NYTimes
DEC 20 1973

THE NEW YORK TIMES, THURSDAY, DECEMBER 20, 1973

Date Said to Question I.T.T-Hartford Deal

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Special to The New York Times

WASHINGTON, Dec. 19 — The Securities and Exchange Commission has material in its files casting doubt on the legality of a key transaction in 1969 that made possible the takeover of the Hartford Fire Insurance Company by the International Telephone and Telegraph Corporation, according to informed sources.

In that transaction, I.T.T. said it would sell a block of Hartford shares it already owned before shareholders voted on the merger. It did this to meet the legal requirement that it must dispose of those Hartford shares in order to get a ruling from the Internal Revenue Service that any capital gains on the exchange of I.T.T. for Hartford stock would be tax-free.

I.R.RE. accepted I.T.T.'s assertion that a proposed sale of 1,741,348 shares of Hartford to Mediobanca, on Italian bank, would be "unconditional," and would take place before the Hartford stockholders voted on the merger. Thereupon I.R.S. gave I.T.T. the ruling it sought in order to induce Hartford shareholders to vote for the merger.

Now, however, questions are being raised as to whether the main fulcrum of the transaction — the sale of I.T.T.'s stock in Hartford—satisfied the legal requirement of a genuine and unconditional sale.

S.E.C. Doubts on Contract

The S.E.C. has never regarded the I.T.T.-Mediobanca contract, signed on Nov. 3, 1969, as a genuine sale because only one of the options in it provided for an immediate purchase of the Hartford shares. Many tax experts have long taken the position that the "sale" was really an arrangement for I.T.T. to "park" the stock with Mediobanca for a fee until it could be sold for a higher price.

Indeed, among the material in S.E.C. files sources say, is a statement by an I.T.T. official to the effect that the idea behind the Mediobanca arrangement was to "sell" the stock to someone who would agree to pay I.T.T. a price based on future values.

Last April the New York district office of the revenue service was reported to have asked the national office to review the 1969 ruling with a view to revoking it. The I.R.S. office in Washington refuses to confirm the report, on the ground that the law prohibits anv discussion of a ruling.

However, in testimony at an S.E.C. hearing last May 3, Howard J. Aibel, I.T.T. general counsel, conceded that the New York I.R.S. office had requested revocation, giving as its reason for the request alleged "inadequate" disclosure to Hartford shareholders and possibly to the revenue service about the Mediobanca transaction.

Impact of Revocation

I.T.T. is concerned about a possible revocation, because it would make the shareholders at the time of the merger subject to a capital gains tax. Unquestionably this would provoke suits for reimbursement on the ground that the shareholders had not been fully informed of the "sale" to Mediobanca. If won, the suits could cost I.T.T. millions of dollars.

In eight months, the national I.R.S. has taken no action on the request. Tax lawyers here have suggested in interviews that the I.R.S. commissioner, Donald C. Alexander, finds himself in a dilemma. On the one hond, these lawyers say, the revenue service rarely revokes a ruling because it is regarded as bad administrative practice.

On the other hand, the commissioner is coming under increasing pressure from some Democratic members of the investigations subcommittee of the House Commerce Committee. As the "legislative oversight" body for the S.E.C., the subcommittee, headed by Harley O. Etaggers of West Virginia, knows about the material in the S.E.S. files bearing on the Mediobanca transaction. It also knows that the commission has given the revenue service access to its files.

Unless Commissioner Alexander responds to the request of the New York office, some

tax experts suggest, suspicion will take root that there was White House pressure behind the 1969 ruling.

tive J. J. Pickle of Texas, ranking Democrat on the subcommittee, told the special Watergate prosecutor, Leon Jaworski, in a letter on Nov. 16 that he believed "there was White House involvement," and he asked Mr. Jaworski to investigate. Mr. Jaworski said he would.

In fact, knowledge of the so-far secret S.E.C. material has transpired as a result of exchanges of correspondence between Mr. Pickle and Mr. Jaworski, Acting Attorney General Robert H. Bork and John Seath, I.T.T.'s director of taxes.

On Oct. 31, Mr. Pickle wrote Mr. Bork and Mr. Jaworski, saying that "there is a possibility that I.T.T. exchanged I.T.T. stock for Hartford stock under extreme misrepresentation to the Hartford stockholders and possibly the Internal Revenue Service."

Seeing the letter in The Congressional Record, Mr. Seath wrote Mr. Pickle on Nov. 21, insisting that the contract with Mediobanca provided for an "outright sale"; that Mediobanca "held all ownership rights in the shares, including the right to vote the shares and to receive dividends," and that "there was no element of fraud or misrepresentation" with respect to I.R.S. or Hartford shareholders.

Mr. Pickle, in a hitherto unpublicized letter, answered on Dec. 6 that there was a question "whether Mediobanca held all ownership rights in the shares," and that while Mediobanca may have "physically" received the dividends it had to turn them over to I.T.T. under the contract.

Pickle Raises Query

Mr. Pickle went on to say that he was concerned that I.T.T. might not have supplied I.R.S. with information it needed for its ruling, for example, "I.T.T.'s relationship with Lazard Frères [the New York investment banking house that acted as I.T.T.'s agent in the transaction] or the latter's relationship with Mediobanca."

"Other facts, not presently made public but contained in S.E.C. files," Mr. Pickle said, "may also have a bearing on this point, and I would hope the I.R.S. will have the benefit of such information."

The Mediobanca transaction was complex, but its objective was simple, namely, to postpone, if possible, the required sale of Hartford shares until they would bring a higher price than at the time of the shareholders' vote on the merger.

There were, in fact, two contracts, both negotiated by Felix G. Rohatyn of Lazard Frères, who was also a member of I.T.T.'s board of directors and executive committee.

Under the first contract, I.T.T. areed to pay Mediobanca $1.3-million in fees for its services.

Under the second, I.T.T. gave Mediobanca three options:

Under Option One, Mediobanca would pay I.T.T. $51 a share for the Hartford stock, or the market price on the day of closing (set for Nov. 9, 1969) if that were higher. Lazard would determine the market price. This was the only option providing for immediate cash payment — at least $88.8-million. It was therefore, the only one in which Mediobanca assumed any risk, and the Hartford shareholders none.

Under Option Two, Mediobanca would pay I.T.T. the fair market value of the shares (as determined by Lazard) during the last two weeks of May, 1971, plus accumulated dividends from the closing to June 10, 1971 — some 20 month away. If the stock declined below $51 a share, I.T.T. would be the loser; if it gained, I.T.T. got the increase.

Tax Experts Doubts

Under Option Three, Mediobanca would pay to I.T.T. whatever it received in a "resale" of the shares, plus dividends, less a 25 cent a share fee for Mediobanca if the resale were after June 30, 1970, and less 51 cents a share if the resale were after Dec. 31, 1970. Lazard controlled the timing of any resale.

The contract provided that the same terms would apply to I.T.T. shares acquired for Hartford shares in the merger.

Tax experts have doubted whether Option One was seriously proposed because Mediobanca finally notified I.T.T. at the signing of the contract on Nov. 3, 1969, that it would not select it.

This has raised the question whether I.T.T. did not know by Oct. 14, when it presented the plan to I.R.S. for approval, that Mediobanca had no intention of an outright purchase under Option One. At any rate, I.T.T. did not inform I.R.S. at any time of Mediobanca's immediate elimination of Option One.

Options Two and Three were riskless to Mediobanca, with Option Three the most attractive because of the additional fees of 25 cents or 51 cents a share. In the end, Mediobanca elected Option Three, and from the resale it remitted to I.T.T. dends. In a telephone interview last week, Mr. Abel said, "We did gain $22-million over the price that we sold to Mediobanca."

In return, Mediobanca received a total of $2.17-million in fees. What was not known at the time of the Mediobanca-I.T.T. contract, either to I.R.S. or the Hartford shareholders, was that Mediobanca had another contract with Lazard to split the fees.

Asked in an S.E.C. hearing last May why I.T.T. had not informed the revenue serivce or Hartford shareholders of this fee-splitting arrangement, Mr. Aibel said he had learned of it only on April 21, 1972, in an otehr S.E.C. hearing.

Response by I.T.T. Aide

When asked for comment last week on Mr. Aibel's statement, Mr. Rohatyn said he felt quite sure that he had told Mr. Aibel of the Lazard-Mediobanca arrangement, but he was certain—and had so testified under oath before the S.E.C. — that he had told the I.T.T. president Harold S. Gensen about it well before I.T.T. had presented the I.T.T.-Mediobanca contract to the revenue service.

Mr. Pickle's contention is that, despite I.T.T.'s protestations to the contrary, the sale to Mediobanca was not a real sale. And many tax experts agree. One nationally known tax law professor, who asked for anonymity, said in an interview this week:

"I could not regard that as a sale but as an arrangement by which I.T.T. hired Mediobanca as an agent to scout around for a buyer."

Again many experts agree with Mr. Pickle that the sale was not "unconditional" because Lazard, I.T.T.'s agent, retained control over the resale, and I.T.T. got any profits from the resale and also the dividends.

Finally, these experts agree with Mr. Pickle that the Hartford shareholders were not informed by I.T.T. that I.T.T., and hence themselves, would have to bear "the market risk" of the stock "sold" to Mediobanca.

Mr. Pickle also contends, with support from some tax lawyers, that I.T.T. should have told the I.R.S. and Hartford shareholders of the relationship, through Mr. Rohatyn, of I.T.T. and Lazard, and the relationship of Mediobanca and Lazard.

On this point of alleged indequate disclosure, the S.E.C. staff, in a draft complaint in June, 1972, against I.T.T. for violations of the securities laws, included a charge of fraud. The then commission chairman, William J. Casey, opposed the inclusion of fraud charge, and the other commissioners went along with him.