PIRELLI AS MANAGER AND INVESTOR IN TELECOM ITALIA (2001-2007)

1. STEWARDSHIP OF THE COMPANY, INVESTMENT, AND STRATEGIES

Summer 2001: investment by Pirelli, through Olimpia, in Telecom Italia
In summer 2001 the Pirelli Group, in tandem with the Benetton family and two Italian banks (Intesa and Unicredito), acquired from Bell, through Olimpia, about 23% of the capital of Olivetti for an overall cost of about EUR 7.2 billion. (A 4% interest already held by Pirelli and Benetton was contributed by them in equal parts.) With about 55% of the ordinary share capital of Telecom Italia, Olivetti was the controlling shareholder in Telecom Italia. The acquisition was funded through equity capital and debt. The initial share capital of the shareholders was about EUR 5.2 billion. Consequently, the acquisition did not "saddle" Telecom with debt.

The arrival of Pirelli was welcomed by the market. At that time the Olivetti Group was facing heavy weather and its asset and financial position were severely overstretched. The national daily *La Repubblica*, in an article of 15 June 2001, wrote: *"...at the moment its market standing is the very worst. The state of Colaninno's companies yesterday was the stuff of a war zone despatch: Olivetti down 5.25% to EUR 2, Telecom down 2.46% to EUR 10,76, Tim has fallen back 4.26% to EUR 6.11, and Seat is 1.34% lower at just EUR 1.18.... with Olivetti under EUR 2 the system of holding companies that control the group is now coming under scrutiny. In particular, Bell has funded about half its holding in Olivetti through borrowings secured on those very same shares. The banks that are exposed to Bell (for about EUR 3,800 billion) might, for that reason, seek additional Olivetti shares to secure the credit lines they have granted.... Clearly, with the shares now holding steady at about EUR 2, the edifice erected to launch the Telecom bid is starting creak*". In these circumstances taking over Olivetti through a cash transaction would have been beyond any organisation. For one thing, it would have necessitated a cascade-type takeover of Telecom Italia and of Tim costing not far from Eur 80 billion, about Lira 160 trillion. As a taunt, the French daily, *Les Echos*, argued that even after the acquisition by Olimpia, Telecom was still open to a takeover : it just needed someone ready to invest such a vast fortune.

As regards the price paid by Olimpia in July 2001 (4.175 euro per Olivetti share), it matched the enterprise value (EV) of Telecom Italia, which was 8.15 times projected EBITDA for end-2001. This was broadly consistent with corporate multiples for the industry in that period, namely 8.24 (source: an analysis by Schroder Salomon "Telecommunication Service" of 10/08/2001). In 2005 Telefonica acquired O2, valuing it at a multiple of 8.5 times EBITDA. The value attributed to the Olivetti shares, clearly inclusive of a premium for the Telecom shares of about 48% (judged as fair in an opinion by Lazard and Merrill Lynch), reflected the controlling shareholding held by the company in Telecom Italia. Again in 2001, following the terrorist attack in the United States on 11 September and with a crisis in the stock market (especially for telecommunications), industry multiples dropped to 6.8 times EBITDA and the original price was re-negotiated as being excessive. Through subsequent manoeuvres (a re-negotiation with Emilio Gnutti, additional purchases of Olivetti shares, and an increase in the capital of Olivetti) the investment by Olimpia rose to EUR 8 billion. The *quid pro quo* was a shareholding in Olivetti of 28.7% at an average price per share now down to EUR 3.13 (25% down on the EUR 4.17 paid at the end of July) and at a lower multiple of 6.1 times EBITDA.
The reduction in the price was engineered through a debenture loan issued by Olimpia and subscribed for by former shareholders in Bell led by Emilio Gnutti. Several months after its acquisition of the shares in Olivetti-Telecom, Olimpia organised a capital increase and the issue of a bond for Olivetti, and injected about EUR 1 billion in its own resources (the capital increase amounted to approximately

EUR 4 billion, a half in shares and a half in convertible instruments). The aim was to bolster the financial structure of Olivetti.

The state of Telecom Italia prior to the change in management

When the new management team under Marco Tronchetti Provera took up the reins, the Olivetti-Telecom Group had, at 30 September 2001, net debt of about EUR 43 billion (inclusive of a put option in favour of JPM) and a 3-tier company structure comprising Olivetti, Telecom Italia, and TIM.

A start to the new management: "cleaning up the balance sheet"

As early as the fourth quarter of 2001, the incoming management at Telecom Italia embarked on a "clean-up" of the balance sheet, writing down a number of over-valued assets by about EUR 3.4 billion. Overall, between 2001 and 2004, Telecom Italia wrote about EUR 11.8 billion off the value of its assets.

Commitment to paying down debt

As from the time that Olimpia acquired its holding in Olivetti-Telecom the net debt of the Olivetti-Telecom Group improved appreciably, falling from EUR 43 billion (at 30 September 2001) to EUR 29.5 billion (at 31 December 2004), due in part to EUR 11.3 billion from the sale of some non-strategic businesses. Following the Telecom-Tim merger, the net debt of the company totalled EUR 46.7 billion, which by the end of December 2006 was reduced to EUR 37.3 billion – a level, it may be noted, below that in September 2001. Even after the Telecom-Tim merger, given both the solidity and prospects of the company, net debt was more than sustainable, as was corroborated by the financial analysts and rating agencies. The "health" of the group was evidenced two years after the merger by the interest shown by Telefonica, AT&T, Slim, and Murdoch in taking a stake in the company. By the end of 2006, the net-debt/ EBITDA ratio of Telecom Italia was less than 3 (about 2.9) and broadly on a par with that of Telefonica (2.8). The net debt target for 2007 under Pirelli's stewardship was EUR 33.5 billion. Furthermore, over the years, Telecom Italia focused efforts on consolidating its indebtedness: 70% of it was at a fixed rate by the end of 2006. In this connection, on 18 February 2008, the then Telecom Italia CEO, Franco Bernabè, stated: *"the work done on consolidation has been excellent, leaving us calm and confident notwithstanding the difficult condition in the markets in recent months"*.

Shedding non-core investments and international development

As from the end of 2001, Telecom Italia began divesting itself of non-strategic international shareholdings, mostly minority stakes in Europe and South America affording no prospect of managerial involvement, in order to build its international presence in mobile communications in Brazil and in broadband in Europe. Moreover, throughout the Pirelli stewardship, there were write-downs of international shareholdings totalling about EUR 6 billion. Many foreign shareholdings bought between 1999 and 2001 – the total outlay was EUR 8.5 billion – had been paid for at what were the going prices in the stock market bubble.

Brazil: surge in mobile telephone subscribers (from 5.3 million in 2002 to 25.4 million in 2006).

In the Brazilian market TIM Brazil increased its customers from 5.3 million in 2002 to 25.4 million by the end of 2006 (a rise of 26% as against 2005), giving it a market share of 25.4%. The company became the market leader among GSM operators, with 23.1 million lines at the end of 2006. Sales revenues earned by TIM Brazil at the end of 2006 stood at EUR 3.96 billion, almost quadrupling the corresponding figure – EUR 1.03 billion – for 2002.

Growth of broadband in Italy and in Europe

In its broadband operations in Italy, Telecom Italia pushed up the number of lines from 390,000 in 2001 to 6.7 million by the end of 2006. Similarly, through its "European Broadband Project", Telecom Italia expanded from 160,000 customers in December 2003 – across the Netherlands, France, and Germany – to 1.9 million at the end of 2006. Revenues from European business stood at EUR 915 million by the end of 2006.

International operations 2001-2006: a record of growth in customers, revenues, and margins
Revenues earned by Telecom Italia through international operations advanced from EUR 3,681 million in 2001 (11.9% of total earnings) to EUR 5,072 million in 2006 (16.2% of the total). EBITDA from international operations rose from EUR 932 million (6.8% of the total) to EUR 1,114 million (8.7% of the total). In addition, during the period Pirelli was in charge, a call option was negotiated on Telecom Argentina, enabling the Telecom Italia Group in 2009 to step up the incidence of the "international" component on revenues and EBITDA. The Group's foreign mobile phone lines increased from 30.7 million in 2001 (56% of the total) to 36.4 million at the end of 2006 (53% of the total), a rise of more than 18%. Over the same period, and starting from nil, its broadband customers in Europe climbed to 1.9 million (about 22% of the company's total for broadband customers).

2001-2005: over 17% of turnover allocated to investment
Between September 2001 and year-end 2006, Telecom Italia spent EUR 26.9 billion in capital investment, of which 70% for innovation. Analysis of the data for the main ex-monopoly operators in Europe between 2001 and 2005 shows that Telecom Italia was the one that committed the highest proportion of turnover (over 17%) to investment, thanks to its notable profitability (its EBIDTA margin – the gross operating margin from revenues – was 41.1% at the end of 2006). Owing to this very investment the Telecom Italia network, as noted in a study by Morgan Stanley in November 2004, was one of the most advanced in Europe in terms of technology and efficiency. From the standpoint of productivity, too, Telecom Italia in 2005 was the telecommunications operator in Europe with the highest turnover per employee (EUR 345 thousand).

Simpler company architecture, and industrial synergy
Through the Olivetti/Telecom-Italia and Tim/Telecom mergers between 2003 and 2005 the so-called "chain of control" was shortened. These operations, in which – as a shareholder – Olimpia invested to avoid the dilution of its interest, were designed to deliver significant financial and industrial benefits for the Telecom Italia Group: a "narrowing of the distance" between indebtedness and cash flow and the increasing integration between fixed and mobile telephone services to create the first "quadruple play" platform in Europe (fixed, mobile, Internet, and IPTV). Additionally, the effect of the merger between Telecom Italia and Tim was to leave the shareholders of the two companies holding the same share, so creating the conditions for them all, without discrimination, to garner the fruits of integration – something which could not have been secured had they held on to their different shares. From an industrial perspective the Telecom-Tim merger made the group better able to steer through the transformation in technology and services that is evident today. The industrial project aimed to create a major integrated operator able to enlist partners from among both telecommunication operators (so broadening the customer base) and providers of innovative content (so offsetting lower revenues from traditional services). This approach would best exploit the convergence of fixed and mobile platforms that would open the way for a new generation of services and products. Indeed, this was the trend gradually emerging among big international groups, such as Microsoft, Google, and Yahoo. It is worth noting the comment by Telecom Italia ex-CEO, Franco Bernabè, on 5 June 2008 in a press interview with *Il Sole 24 Ore*: "*The integration of the fixed and mobile businesses that we continue to pursue was set in train by him (*Marco Tronchetti Provera – editorial note*)...,The aim is to attain full integration between fixed and mobile businesses"*. The operation won support both on industrial and on more specifically financial grounds, a fact highlighted by Italian and international press reports of comments from various parties involved. Analysts Merrill Lynch, for example, spoke of "strategic logic". Nor was there a shortage of comment from the main suppliers in the industry. Siemens, for example, declared: *we are very much in favour of the integration of two important operators such as Telecom Italia and Tim... It's our view that this integration can have extremely positive effects from an industrial and strategic standpoint..."*. Yet again, Alcatel stated: *"From a technology and from a market standpoint a*

convergence between fixed and mobile telephony is an advantage for users: the ability to use the same services both on fixed phones and cell phones is something customers certainly appreciate" (Ansa, 6 December 2004)

In particular, attention is drawn to the article published by the Financial Times under the heading "*Normitalia*". In pointing to the advantages of shortening the control chain, it commented: *"TI's traditional perceived risk – minority shareholder abuse – is diminished. TI is merging with TIM, its mobile unit. This will leave Olimpia, TI's controlling shareholder, with a 20 per cent stake, limiting its capacity to misbehave. One barometer of corporate governance risk is TI's non voting shares, wich are seen as most vulnerable. Their discount to the ordinary shares is now just 18 per cent from a peak of over 40 per cent. Net debt will be a high 44bn after TIM merger. But, given a market value of 52bn and stable operating performance, it is manageable…But, with TI's structure now looking normal, the preoccupations of shareholders may become more conventional too".*

The plan to shorten the shareholder chain of Telecom Italia, put into effect by Marco Tronchetti Provera, meant that a sum, net of dividends, of EUR 19 billion was returned to the market (the result of buying back the minority holdings in Olivetti and Tim for respectively EUR 5.3 and EUR 14 billion).

Corporate governance: Telecom Italia – an exponent of national and international best practice

Under Pirelli's management Telecom Italia brought in a system of corporate governance in line with best international practice. The approach was one of steady progress. A major step on the way was the adoption, by the board of directors that took office in 2004, of a majority of independent directors. As of 2004 the corporate governance arrangements extended to a practice regarding related parties that was among the most advanced. Whenever the Board was to approve various deals, the independent directors of Telecom Italia would systematically carry out additional investigation and verification, over and above that of the Board itself. This duty was the task of the audit and corporate governance committee (made up wholly of independent directors) or of outside advisors selected by the independent directors. This was the procedure followed for the merger of Telecom and Tim to appraise the share exchange ratio and it was again adopted when restructuring the Internet division. Finally, in the largest deals involving related parties (for example, property sales to companies in which Pirelli RE was a minority investor), the board of directors entrusted the audit and corporate governance committee with vetting the binding procedures for assuring due and proper process. This was at a time when there was no mandatory or voluntary regulation in Italy in this connection.

Marco Tronchetti Provera and stock options: the facts

Contrary to mistaken reports by some commentators, during his management of Telecom Italia Marco Tronchetti Provera did not at any time receive stock options or, following his resignation as company chairman on 15 September 2006, did he benefit from a golden handshake. Nor, as regards stock options, did he collect over EUR 230 million from the sale of Pirelli's first generation phototonics operations to Corning. The truth is that given the value created for Pirelli and its shareholders through the sales to Cisco and Corning in 2000 (with proceeds of $2.15 billion and $3.6 billion respectively and a net capital gain of EUR 3.9 billion), Tronchetti Provera was awarded a net stock option worth EUR 79 million. This figure is appreciably lower than that reported in many accounts during those years and was calculated as the difference between EUR 133 million, the amount he received net of taxes, and EUR 54 million of extraordinary earnings linked to Pirelli's results, which Tronchetti Provera, despite his entitlement, chose to waive.

Regarding this event three facts – borne out *inter alia* by official documents lodged with the stock market authorities in Italy and in the USA – are of importance:

1) the stock options were not sought by Tronchetti Provera or the other Pirelli directors but by the investment banks handling the Nasdaq listing of Otusa, the company subsequently sold to Corning; they viewed the stock options as essential for convincing the market of the trust and commitment of top management regarding the future of the company;

2) Marco Tronchetti Provera accepted his appointment as the administrator of Otusa at the explicit request of the banks, made in consideration of the positive turnaround achieved at Pirelli, and following the sudden withdrawal of another manager who was to have taken up the appointment;

3) Marco Tronchetti Provera decided to bring forward the conclusion of the agreement with Corning to avoid the application of a tax rate to the stock options that was more favourable to the directors (12.5% as against the 46% rate that was subsequently applied).

Divestment of properties by Telecom Italia and the role of Pirelli RE

One aspect of Pirelli's stewardship attracting heavy criticism is Telecom Italia's divestment of its property holdings. The argument is that the various deals enriched Pirelli RE, controlled by the Pirelli Group, and impoverished the telecommunications company. The facts and the numbers, see below, show that this was not the case.

- Firstly, it should be noted that the bulk of Telecom Italia's properties were disposed of under the management preceding that of the Pirelli Group.
- The second deal to dispose of the company's properties, the first during Pirelli's stewardship, was made between 2002 and 2003. In this case, too, there was no sale of properties to Pirelli RE. The deal involved a merger of the properties contributed by Telecom Italia with those owned by the joint venture between the real-estate funds of Morgan Stanley (75%) and of Pirelli RE (25%). Telecom contributed properties for a value of EUR 1.6 billion in exchange for which it took about 49% of the companies set up, while the real-estate venture, in return for properties worth EUR 1.7 billion, took about 51%. The values of the properties and, accordingly, the share exchange rate, were determined through an independent expert appraisal made by CB Richard Ellis, one of the most respected valuers internationally. The properties were transferred to two companies, Tiglio I and Tiglio II, and were then disposed of in transactions on the open market.
- The third operation was transacted between 2005 and 2006 and involved 1,300 properties worth about EUR 1 billion. In this case Pirelli RE handled the due diligence and the reorganisation of the assets, subsequently acquired by a joint venture in which Pirelli RE was a partner, but with a minority holding,
- Out of a total of about EUR 15.5 billion worth of properties under management by June 2007, those owned by Pirelli RE on a pro rata basis totalled EUR 4.2 billion (27%), and of these just EUR 480 million (3% of the total under management) were former properties of Telecom.
- The Tiglio I and Tiglio II deal enabled Telecom Italia to deconsolidate its property holdings and as an effect of their leverage it was able bring forward collection of the proceeds and to later participate, pro rata, in the subsequent capital gains deriving from their placement. The operation was a sale and lease-back deal, with a return on the core investments (put at between 10.5 and 11%) that outweighed the rental costs (7-8%). A similar choice was adopted by other industrial groups and TLC operators, including Ft, Bt, Dt, Kpn, Swisscom, and Telenor.
- The logic in aggregating the two portfolios was that the different sets of properties complemented one another in terms of their risk/return profile. The Telecom Italia properties were of less quality and offered a strong cash flow generated by the new leases taken out on them. Vice versa, the properties of the joint venture were of prestige quality but, given their pre-existing leases, had a weaker cash flow. The real-estate product made up in this way gave rise to the Tecla and Berenice funds, which opened the way for the creation of a property fund industry. The takeover bid for Tecla and Berenice galvanised the financial market with a battle that, along with Gamma RE, in which Pirelli had a stake, saw contenders that included international investment banks, such as Morgan Stanley,

Goldman Sachs, and Merrill Lynch. All this shows how Pirelli RE, as from the formation of the Tecla and Berenice funds, aimed to create a new product and to generate abundant returns for fund investors. Indeed, with the launch of the bid, it can be seen to have heightened the liquidity and standing of the property fund market.

- As of 2004, in property deals between Telecom Italia and related parties other than group companies (for example, where properties were sold to funds or corporate vehicles in which Pirelli RE had only a minority holding), the audit and corporate governance committee, made up solely of independent directors, were mandated to appraise the procedures for ensuring due observance of propriety.

2. DEVELOPMENT STRATEGIES AND THE FAILURE OF NEGOTIATIONS WITH MURDOCH, TELEFONICA, AND AT&T

Summer 2006: the regulatory framework and the "media&broadband" plan

Between spring and summer 2006, owing to the regulatory framework, the outlook for Telecom and Tim changed, becoming more challenging. The first identifiable industrial result of integrating Telecom and Tim was to have been the market launch of "Unico", the first telephone combining aspects of fixed and mobile telephony, scheduled for July 2006. Telecom Italia had counted on sales of 1 million units by 2008. However, the market launch was deferred indefinitely when the board of Agcom (Italy's Communications Regulator) decided in June 2006 to impose a halt and, at about the same time, agreed instead to a 6-month trial period for 30,000 phones. Previously the Regulator had also put a brake on other, especially innovative, offers of "ADSL" (high-speed internet) services. Despite all this, in its annual report in July, Agcom acknowledged that: *"in the telecommunications segment….Italy is held up in Europe as a country of excellence when it comes to promoting services with an innovative technological content. The European Commission, in its most recent report on the state of electronic communications, stresses the leading role of Italy in mobile telephony and unbundling… In the spread of broadband we were ranked among the lowest. Today, Italy, though starting from way down the field, is advancing at a rate of growth (187% in two years), significantly ahead of that of the 15-member EC".* It was in this period, too, that controversy broke out concerning the landline network. Support was voiced in various quarters for spinning it off and. in some cases, for imposing this forcibly. The effect was to create uncertainty in the market and to weaken the hand of the Telecom management, engaged both then and later in negotiations (first with Murdoch and subsequently with Telefonica, AT&T, and America Movil) in a search for possible industrial partners for pressing on with the development of the company and with the industrial project that had been chosen. The controversy about the network was all over the business pages of the newspapers for weeks. On several occasions the company publicised its opposition to the operation, which, in industrial terms, would not have served its interests. The debate about the spinoff seemingly took on a dimension that was more political than industrial, with some quite authoritative commentators changing their stance several times over the period. As regards the strategic value of the network for Telecom Italia, the words of Franco Bernabè on 30 September 2009 come to mind: *"Telecom Italia is the network and without the network there is no Telecom Italia".*

Faced with this fierce controversy, the regulatory framework, and the need to further focus the Telecom Italia Group on the broadband and media business in Italy and elsewhere in Europe, the management submitted a reorganisation plan to the board of directors on 11 September 2006. The plan envisaged separating fixed telephony, mobile telephony, and the access network, and it addressed two needs: 1) to ease the anomalous pressure from the regulator, political interests, and competitors regarding the network by separating access; 2) to demonstrate to Murdoch that political influence would not deflect the group in its strategic decisions and that, if necessary, it could free up resources to meet an acceleration of ambitious technological and industrial investments.

Strategy: the negotiations with NewsCorp and Telefonica

As a step forward in the business of selling content via broadband, Telecom Italia started negotiations in spring 2006 with Rupert Murdoch's News Corporation. The aim was to reach an agreement whereby Telecom Italia would, via broadband, transmit content produced by the NewsCorp Group. Discussions between the two companies were broken off in September (on 20 September, the newspaper *Corriere della Sera* reported remarks by Murdoch to Wall Street analysts that touched on the situation with Telecom: "Too much politics. I must look for equity partners for Sky Italia"). The agreement with Murdoch could have been extended to another major telecommunications group, so amassing 300 million customers and creating a big media and telecommunications player able to compete with Microsoft, Google, and Yahoo.

Midway through September Marco Tronchetti Provera resigned as the Chairman of Telecom Italia. In the months after, following up on regular contacts in the past between Telecom and Telefonica, Marco Tronchetti Provera, as the Chairman of Pirelli, began negotiations with Telefonica for it to become a shareholder in Olimpia with a minority stake. Concurrently, Telecom Italia undertook an analysis of industrial synergy with Telefonica. The purpose of the exercise was to establish an industrial partnership between the two groups with the potential to generate cost synergies and additional international expansion. The negotiations, announced on 11 February 2007, were accompanied by a lively debate among politicians and journalists regarding the "Italianness" of Telecom Italia, despite assurances from Pirelli that a preponderant share of the capital in Olimpia would remain in Italian hands. On March 1 2007, during a conference call with analysts, the chairman of Telefonica, Cesar Alierta, announced a suspension of the negotiations because "the circumstances make it difficult (for us) to continue". Some weeks later, the lead independent director of Telecom Italia, Guido Ferrarini, speaking for the company's independent directors, wrote to the chairman, Guido Rossi, complaining of a lack of transparency by management regarding the company's strategic plan and, in particular, the discussions with Telefonica.

Pirelli exits Olimpia: negotiations with AT&T e America Movil

On 12 March 2007, following the failure of the negotiations with Telefonica and the ensuing stalemate, the board of directors Pirelli & C. SpA authorised its chairman, Marco Tronchetti Provera, to explore all options regarding Olimpia – not excluding the disposal of the shareholding – for best enhancing the value of the asset in the interest of all its shareholders. On 1 April, Pirelli and Sintonia announced to the market that discussion had been started with international operators of the standing of AT&T and America Movil for the sale of 66% of Olimpia, and while negotiating they obtained a valuation for the share in Olimpia significantly above that obtained by the shareholders in Telco The news was met with widespread opposition, despite well-intended statements by the management of the American companies and the fact that a right of pre-emption remained with Mediobanca and Generali. Some politicians, including leading ones, called for Telecom to be deprived of its government licences (though no such licence existed), while others renewed the demands to nationalise the network. The American ambassador in Rome, Ronald Spogli, criticised the government intervention in the economy that typified Italy, prejudicing American investment to the advantage of other European countries, such as Germany, France, and Spain. Only the offer by America Movil remained effective.

Political interference in Telecom Italia's development strategy

In April 2007, at the time of negotiations between Telecom Itlia headed by Marco Tronchetti Provera and AT&T, the US ambassador to Rome, Ronald Spogli, criticized the public interference in the economy which characterized Italy (*Corriere della Sera, 17 April 2007*) and commented the breakdown in negotiations as follows: *"l'Itay has lost the interest of a company of the highest level, capable of improving the telecommunications services, reduce costs for Italian users and increase the value of a national company"* and that "the American one is company in which the government establishes the rules, which is certain sectors a very significant and very tough, *but leaves the sectors to develop in the right way. In Itay there is a long tradition of a much stronger government presence in the business economy. In the coming years it will be very important for Italians to decide if this is the system that they want for the future".* Already in September of 2006 there had been "*considerations of a political nature" ("Too much politics, I have to find partners for Sky Italia", Corriere della Sera, 20 September 2006)* which led to the abandonment of negotiations between Telecom Italia and Rupert Murdoch who declared: *"we have begun negotiations with the group, but we thought it would be much better to remain independent"*. But the role of politics in the entire affair was recognized over time also by witnesses to the facts of the period. One recalls, among others, the former editor of Corriere della Sera, Ferruccio De Bortoli, when he said (30 June 2015): *"Tronchetti Provera was the victim of the ideological prejudices of the centre left (....).I have also had moments of dialogue with him, but I must say he always respected the autonomy of journalists and he paid the price of his independence"*. Also Paolo Mieli, Chairman of Rcs Libri and a former editor of Corriere della Sera, acknowledged that: *"in these years there have been stories told of the bands of the right, but not about the bands of the left who however existed and who got away with it, but I don't think the historians will forget"*. Political interference, at a distance of years, also emerged in an interview in Corriere della Sera *("The Cdp needs to be stronger? New capital is needed right away", 20 June 2015)with* by Massimo Mucchetti, chair of the Senate Industry Commission, when he declares that the Rovati plan (which proposed the separation of Telecom's network) "was developed on behalf of the *Prodi government"*, also when Giovanni Pons wrote in "Repubblica" *("'French' Telecom is behind with the network. The Government is alarmed", 20 June 2015) writes of "he who on behalf of the Prodi government had gone to Murdoch to discourage his proceeding with the strategic alliance with Telecom then headed by Tronchetti Provera".*

The press has recently also recalled how political interference influence the development of the convergence strategy launched by Pirelli. In an article in Corriere della Sera (*Telecom and the story which must not be repeated, 14 May 2015*) Daniele Manca – with regard to Pirelli's management - writes: " We are at the beginning of the *2000s A deep restructuring is launched... But at that point the assault recommences. Plans for the hiving off the Network from Telecom begin to circulate.... Telecom is simultaneously negotiating with Murdoch an agreement which holds together the Australian-American entrepreneur, active in the area of TV and press content, and the Italians who have networks and technological services. It was the famed convergence, an idea which in these months is being implemented through many similar agreements between telecommunications and content companies around the world (the last between Verizon and America Online). The across-the-floor political reaction was immediate. The non-critical defenders of Italianess raise the hackles, that never looks to the interests of the Country but always those of the flag... Telecom and Pirelli found themselves in the middle of such a conflict which, before the block on alliances, their leader Marco Tronchetti Provera decided to hand over the reins".* In an article in "Il Sole 24 Ore" (Ten years without a reason, *12 June 2015*) Alessandro Plateroti writes: "In the recent history of *Telecom too often it looks to the pas, almost always looking for alibis and justifications for the less than brilliant present. Also because of this, asking where the company would be now if the plan and strategy of Tronchetti had been supported, is an exercise of little use".*

28 April 2007: agreement with the Telco shareholders

The failure of the negotiations with AT&T and America Movil was followed by the involvement of an Italian consortium backed by a partnership with an international operator. As a result, on 28 April 2007, Pirelli and Sintonia reached an agreement with a group of leading Italian financial investors (Intesa, Mediobanca, Generali, and Sintonia) and with Telefonica for the sale of 100% of the capital of Olimpia. Telefonica further offered to make a significant investment in Telecom Italia and to become one of the new shareholders (with a fully disclosed shareholding of about 10%). The agreement, signed on 4 May, was finalised on 25 October 2007. Contrary to what many commentators now claim, no extravagant amount was paid for the shareholding. Indeed, when Telco took over the shareholding in Telecom Italia from Olimpia the figure paid was less than what AT&T and Slim had offered earlier.

3. INVESTMENT BY OLIMPIA AND PIRELLI IN TELECOM ITALIA, AND THE FICTION SURROUNDING THE DIVIDEND INCOME FROM IT

According to some commentators Pirelli and Olimpia allegedly squeezed the best out of Telecom Italia through the dividends they drew to service their debts, so depriving the company of the investment for developing it. However, the numbers show that Olimpia and its shareholders (especially Pirelli and Benetton) made a substantial investment in Telecom Italia and at all times drew on their own funds. Furthermore, the simplified structure of Telecom Italia, brought about under Pirelli's, stewardship, enabled minority shareholders to receive about EUR 19 billion (in addition to their dividends).

The investment by Pirelli and Olimpia in the Olivetti-Telecom deal and the EUR 19 billion returned to investors

As noted at the start, the acquisition of the share in Olivetti-Telecom was financed with a mix of equity and debt. The initial equity capital of the shareholders was about EUR 5.2 billion. A few months after the acquisition of the share in Olivetti-Telecom, Olimpia organised an increase in capital and a bond issue for Olivetti and contributed about EUR I billion of its own resources to this (the increase in capital totalled about EUR 4 billion, a half in shares and a half in convertible instruments). The aim was to provide Olivetti with a more robust financial structure. Investment continued in the period 2003-2005, when Marco Tronchetti Provera decided on an operation to shorten the Telecom Italia shareholding chain. With two increases in capital , amounting overall to EUR 2.8 billion, Olimpia made a determining contribution to ensuring the Olivetti-Telecom and Telecom-Tim mergers.

As is known, the Olivetti-Telecom and Telecom-Tim mergers made it possible to simplify the corporate structure of Telecom Italia, to narrow the distance between cash flow and debt, making running the company easier, and to assist the convergence between the fixed telephone and mobile telephone platforms. Added to this, there was also a benefit for all the shareholders, who had EUR 19 billion "returned" to them through the buyback of the minority holdings in Olivetti (EUR 5.3 billion) and in TIM (EUR 14 billion).

It follows that overall investment by the shareholders in Olimpia totalled about EUR 9 billion, of which EUR 6.5 billion was undertaken by the Pirelli Group (EUR 3.9 billion was sourced from the deal with Corning and Cisco and EUR 2.6 billion through capital increases and asset sales). Accordingly, the Telecom operation did not entail any increase in debt either for Pirelli or for the companies downstream of Olimpia. By the end of 2006 the debt/equity ratio of Pirelli was 0.42, while that of Olimpia never rose above 1. A breakdown of the investment made by Pirelli is as follows: EUR 3,120 million to subscribe for the initial capital of Olimpia (2001), EUR 388 million to subscribe for the increase in the capital of Olimpia needed to support the Olivetti-Telecom merger (2003), EUR 1,344 million to subscribe for the increase in capital needed by Olimpia to support the Telecom-Tim merger (2005), EUR 497 million for the buyback of Hopa's share in Olimpia (2006), and EUR 1,170 million to buy back the holdings of Banca Intesa and Unicredito in Olimpia (2006). Throughout all this indirect investment in Telecom Italia, Pirelli received no dividends through Olimpia.

Olimpia and the dividend policy of Telecom Italia

On the vexed topic of dividends, it should first be recognised that Olimpia – which held 12.4% of the share capital of Telecom Italia (made up, as known, of ordinary as well as non-voting shares) – derived marginal benefits in this respect as compared with all the other shareholders. As stated by the management on several occasions, the dividend policy pursued by Telecom Italia while Pirelli was in charge was not devised to serve the interests of a just one shareholder. On the contrary, much like some of its counterparts in the telecommunications industry (Deutsche Telekom, for example, which in 2006 had one of the highest payout ratios among European operators), Telecom Italia took account of the demands of investors. They looked to the dividend as one of the strongest plus features of an industry that in recent years on the stock market had received something of a drubbing. It must also be stressed that the Telecom Italia dividend policy did not jeopardise its industrial development, and this is supported by the observations of Agcom in 2006 and by the huge investment undertaken as cited above. Olimpia, over the course of the years, improved its ordinary operating activities, which moved into profit as early as 2004. The financial soundness of Olimpia was not dependent on Telecom Italia maintaining a high payout. Indeed, as from financial year 2006, Olimpia could have posted a positive result for its ordinary operating activities even if the payout by Telecom had been reduced by 50%. Again, as from 2006, Olimpia could have foregone its dividend from Telecom Italia for about five years (up to 2010) without in any way infringing the covenants attaching to its credit lines. Such was the strength of its balance sheet that its gearing (net-debt/equity ratio) never exceeded 1. If, purely as a supposition, Telecom Italia had stopped paying dividends as from 2006, that threshold would have been breached only in 2009.

Table 1: Olimpia and the dividend income from Telecom Italia

(EUR x millions)

	Ord+extraord. operating activities	Net interest	Dividend income	Write-downs	Net result	Net financial position	Net result before write-downs	Net result before write-downs: 50% dividend income
2001	(0.9)	(30.5)			(31.4)	3,509.0	(31.4)	(31.4)
2002	(4.3)	(173.0)		(68.4)	(245.7)	3,675.8	(177.3)	(177.3)
2003	(11.5)	(174.7)		(143.4)	(329.6)	3,277.8	(186.2)	(186.2)
2004	(2.0)	(164.8)	182.4		15.6	3,251.1	15.6	(75.6)
2005	(1.0)	(168.0)	263.1	(1,191.0)	(1,096.9)	3,164.3	94.1	(37.5)
2006	(1.4)	(140.9)	337.0	(3,131.4)	(2,936.7)	2,870.7	194.7	26.2
2007 (to 25./10)	(0.9)	(102.1)	337.0		234.0	2,696.8	234.0	65.5

The covenants governing the credit lines imposed:
for €2.4bn line, net financial position was not to exceed €4bn
for €0.6bn line, net financial position was not to exceed €6bn
for €0.3bn line, net financial position was not to exceed €6bn.

The value reached by TI at which Olimpia pledged all the TI shares was approximately 1.30

Table 2: projection for Net financial position and equity 2006+, assuming no dividend income from Telecom Italia (base interest 2006+5%)

	Ord+extraordinary operating activities	Net interest	Net financial position	Net equity	Gearing
2006	(1.4)	(140.9)	3,207.7	3,969.0	0.81
2007	(1.4)	(147.9)	3,357.0	3,819.7	0.88
2008	(1.4)	(155.3)	3,513.8	3,662.9	0.96
2009	(1.4)	(163.1)	3,678.3	3,498.4	1.05
2010	(1.4)	(171.3)	3,851.0	3,325.7	1.16
2011	(1.4)	(179.8)	4,032.2	3,144.5	1.28
2012	(1.4)	(188.8)	4,222.4	2,954.3	1.43

The debt of Olimpia: from EUR 3.6 billion in 2002 to EUR 2.87 in 2006

Over time net debt at Olimpia fell, coming down from about EUR 3.6 billion in 2002 to about EUR 2.87 billion by the end of 2006. By the time of its sale the company carried debt of less than EUR 2.7 billion and had EUR 400 billion in unutilised lines of credit. Its debt was due to mature between 2010 and 2012. About 70% of its debt was at a fixed rate (present average cost of about 4.5%).

4. TOP MANAGEMENT'S EXTRANEOUSNESS TO THE JUDICIAL MATTERS LINKED TO TELECOM

The magistrates annulled all the accusations of guilt against Marco Tronchetti Provera relative to the Telecom saga. The investigations carried for almost 10 years by public prosecutors, different magistrates and belonging to different courts, always excluded any responsibility on his part. The so-called "illegal dossiers" situation, in which Mr. Tronchetti was never involved at the trial level, was closed with the sentence of the Assizes Court of Milan which excluded any responsibility on the part of Tronchetti Provera and identified the true culprits, concluding that the illegal events were *"put into being to force the company's hand and achieve goals of common interest (in short money and power), all to the exclusion of the interests of the Group, and also of the senior management"*. The following are some of the statements from the magistrates that investigated the matter over the years:

1) **<u>Request of dismissal from Luigi Grillo, public prosecutor Fabio Napoleone (Augost 2008)</u>** *"The news of the existence of a centre, within Telecom Italia, engaged in the unlawful phone tapping of countless individuals in politics, finance, and areas of social life – wrote Napoleone – though uncorroborated by legal findings, has been circulated so widely and repeatedly by the media that it has instilled in the public at large a conviction as to its authenticity, to the point that this mass suggestion widely affects even established institutions that have, in official documents, for quite some time, confused the illegal compilation of dossiers with the activity of unlawful phone tapping".*

2) **<u>Application to the Italian Supreme Court: Public Prosecutor, Stefano Civardi (June 2010):</u>** *"It's all part of what spies do - having a special relationship with the news media in order to release information suited to their designs and to create disinformation. In these espionage proceedings, the versions given to the media by four of the principal suspects in numerous interviews and even through publishing books..... have not always accorded with the documentary evidence to the court. Frequently, however, they have acquainted the public with the defence strategies to be used in court. To adopt as a basis the insinuations of the accused - heralded by a big advertising build-up and embraced by publishing groups - rather than the case documents leads to inescapable errors, which, as in this instance, emerge as judicial reasoning at odds with the findings in the proceedings".*

3) **<u>Unlawful dossier trial (in Italy's "Assize" Court): Public Prosecutor, Stefano Civardi (February 2013)</u>** *"The need was to home in on an important target* (Marco Tronchetti Provera – editorial comment) *that could distract the public from the two-pronged miraculous operation: recovering the money and freeing one of the heads of Sismi [intelligence service]..... No one is blind to the fact that in proceedings like these – which are, so to speak, against the established order – the defence is prepared inside and outside the courtroom and the preparation outside can, in fact, be the more effective. This, if I may use the term, is an espionage trial and the thing about spies is not only that they traffic in the power of confidential information, but they influence public opinion through the news media. .....How often has the personal recollection of the witnesses coincided with what was learnt reading a newspaper or an article on the web? And the judges must fight against the same treacherous temptations, [must] distinguish what is in the case papers from what for many - and perhaps for everyone - is the talk of the town. This alone is the way to do justice, to break the power of information that consorts with the power of disinformation so long exercised by our criminal conspirators... Allow me , too, a final remark - almost a sanity check in this summing up - on the media power of the spies that reaches into the proceedings themselves. The defence for Preatoni sought to bring up a matter...a presentable version of the term tiger team....by submitting the definition taken from Wikipedia. If you go to Wikipedia, can you guess what the bibliography is?... The sources for the entry are the book by Pompili, who has*

never made an appearance here, but during his escapades has written "Le tigri di Telecom"; Bernardini, interviewed by Randacio, in "Una vita da spia", another scholarly essay; Tavaroli, together with Boatti, in 'Spie'. We have also a civil party to the proceedings, Mucchetti, in 'Il baco del Corriere', and the journalist Orlando 'la Repubblica del ricatto. Dossier, segreti e depistaggi nell'Italia di oggi'. Cipriani...Normal justice is justice that provides redress for the harm done to public opinion...I say to the Court, if, the day after the testimony of Tavaroli you had read the newspapers, you would have sworn there no journalists were in court to hear him. You, however, were there and you heard him.... and you have seen once again how the reality of trial proceedings is something different as compared to so-called case reporting".

With regard to the Kroll affair, which represents a distinct case from the so-called "illegal dossiers", Mr. Tronchetti Provera was condemned in the first instance to one year and eight months for the presumed receipt of illegal materials. To obtain full judgement, Mr. Tronchetti Provera chose to renounce the statute of limitations and, on June 11, 2015, the Milan Court of Appeals absolved him with full acquittal because the fact did not constitute a crime (article 530 c.p. paragraph 1).

On February 18, 2016, the Court of Cassation communicated its decision to return the documents to the Milan Court of Appeals for a new Appeals process, at the end of which, on February 9, 2017, Marco Tronchetti Provera was again absolved because the fact does not constitute a crime. The grounds of the sentence of absolution underline that Marco Tronchetti Provera exclusively defended himself against "a true and real act of aggression" on the part of Kroll. It does not emerge "in any manner from the documents" – it states – a final purpose of acquiring the goods of illegal provenance, on the part of Marco Tronchetti Provera, other than that of reporting the facts committed to damage him, his family and the company he headed". "That a true and real act of aggression was under way to damage him – it states – is confirmed" and "the defense appeared to be in proportion to the offense". "The action – the Court concludes –appears indispensable ... in that the simple report, without findings, could have come to nothing or even led to incrimination for slander".

The object of the Kroll affair a was a CD sent to the headquarters of Pirelli – and immediately sent to the Brazilian judicial authorities – containing material proving the espionage carried out by the Kroll agency to the damage of Telecom Italia, of Mr. Tronchetti Provera and of his family.