging purposes. The general hedges are not designed against specific transactions. Under U.S. GAAP, derivatives that are not designated to hedge specific transactions are accounted for at estimated market value with gains and losses being recognized in the statements of income currently. The reconciliations below include adjustments to reflect these types of derivatives at their estimated market value in the statements of income.

Effect of U.S. GAAP Adjustments on WIND Equity

Certain differences between Italian GAAP and U.S. GAAP exist in the accounts of WIND, primarily related to start-up costs, which are required to be expensed for U.S. GAAP purposes. The reconciliations below include adjustments to recognize the Company's investment in WIND on a U.S. GAAP basis.

Restructuring Reserve

The Italian GAAP financial statements reflect accruals for anticipated restructuring charges to occur in the future. U.S. GAAP requires that certain conditions must be met before a restructuring accrual can be established. These conditions have not been met, therefore, the reconciliations below reflect adjustments for the difference in the timing of the accruals.

Deferred Taxes

As discussed in Note 20, during 1997, a change in the Italian tax laws was enacted which changed the tax rates effective January 1, 1998. As the enactment date of this change was during 1997, the deferred tax assets and liabilities previously reflected under U.S. GAAP were adjusted to reflect the new rates. The amount of this reversal under U.S. GAAP was approximately lire 286 billion. The reconciliations below include an adjustment for the difference between the Italian and the U.S. GAAP impacts .

Prior to 1998, for Italian GAAP purposes, the Company recognized deferred income taxes only for certain book and tax differences, while SFAS No. 109, "Accounting for Income Taxes," requires the recognition of deferred income taxes on all temporary book and tax differences. The reconciliations below include these adjustments.

Beginning in 1998, with the application of Italian Accounting Standard No. 25, the Company began recognizing deferred tax assets on all temporary differences between book and tax bases. This is substantially consistent with U.S. GAAP, and the reconciliations below include an adjustment since deferred tax assets were recorded in prior years for U.S. GAAP purposes.

Extraordinary Income and Expenses

As discussed in Note 2, items are recorded as extraordinary under Italian GAAP if they meet a certain criteria. U.S. GAAP requires more stringent conditions for extraordinary item classification by also requiring the underlying event or transaction to clearly possess a high degree of abnormality and be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the event operates. Items recorded by the Company as extraordinary in the years presented herein for Italian GAAP would not qualify as extraordinary under U.S. GAAP. Such items have been reclassified to the appropriate income statement captions as determined by U.S. GAAP, and consequently have been included in the determination of operating income contained in the condensed consolidated statements of income presented in Note 24.

(24) RECONCILIATION BETWEEN NET INCOME AND SHAREHOLDERS' EQUITY DETERMINED UNDER ITALIAN GAAP AND U.S. GAAP

The following table summarize the significant adjustments to consolidated net income for the years ended December 31, 1997, 1998 and 1999 that would be required if U.S. GAAP had been applied instead of Italian GAAP:

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1999</u>
	(billions of lire (a))			(millions of U.S. dollars (a))
Net Income as reported in the consolidated statements of income..	3,327	4,286	4,541	2,362
Items increasing (decreasing) reported net income:				
Depreciation on restated fixed assets.....	619	433	403	210
Capitalized interest and related depreciation (b).....	218	(4)	(74)	(39)
Write-down of fixed assets.....	428	-	-	-
Unbilled revenues.....	(14)	(18)	181	94
Pension and employee termination accounting	71	(55)	(104)	(54)
Other postretirement benefits accounting.....	(16)	(17)	(46)	(24)
Social security withholdings and contribution.....	42	42	42	22
Derivatives.....	12	(71)	52	27
Effect of U.S. GAAP adjustments on WIND equity.....	-	-	(55)	(29)
Restructuring reserve.....	-	-	59	30
Deferred taxes.....	(439)	(933)	(362)	(188)
Tax effect of reconciling items.....	(1,071)	(132)	(191)	(99)
Approximate net income in accordance with U.S. GAAP.....	3,177	3,531	4,446	2,312
	=====	=====	=====	=====
Basic and diluted earnings per share in accordance with U.S. GAAP (c)	262	291	367	0.19
	=====	=====	=====	=====

(a) Except per-share data which is in lire and U.S. dollars

(b) Includes related depreciation of lire 90 billion, lire 121 billion, lire 135 billion and U.S. \$70 million, respectively.

(c) The approximate per share amounts have been calculated in accordance with SFAS No. 128, "Earnings Per Share". See Note 25 for additional information on earnings per share. For purposes of these calculations the weighted average number of shares was 12,126,150,379 shares as of December 31, 1997, 1998 and 1999, respectively.

The following table summarizes the significant adjustments to consolidated shareholders' equity as of December 31, 1998 and 1999 that would be required if U.S. GAAP had been applied instead of Italian GAAP:

	1998	1999	1999 (millions of U.S. dollars)
	(billions of lire)		
Shareholders' equity as reported in the consolidated			
Balance sheet.....	35,880	34,034	17,700
Items increasing (decreasing) reported shareholders' equity:			
Restated fixed assets and related depreciation	(3,718)	(3,315)	(1,724)
(a).....			
Capitalized interest and related depreciation	2,992	2,918	1,518
(b).....			
Unbilled	906	1,087	566
revenues.....			
Pension and employee termination	(94)	(118)	(61)
accounting.....			
Other postretirement benefits accounting	(1,959)	(2,005)	(1,043)
.....			
Social security withholdings and	(42)	-	-
contribution.....			
Derivatives.....	(59)	(7)	(4)
.....			
Effect of U.S. GAAP adjustments on WIND	-	(55)	(29)
equity.....			
Restructuring	-	59	31
reserve.....			
Deferred	157	(205)	(107)
taxes.....			
Tax effect of reconciling	722	502	261
items.....			
Approximate shareholders' equity in accordance with U.S.	34,785	32,895	17,108
GAAP.	=====	=====	=====

(a) Includes related accumulated depreciation of lire 24,133 billion, lire 24,342 billion, and U.S. \$12,660 million, respectively.

(b) Includes related accumulated depreciation of lire 528 billion, lire 663 billion and U.S. \$345 million, respectively.

There are other differences between Italian GAAP and U.S. GAAP which have not been included in the U.S. GAAP reconciliation because their effects on net income and shareholders' equity are not considered material. Following is a brief description of such differences:

1. Cost of Removal and Land Depreciation – The Company does not specifically provide a reserve for the cost of removal of utility plant upon completion of its service period since the environmental laws in Italy do not require removal of generating assets. The Company does, however, provide depreciation on land on which generating stations and other property are located. Under U.S. GAAP, land is not depreciated, but specific provisions are generally made for the cost of removals as a reduction in net utility plant or reflected as a liability in the balance sheet. The effect of not providing for the cost of removal of plant or the depreciation of land is not material, individually or in the aggregate, on the Company's financial position and results of operations.

2. Equity Method of Accounting for WIND -- In the Italian financial statements presented for 1997 and 1998, the Company's investment in WIND is accounted for under the cost method of accounting. Under U.S. GAAP, WIND is to be accounted for under the equity method since the Company has significant influence (but not control) over the investment. This effect is not material to the Company's financial position and results of operations for 1997 and 1998.
3. Newly Organized Companies -- As discussed in Note 2, the results of operations for certain subsidiaries have been excluded from the consolidated statement of income due to the limited scale of their operations. These effects are not material, individually or in the aggregate, to the Company's financial position or results of operations.

The condensed consolidated balance sheets as of December 31, 1998 and 1999 presented below have been restated to reflect the principal differences between Italian GAAP and U.S. GAAP as discussed above.

CONSOLIDATED BALANCE SHEETS	As of December 31,		1999
	1998	1999	
	-		(millions of U.S. dollars)
	(billions of lire)		
Assets			
Current	13,480	12,240	6,366
Assets.....			
Fixed Assets,	74,961	73,014	37,972
net.....			
Other non-current	2,218	1,307	680
assets.....			
	-----	-----	-----
	90,659	86,561	45,018
	=====	=====	=====
Liabilities and Shareholders' Equity			
Current	21,832	20,904	10,871
liabilities.....			
Long-term	17,000	16,961	8,821
debt.....			
Other non-current	17,042	15,801	8,218
liabilities.....			
	-----	-----	-----
Total	55,874	53,666	27,910
liabilities.....			
	-----	-----	-----
Shareholders'	34,785	32,895	17,108
equity.....			
	-----	-----	-----
	90,659	86,561	45,018
	=====	=====	=====

The condensed consolidated statements of income for the years ended December 31, 1997, 1998 and 1999 presented below have been restated to reflect the principal differences between Italian GAAP and U.S. GAAP as discussed above.

CONSOLIDATED STATEMENTS OF INCOME

	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>1999</u>
	-	-		
		(billions of lire)		(millions of U.S. dollars)
Total operating revenues.....	39,603	39,770	40,765	21,201
Total operating expenses.....	31,291	31,083	30,886	16,063
Operating income.....	8,312	8,687	9,879	5,138
Financial income (expense).....	(1,877)	(1,434)	(1,018)	(529)
Equity losses and other non operating expenses.....	-	-	(674)	(351)
Income before income taxes.....	6,435	7,253	8,187	4,258
Income taxes.....	3,258	3,722	3,741	1,946
Net income.....	3,177	3,531	4,446	2,312
	=====	=====	=====	=====

The condensed consolidated statements of changes in shareholders' equity for the years ended December 31, 1998 and 1999 presented below have been restated to reflect the principal differences between Italian GAAP and U.S. GAAP as discussed above.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

	<u>Share Capital</u>	<u>Retained Earnings</u>	<u>Minimum Pension Liabilities</u>	<u>Total</u>
	-			
		(billions of lire)		
Balance as of December 31, 1997.....	12,126	20,864	(762)	32,228
Minimum pension liabilities.....	-	-	(52)	(52)
Net income.....	-	3,531	-	3,531
Dividends.....	-	(922)	-	(922)
....				
Balance as of December 31, 1998.....	12,126	23,473	(814)	34,785
	=====	=====	=====	=====

Minimum pension liabilities.....	-	-	51	51
Net income.....	-	4,446	-	4,446
Distribution of reserves.....	-	(4,422)	-	(4,422)
Dividends.....	-	(1,965)	-	(1,965)
....				
Balance as of December 31, 1999.....	12,126	21,532	(763)	32,895
	=====	=====	=====	=====
		(millions of U.S. dollars)		
Balance as of December 31, 1999.....	6,306	11,198	(396)	17,108
	=====	=====	=====	=====

DISCLOSURE OF COMPREHENSIVE INCOME

	<u>1998</u>	<u>1999</u>	<u>1999</u>
	(billions of lire)		(millions of U.S. dollars)
Net income.....	3,531	4,446	2,312
Minimum pension liabilities.....	(52)	51	26
Total comprehensive income.....	3,479	4,497	2,338
	=====	=====	=====

(25) ADDITIONAL U.S. GAAP DISCLOSURES

(a) Concentrations of Risk and Certain Significant Estimates

The ENEL Group is a vertically integrated energy company involved in the generation, transmission, and distribution of electricity throughout Italy as well as being involved in research and development, nuclear plant management, information technology services, estate management and general services, engineering management and contraction, and telecommunication services.

The Company's business is largely determined by laws, regulations and policies established by the European Union and the Italian government. As described in Note 3, the regulatory framework for the Italian electricity market changed significantly in 1999 with the implementation of the Bersani Decree, which is designed to liberalize and create more competition in the Italian electricity market. The changes caused by the Bersani Decree include the adoption of a new tariff structure, the restructuring of the Company's transmission business in order to transfer the operation and management of the transmission network to the System Operator, the reorganization of the Company's generation, transmission and distribution operations into separate business units and the requirement that the Company sell no less than 15,000 MW of its generating capacity by January 2003. Because these regulations are still in the process of being implemented, the ultimate impact on the Company's business and the Italian electricity market is difficult to predict.

Tariff Structure

The Italian regulatory authorities implemented a new tariff regime that took effect on January 1, 2000. The new tariff regime will result in a significant reduction of the Company's tariff revenues. Lower fixed tariff rates apply in 2000 for generation, transmission and distribution.

Generation

The Bersani Decree provides that after January 1, 2003 no single company or group may generate or import more than 50% of the total amount of electricity generated and imported in Italy. In 1999, the Company generated and imported 75 % of the total electricity generated and imported in Italy. To comply with this provision, the Company has developed a plan to dispose of plants representing approximately 15,057 MW of the Company's net installed capacity, which is equivalent to approximately 16,000 MW of gross installed capacity.

The Bersani Decree provides that the disposal of the ENEL Group's excess generation capacity should happen at market prices. Nonetheless, the sale of that capacity must also comply with several requirements under the decree which could adversely affect the price the Company receives.

Distribution

The Bersani Decree calls for significant consolidation among existing electricity distributors in urban areas. If operators in the distribution market fail to consolidate in the way described in the new regulation by September 2000, the Company may be obliged to sell its distribution networks in a number of metropolitan areas.

Increased Competition

For many years the Company has had virtually no competition in the generation and transmission market and limited competition in the distribution market in Italy. The Company currently faces limited competition from independent power producers and municipal utilities in generation. The Company expects that competition in the generation of electricity will increase after the disposal of at least 15,000 MW of generating capacity. The Company also faces competition from suppliers and wholesalers for sales to customers that are intensive users of electricity and may freely purchase electricity from different producers.

Basis of Presentation

The preparation of financial statements in conformity with Italian GAAP, along with the reconciliation to U.S. GAAP, requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(b) Accounting for Deferred Income Taxes

Under SFAS No. 109, the Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns.

Deferred tax assets and liabilities are determined based on the temporary differences between the financial and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

A detail of the provision for income taxes for the years ended December 31, 1997, 1998 and 1999 is as follows:

	<u>1997</u>	<u>1998</u> (billions of lire)	<u>1999</u>	<u>1999</u> (millions of U.S. dollars)
Current	2,096	2,785	2,834	1,474
.....				
Deferred	1,162	937	907	472
.....				
	<u>-----</u>	<u>-----</u>	<u>-----</u>	<u>-----</u>
	3,258	3,722	3,741	1,946
	<u>=====</u>	<u>=====</u>	<u>=====</u>	<u>=====</u>

The difference between the statutory and effective tax rate for the years ended December 31, 1997, 1998 and 1999, is due to the following factors:

	<u>1997</u>	<u>1998</u>	<u>1999</u>
Statutory tax rate	53.2%	48.0%	48.0%
.....			
Tax on net equity	3.0	-	-
.....			
Deferred income taxes for the year calculated at the new tax rates.....	(3.1)	-	-
Reversal of deferred tax liabilities no longer required following the Italian tax reform.....	(3.6)	-	-
Valuation allowance.....	-	3.1	(3.1)
.....			
Permanent differences and other.....	1.1	0.2	0.8
	<u>-----</u>	<u>-----</u>	<u>-----</u>
Effective tax rate.....	50.6%	51.3%	45.7%
	<u>=====</u>	<u>=====</u>	<u>=====</u>

The components of the net deferred tax assets (liabilities) as of December 31, 1998 and 1999 are as follows:

	<u>1998</u>	<u>1999</u>	<u>1999</u>
	(billions of lire)		(millions of U.S. dollars)
Deferred tax assets:			
Pension and other post retirement benefits	781	984	512
.....			
Revaluation of fixed assets	1,534	1,367	711
.....			
Provision for contingent liabilities.....	988	647	336
Bad debt reserve	262	249	129
.....			
Fixed assets	134	74	39
.....			
Other	50	65	34
.....			
Subtotal	3,749	3,386	1,761
.....			
Deferred tax liabilities:			
Accelerated depreciation	(5,373)	(6,206)	(3,228)
.....			
Capitalization of interest on fixed assets	(1,234)	(1,204)	(626)
.....			
Unbilled revenues	(374)	(448)	(233)
.....			
Equity reserves	(205)	(205)	(106)
.....			
Subtotal	(7,186)	(8,063)	(4,193)
.....			
Less:			
Valuation Allowance.....	(228)	-	-
Net deferred tax liabilities	(3,665)	(4,677)	(2,432)
.....			
	=====	=====	=====

As discussed in Note 20, the Company will now be able to realize the full benefits of certain deferred tax assets. For U.S. GAAP purposes, the Company had previously reflected a valuation allowance against these deferred tax assets. Because the benefits were realized in 1999, the valuation allowance was removed during the year.

(c) Segment Information

Effective December 31, 1998, the Company adopted SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information".

The Company operates primarily throughout Italy and its core businesses are focused on generation, transmission, distribution and sale of electricity. No geographic information has been presented since substantially all of the Company's operating activities are located in Italy.

The other activities of the Company include: research and development, information technology services, real estate management and general services, engineering management and contraction, and telecommunication services. These activities are mostly carried out within the ENEL Group, with limited services provided to third parties.

Until October 1, 1999, the Company's reportable segments were strategic divisions which were formed during the second half of 1997 and began operating as separately identifiable divisions in 1998. Each division had its own management structure, headed by a division manager who reported directly to the Principal Executive Officer of the Company. Beginning October 1, 1999, separate companies were formed to carry out the activities of the main divisions of the Company.

Prior to 1998, the Company managed its operations on a total utility-basis, without separate identifiable business segments. Certain groups within the Company provided services on a company-wide basis. These consisted primarily of information technology, research and development, construction and engineering. These groups provided no services to third parties, and the related assets of these groups totaled less than one percent of consolidated assets. The related costs were considered as costs of providing utility service and as such were included as operating costs for purposes of determining tariffs. As such, no separately reportable segments exist for 1997.

As described in Note 3, the Italian electricity sector is currently going through significant changes which will have impacts on each of the Company's segments, including (but not limited to) changing tariff rates and reorganized activities. The changes will ultimately impact the comparability of 1998 and 1999 segment information to future periods. Revenues and expenses within the reported segments will likely change due to tariff reductions, the implementation of transmission services and the required disposal of at least 15,000 MW of net installed capacity.

Transfer pricing for intersegment sales between the divisions and for operations of the separate companies after October 1, 1999 were based on internal management allocations which were not representative of approximate prices that will be charged beginning in 2000 after the changes caused by the Bersani Decree.

The accounting policies of the segments are the same as those described in the significant accounting policies (Note 2).

Information about the Company's segments for the years ended December 31, 1998 and 1999 is as follows:

<u>1998</u>	Generation	Transmission	Distribution	Other (a)	Eliminations	Consolidated (b)
	(billions of lire)					
Revenues	19,270	19,010	27,280	4,153	(29,925)	39,788
(c).....						
Operating Income	6,930	175	3,434	(806)	(129)	9,604
.....						
Depreciation and Amortization	2,297	385	2,863	491	-	6,036
...						
Capital Expenditures	1,869	594	3,007	401	-	5,871
.....						
Identifiable Assets	41,047	9,336	25,545	15,489	(838)	90,579
.....						

<u>1999</u>	Generation	Transmission	Distribution	Other (a)	Eliminations	Consolidated (d)
	(billions of lire)					
Revenues	18,584	16,157	28,166	3,803	(26,126)	40,584
(c).....						
Operating Income	6,333	110	4,493	(463)	(47)	10,426
.....						
Depreciation and Amortization	2,493	427	2,880	401	-	6,201
...						
Capital Expenditures	1,578	436	3,246	393	-	5,653
.....						
Identifiable Assets	42,232	7,789	30,944	16,711	(11,743)	85,933
.....						

<u>1999</u>	Generation	Transmission	Distribution	Other (a)	Eliminations	Consolidated (e)
	(millions of U.S. Dollars)					
Revenues	9,665	8,403	14,648	1,978	(13,587)	21,107
(c).....						
Operating Income	3,294	57	2,337	(241)	(25)	5,422
.....						
Depreciation and Amortization....	1,297	222	1,498	208	-	3,225
Capital Expenditures.....	821	227	1,688	204	-	2,940
Identifiable Assets	21,964	4,051	16,093	8,690	(6,107)	44,691
.....						

- (a) Other activities include: research and development, information technology services, real estate management and general services, engineering management and contraction, and telecommunication services. None of these divisions has met any of the quantitative thresholds for determining reportable segments. The other activities in 1998 also included the discontinued nuclear plant management.
- (b) Amounts in accordance with U.S. GAAP approximate lire 39,770 billion, lire 8,687 billion, lire 6,543 billion, lire 5,871 billion and lire 90,659 billion, respectively

- (c) Includes elimination of intersegment revenues of lire 29,925 billion in 1998 and lire 26,126 billion (U.S. \$13,587 million) in 1999, respectively.
- (d) Amounts in accordance with U.S. GAAP approximate lire 40,765 billion, lire 9,879 billion, lire 5,933 billion, lire 5,653 billion and lire 86,561 billion, respectively
- (e) Amounts in accordance with U.S. GAAP approximate U.S. \$ 21,201 million, U.S. \$5,138 million, U.S. \$3,086 million, U.S. \$2,940 million and U.S. \$45,018 million, respectively.

(d) Earnings per Share

In accordance with SFAS No. 128, "Earnings per Share", basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding. The computation of diluted earnings per share is increased to include any potential common shares. Potential shares include options, warrants, and convertible securities. For the years ended December 31, 1997, 1998 and 1999, the Company had no potential common shares therefore basic and diluted earnings per share were equal.

The computation of basic and diluted earnings per share for the years ended December 31, 1997, 1998 and 1999, prepared in accordance with U.S. GAAP, are as follows:

<u>Basic and Diluted EPS</u>	1997	1998	1999	1999
		(billions of lire*)		(millions of U.S. dollars*)
Net income available to common shareholders	3,177	3,531	4,446	2,312
.....				
Weighted average shares outstanding (in millions)	12,126	12,126	12,126	12,126
.....				
Earnings per share (basic and diluted).....	262	291	367	0.19
	=====	=====	=====	=====

(*) – Except per-share data which is in lire and U.S. dollars

(e) Fair Value of Financial Instruments

As required by SFAS No. 107, "Disclosures about Fair Value of Financial Instruments", the Company has estimated the fair values of its financial instruments held.

In the normal course of its business, the Company utilizes various types of financial instruments. These instruments include recorded assets and liabilities, as well as items that principally involve off-balance sheet risk. Information about the fair value of the Company's financial instruments is presented below.

- Cash equivalents and marketable securities: the carrying values of cash equivalents and marketable securities approximate their fair values because of their short maturities.
- Social security relief receivable: the fair value of this receivable, including current maturities, is estimated based on the discounted value of future cash flows expected to be paid, considering current rates of interest.
- Short-term debt: the carrying value of short-term debt approximates fair value because of the short period of time between the origination and maturity of the borrowings.
- Bonds Payable-listed: the fair value of bonds payable-listed is based upon period-end market prices.
- Other bonds and long-term debt (including current maturities): the fair values of other bonds and long-term debt (including current maturities) are based on discounted cash flow analyses.

	As of December 31,			
	1998		1999	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(billions of lire)			
Social security relief receivable (current and non-current portion).....	520	581	362	389
Bonds payable-listed.....	11,804	11,928	9,657	9,524
Other bonds and long-term debt, including Current maturities.....	14,932	15,325	11,042	11,209

- Derivative financial instruments: the fair value of derivatives generally reflects the estimated amounts that the Company would pay or receive to terminate the contracts at the reporting date, thereby taking into account the current unrealized gains or losses of open contracts. Appropriate pricing models and current market input data (such as volatility, interest rate curves and foreign exchange rates) have been used to estimate the fair value for the Company's derivatives.

	As of December, 31	
	1998	1999
	Fair Value	
	(billions of lire)	
Interest rate swaps.....	(282)	(170)
Interest rate collars.....	(116)	(27)
Forward rate agreements.....	(4)	-
Total interest rate derivatives.....	(402)	(197)
Forward.....	(1)	(10)
Options.....	(7)	(7)
Total foreign exchange derivatives.....	(8)	(17)
	(410)	(214)

Interest rate derivatives used by the Company mainly consist of interest rate swaps and interest rate collars, in order to lock in a fixed interest rate to balance the fix/floating ratio on its long term debt.

The considerable increase in the fair value of interest rates derivatives recorded at year end 1999 compared with year end 1998 is mainly due to the significant growth of Euro interest rates.

At December 31, 1999, the Company accrued an amount of lire 180 billion as provisions for the restructuring of financial instruments. The accrual covers the charges, which may potentially be retrieved, deriving from restructuring of interest rate derivative contracts linked to medium and long-term debt repaid before expiration during the year. Such costs, calculated as the fair value at December 31, 1999 of derivative instruments resulting from the restructuring, will be deferred and spread over the life of the restructured hedging contracts. Net of such provision, the fair value of interest rate derivatives would be negative lire 17 billion.

(f) Effects of Regulation

As discussed in Note 3, the Company is subject to the regulatory control of the Energy Authority with additional oversight provided by numerous laws, decrees and codes. The current regulatory tariff structure provides the Company with recovery of certain levels of cost through a price cap framework, and not necessarily its specific cost of providing service. Accordingly, SFAS No. 71, “Accounting for the Effects of Certain Types of Regulation”, which relates to an entity whose rates are regulated on an actual cost basis, is not currently applicable to these consolidated financial statements.

(g) Utility Plant

The Company's utility plant under U.S. GAAP, broken down by plant categories, is as follows:

	<u>1998</u>	<u>1999</u>	<u>1999</u>
	(billions of lire)		(millions of U.S. dollars*)
Utility plant, gross:			
Generating Plant:			
Hydroelectric.....	12,562	12,826	6,670
...			
Thermal.....	37,059	38,548	20,048
.			
Geothermal and other renewable sources.....	2,154	2,696	1,402
Transmission line.....	8,496	9,689	5,039
Distribution Network.....	52,470	54,353	28,267
Land and Buildings.....	2,681	2,199	1,144
Other.....	7,144	4,407	2,292
...			
Construction in progress.....	7,742	6,756	3,514
	-----	-----	-----
Total.....	130,308	131,474	68,376
	=====	=====	=====
Accumulated Depreciation:			
Generating Plant:			
Hydroelectric.....	3,435	4,063	2,113
...			
Thermal.....	12,990	14,688	7,639
.			
Geothermal and other renewable sources.....	866	1,001	521
Transmission Line.....	2,815	3,363	1,749
Distribution Network.....	29,580	31,595	16,432
Land and Buildings.....	664	623	324
Other.....	4,997	3,127	1,626
....			
Construction in progress.....	-	-	-
	-----	-----	-----
Total.....	55,347	58,460	30,404
	=====	=====	=====
Utility plant, net:			

Generating Plant:			
Hydroelectric.....	9,127	8,763	4,557
....			
Thermal.....	24,069	23,860	12,409
..			
Geothermal and other renewable sources.....	1,288	1,695	881
Transmission Line.....	5,681	6,326	3,290
Distribution Network.....	22,890	22,758	11,835
Land and Buildings.....	2,017	1,576	820
Other.....	2,147	1,280	666
....			
Construction in progress.....	7,742	6,756	3,514
	-----	-----	-----
Total.....	74,961	73,014	37,972
	=====	=====	=====

(h) Impairment of Long-lived Assets

For U.S. GAAP purposes, the Company assesses potential impairment of certain assets under the provisions of SFAS No. 121, "Accounting for the Impairment of Long-lived Assets and for Long-lived Assets to be Disposed Of". In applying SFAS No. 121, the Company assesses potential impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In making this assessment, the Company groups its assets at the lowest level of identifiable cash flows that are largely independent of the cash flows of other utility plant assets. In the Company's case, the assets are grouped by generation, transmission and distribution assets. Management believes that the recorded costs of its long-lived assets are recoverable.

The Company currently has certain assets to be disposed of. These assets mainly relate to two thermal plants that were being constructed at two generating sites in the central and south of Italy. The plants mainly consist of boilers and furnaces that no longer have the correct technology characteristics, due to technological changes during the construction of the plants. Particularly for the most significant plant, following a decree by the Prime Minister (which partially reduced the authorized power capacity) the Company in 1993 wrote-down the carrying value of the related assets by lire 462 billion. As previously disclosed in Note 23, in 1994, the Company wrote-up the value of such plant by lire 428 billion since a preliminary sales agreement was signed. This transaction was however not finalized and in the following two years there were various negotiations that were not completed. In 1997, the Company reversed the above mentioned write-up taking into account both the technological gap accumulated with respect to the current standards and the difficulties in the sales process. The estimate of the fair value was based on international market price comparisons to similar plants and equipment, as reported by the World Bank in an appraisal report prepared for the study of similar initiatives in China, and on various preliminary negotiations with potential acquirers based in developing countries.

During 1998, the probability of a favorable outcome from sales became less probable because of the technological change from the time these traditional plants began to be constructed. In particular, because of technological advances, combined cycle gas turbine plants now cost less to construct than traditional plants

and they also are more efficient than traditional plants. Additionally, the economic crises in 1998 in emerging markets, which represent the potential target for this kind of traditional technology, reduced the probability of sales to an external party.

During 1998, the Company reviewed the estimate of the fair value of these assets, not only using some of the above criteria, but also on the basis of potential utilization in construction joint-ventures by the Company's engineering and construction subsidiary, Enel POWER S.p.A..

In 1999, the Company continued its analysis of the recoverable value associated with the two thermal plants that were halted during construction. In performing this analysis, the Company considered a variety of potential available options for the ultimate disposal or usage of these assets. These available options are being discussed with outside parties. As a result of the discussions to-date the Company reduced the carrying value to an amount that could be recoverable on ultimate disposal and approximating the salvage value. The Company believes the ultimate disposal of these assets will occur within the next two years. The carrying value of these assets, net of reserves, was approximately lire 120 billion as of December 31, 1999.

(i) New Accounting Standard

The Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", which establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet as either an asset or liability measured at its fair value. SFAS No. 133 requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. SFAS No. 133 is effective for fiscal years beginning after June 15, 2000. The Company has not yet quantified the impacts of adopting SFAS No. 133 on its financial statements and has not determined the timing of or method of its adoption of SFAS No. 133. However, SFAS No. 133 could increase volatility in earnings and other comprehensive income.

(j) Pension and Other Postretirement Benefit Costs

Certain employees of the ENEL Group are covered under pension plans, which allow for retirement benefits based upon compensation and years of service (see Notes 2 and 11). In accordance with SFAS No. 87, the Company accrues the amount due to each employee at year-end based upon these dates and certain assumptions.

Certain employees of the ENEL Group are also covered under certain other postretirement benefit plans (see Note 2). In accordance with SFAS No. 106, the Company accrues the amount due to each employee at year-end based upon these dates and certain assumptions.

The following table displays the assumptions used for pension and other postretirement benefits costs, a reconciliation of the benefit obligations, plan assets and funded status of the plans:

Weighted Average Assumptions as of December 31:

	Pensions Benefits		Other Postretirement Benefits	
	<u>1998</u>	<u>1999</u>	<u>1998</u>	<u>1999</u>
	-	-	-	-
Discount rate	4.5%	5.0%	4.5%	5.0%
Expected long term rate of return on plan assets	N/A	N/A	N/A	N/A
Rate of compensation increase	2.5%	3.0%	N/A	N/A

Change in Benefit Obligation:

	<u>1998</u>	<u>1999</u>	<u>1998</u>	<u>1999</u>
	-	-	-	-
		(billions of lire)		
Benefit obligation at January 1	7,466	7,438	1,942	1,959
Service cost	301	281	19	52
Interest cost	385	327	77	87
Actuarial (gain) loss	719	(4)	-	91
Curtailment cost	224	-	-	-
ASDE Pension Plan Liability	63	-	-	-
Benefit paid from corporate assets	(1,720)	(2,172)	(79)	(93)
Benefit obligation at December 31	<u>7,438</u>	<u>5,870</u>	<u>1,959</u>	<u>2,096</u>

Reconciliation of Funded Status of the Plans:

Funded (unfunded) status	(7,438)	(5,870)	(1,959)	(2,096)
Unrecognized net (gain) loss	1,572	1,460	-	91
Unrecognized net transition obligation	(138)	(125)	-	-
Prepaid (accrued) benefit cost	<u>(6,004)</u>	<u>(4,535)</u>	<u>(1,959)</u>	<u>(2,005)</u>

Adjustment for minimum liability	(1,093)	(965)	-	-
.....	-----	-----	-----	-----
Amount recognized in Balance Sheet	(7,097)	(5,500)	(1,959)	(2,005)
.....	=====	=====	=====	=====
Components of Net Periodic Benefit Cost:				
Service cost (net of employee contribution)	301	281	19	52
.....				
Interest cost	385	327	77	87
.....				
Net amortization and deferral	70	51	-	-
.....				
Net periodic benefit cost	756	659	96	139
.....	-----	-----	-----	-----
Curtailment cost	224	-	-	-
.....				
Settlement cost	55	45	-	-
.....				
Special recognition (ASDE plan)	63	-	-	-
.....				
Total cost accrual	1,098	704	96	139
.....	=====	=====	=====	=====

Change in Plan Assets:

There are no assets with respect to any of the plans.

Most of the Company's employees were enrolled in the Electricity Fund managed by INPS. In 1999, the Italian parliament enacted a law that requires the government to terminate industry specific retirement funds, such as the Electricity Fund, and to merge them into the retirement fund in which Italian workers generally are enrolled.

During 1999, the Italian parliament approved the budget for 2000. The budget includes provisions that addressed the reform of the specific retirement funds described above. Under the government's budget for 2000:

- The Electricity Fund was terminated as of January 1, 2000 and covered workers are now enrolled in the general pension fund for Italian employees;
- The Company will pay substantially all of the lire 1,500 billion that electricity companies are required to pay each year to the general pension fund in the three year period 2000-2002; and
- The law provides the Company with the option to expense these amounts paid in the years 2000-2002 either as paid over the three-year period or proportionately over the twenty year period 2000-2019.

For U.S. GAAP purposes, the Company will be required to expense these amounts in 2000-2002, during the year that the contributions are paid.

(26) SUBSEQUENT EVENTS

In March 2000, the Company granted 19,690,000 stock options to certain managers. The right to exercise the options shall vest and be exercisable if the Company's average share price exceeds certain predetermined target market prices,

or other alternative criteria established by the Board of Directors. These options can be earned no earlier than December 31, 2000, and will not be exercisable any earlier than March 1, 2001.

At the Company's shareholders' meeting on May 26, 2000, the shareholders approved the Board of Directors' proposal to pay an aggregate dividend of lire 2,813 billion, or lire 232 per ordinary share, in respect to the year ended December 31, 1999.