Leaked Papers on I.T.T. Fascinate Tax Lawyers

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WASHINGTON, May 5—In the big tax law firms here, the must reading these days is a well-leaked document on which the Internal Revenue Service based its March 6 revocation of a 1969 ruling that was essential to the International Telephone and Telegraph Corporation's plan to acquire the $1.5-billion Hartford Fire Insurance Company.

The 1969 ruling allowed an immediate tax-free exchange of Hartford shares for I.T.T. shares in the merger, the largest in the nation's history. Had the ruling not been revoked before April 15, the statute of limitations would have run out, making no recovery of taxes possible in this case.

The Revenue Service's belated analysis—in 110 single-spaced pages—of what I.T.T. proposed in its application and what it actually did after it got it has raised some questions, not only for lawyers but also for financial analysts and, of course, the former Hartford shareholders, now faced with a potential tax problem.

Interest in Evidence

I.T.T. has challenged the I.R.S. revocation in court, and lawyers who advise corporations on acquisitions will be most interested in the evidence on which the service based its conclusion that the company had not disclosed all that it should in its application for the ruling and had not carried out its representations to the service.

But financial analysts are still asking questions. For example:

¶Did Harold S. Geneen, I.T.T.'s chief executive officer, and Howard J. Aibel, its general counsel, invite revocation of the ruling—and thereby subject former Hartford shareholders to perhaps $35-million in tax liabilities, to be reimbursed by I.T.T.—by authorizing violations of the representations made to the I.R.S. in the company's application?

¶Did they lose millions of dollars in authorizing resales of shares by Mediobanca, the Italian bank that was represented to the I.R.S. as the independent buyer of the 1.7 million Hartford shares owned by I.T.T.? Under the agency's regulations, I.T.T. had to dispose of these shares "unconditionally" to get the tax-free ruling.

Geneen's Objectives

Mr. Geneen had two objectives in 1969. The first was to get the tax-free ruling in order to attract votes of Hartford shareholders for the merger. To get that ruling, the company assured the I.R.S. that it would unconditionally sell to an independent third party the Hartford shares it had acquired to put pressure on Hartford direc-

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tors to agree to a merger, and that it would sell those shares before Hartford shareholders voted on the merger.

The assurance was in the application of April 15, 1969, for the ruling, which it obtained on Oct. 13.

But by October, Mr. Geneen had a different problem. Hartford stock was selling considerably below the average $51 a share that I.T.T. had paid for its 1.7 million shares.

Mr. Geneen and Mr. Aibel, in later testimony before the Securities and Exchange Commission discussed their second objective. Their testimony has never been made public, but is revealed in the I.R.S. document. Mr. Geneen said:

". . . The stock was much lower than it would be after the merger went through and we would have suffered a loss and created a windfall for somebody else. And we concluded that the only reasonable way to sell it would be to sell it in some manner so it would be sold and a price placed on it after the merger went through."

'Future Values'

And Mr. Aibel testified:

"We really didn't want to dispose of the stock for less than we had paid for it because we were convinced that in the long term, whether or not there was a merger, the stock would be much more than the current market value. The idea was to sell the stock to someone who would agree to pay us a price on future values."

And so, on the day after getting the ruling in 1969, I.T.T. applied for a supplemental ruling, based on a plan to sell the stock to Mediobanca—a buyer recommended by Lazard Frères, which had served as I.T.T.'s agent in putting the merger together and which had a long-standing relationship with Mediobanca.

Under one of the sales options in the contract presented to the I.R.S. for approval—and, according to the I.R.S. document, the only option ever seriously considered by Mediobanca—the bank, without expending any cash, would simply credit I.T.T. on its books for the shares at $51 a share, would re-sell the shares through Lazard at a time and price recommended by Lazard, and remit the proceeds and dividends to I.T.T. through Lazard. For this service, it would collect $1.3-million for its "commitment," plus a "sweetener" of 0.255 or 0.51 cents a share depending on how long it held the shares before re-selling them.

The I.R.S. was not told of the relationship between I.T.T. and Lazard, nor, as disclosed in the agency's study, that Lazard was "to receive in excess of a million dollars if the I.T.T.-Hartford merger were consummated." Nor was the I.R.S. informed that Lazard would get half of the fees paid by I.T.T. to Mediobanca, although the agency found that I.T.T. "had knowledge" of this "profit-sharing arrangement."

In I.T.T.'s supplemental application, John Seath, an officer in charge of the company's tax matters, assured the I.R.S. that the arrangement would be an unconditional sale. He wrote:

"While the price may be affected by Mediobanca's elections and by market considerations, it can under no circumstances be affected by anything I.T.T. does or can do. I.T.T. in no way has any right to determine price or to exercise, directly or indirectly, any rights with respect to Hartford shares (except, of course, the right to receive payment)."

Mr. Seath also assured the I.R.S. that Mediobanca would make any re-sales of Hartford stock, or of I.T.T. stock after the exchange, through Lazard Freres—characterized as "independent investment bankers"—in an "arms-length transaction" over which I.T.T. would have no control or influence.

The I.R.S. document said that in a separate agreement Nov. 3, 1969, Mediobanca assured Lazard that in accordance with its contract with I.T.T., "we are to sell the shares through you," and "you are hereby instructed to sell the shares in such amounts and at such times as you deem advisable, having in mind the best interests of all parties concerned."

Despite the wording of the contract and I.T.T.'s representations to the I.R.S., the service discovered that Mediobanca sold 1.3 million shares of I.T.T. stock after the exchange—76 per cent of the total—without going through Lazard Frères.

On Nov. 12, 1970, 800,000 shares at $49 each went to the Dreyfus Fund. On that day, the I.T.T. series N stock, which was exchanged for Hartford shares, closed at $54. Although the sale price could be justified because of the size of the block and although Lazard had advised Mediobanca on a minimum selling price, nevertheless the sale was not through Lazard. Mediobanca requested and received from I.T.T. a waiver on what the I.R.S. called a "technical breach" of contract.

Then, on Dec. 8, 1970, Mediobanca informed I.T.T. that it had prospective buyers for blocks of 100,000 and 400,000 shares at $55 a share—a price recommended shortly before by Lazard for sales of 100,000 shares and over. Mediobanca again received approval without going through Lazard.

The 100,000 shares went to Dreyfus-Basle, a 10 per cent partner with Mediobanca in the two-member "syndicate" that "bought" the shares from I.T.T. The 400,000 sale was to International Investment Associates, whose president was Gene Guyot and one of whose directors was Michael David-Weill, both partners in Lazard's Paris firm.

Both buyers actually had options to buy the shares by May 1, 1971. Dreyfus-Basle picked up the option on March 29, as I.T.T. stock closed at $76, giving Dreyfus-Basle a paper profit of $21 a share, or $2.1 million. When Investment Associates, having got an extension of its option, bought 400,000 shares on May 26, the closing price was $80 a share, a paper profit of $25 a share or $10-million.

The I.R.S. study concluded that on these two sales I.T.T. played a significant substantive role," and was, in fact, "the independent investment banker" that I.R.S. had been assured by I.T.T. would be Lazard.

Largely on the basis of these sales, the I.R.S. concluded that "the proposed I.T.T.-Mediobanca transaction did not constitute an unconditional disposition by sale" as required by law, and that the transaction "was not consummated in accordance with the representations made to us by I.T.T. in its supplemental ruling application."

In the puzzling situation involving the merger, which critics have often charged was approved by the Justice Department in 1971 only after Mr. Geneen enlisted the aid of top officials of the Nixon Administration, these questions remain unanswered:

¶Why did I.T.T. jeopardize its ruling by waiving the contract requirement on sales through Lazard? An attorney for I.T.T. said in an interview: "I don't have a clue why the sales were made directly by Mediobanca. But what the hell difference does it make? We feel that is not material to the question of whether there was an unconditional sale to Mediobanca."