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## Bear Stearns Nearing Collapse Twice in Frenzied Last Days

*Paulson Pushed Low-Ball Bid, Relented; a Testy Time for Dimon*

By KATE KELLY

*(See Corrections and Amplifications item below.)*

It had been a rough day, but when Alan Schwartz headed for home on Friday, March 14, the [Bear Stearns](#) Cos. chief executive thought he'd have a month to find a buyer for his teetering firm.

A quickly concocted loan, guaranteed by the government for up to 28 days, allowed the brokerage to open its doors that morning. But its stock continued to spiral down, its clients continued to flee and its trading partners continued to disappear. It grew obvious to Treasury Secretary Henry Paulson Jr. that Bear Stearns wouldn't last the weekend. It was time for an awkward conversation.

Mr. Schwartz was in the dark back seat of a car whisking him from Manhattan to Greenwich, Conn., when he got a call from Mr. Paulson and New York Federal Reserve Bank President Timothy Geithner.

"You need to have a deal by Sunday night," said Mr. Paulson, a seasoned former Wall Street executive.

Mr. Schwartz was stunned. Now, with the market in shock at Bear Stearns's travails and its stock price cut to ribbons, he'd have to find the best offer he could to fend off bankruptcy.

The confusion over the financing was a testament to the speed with which Bear Stearns had fallen and the urgent need government officials felt to cushion the impact on the financial system.

At their gloomiest, regulators believed a bankruptcy filing could stoke global fears, threatening to topple other financial institutions and to send the Dow Jones Industrial Average into a 2,000-point nose dive.

The phone call to Mr. Schwartz capped a helter-skelter week -- and presaged another 10 days of chaos. Interviews with more than two dozen executives and others directly involved show that Bear Stearns nearly died not once, but twice.

That weekend, the firm agreed to sell itself to J.P. Morgan Chase & Co. for a mere \$2 a share after Mr. Paulson personally urged the bank to cut a higher bid. But a single clause tucked in the 74-page deal agreement set off a series of increasingly dire events that nearly scuttled the rescue brokered and financed by the Fed.

At one point, J.P. Morgan threatened to pull financing it had promised to provide for Bear Stearns. In turn, Bear Stearns executives considered suing J.P. Morgan, and the firm nearly was forced to liquidate its assets. Finally, Bear Stearns agreed to a price of about \$10 a share, which stockholders are poised to approve at a meeting Thursday.

By the time Mr. Schwartz faced investors on a midday conference call on March 14, he had been at the office for more than 24 tense hours.

On the call, Mr. Schwartz said that while Bear Stearns's cash on hand had "deteriorated," the funding from the Fed, routed through J.P. Morgan, would allow the firm to resume doing "business as usual." Bear Stearns had moved its first-quarter earnings announcement up from March 20 to March 17, he added, and he felt "comfortable" with the range of analyst estimates, some of which placed Bear Stearns's expected profit at more than \$1 a share. Longer term, Mr. Schwartz added, Lazard Ltd. had been hired to generate a possible deal for Bear Stearns.

In fact, teams from J.P. Morgan and J.C. Flowers & Co., the leveraged-buyout outfit that had briefly been interested in a stake in the company last summer, were in the firm's Madison Avenue offices that afternoon, scouring its books.

It was painfully apparent that neither the Fed's moves nor Mr. Schwartz's reassurances were having their desired effect. The rescue was seen in the market as a sign of weakness rather than one of hope.

Bear Stearns executives had heard rumors that some of the firm's big clients -- including Citadel Investment Group, a powerful Chicago hedge fund -- had made big bets that Bear Stearns's shares would fall. The brokerage's leaders feared that word of a big player taking a so-called short position could lead others to make the same moves, helping to depress the share price further.

Early that afternoon, Citadel CEO Kenneth Griffin called Tom Marano, the head of Bear Stearns's mortgage division, to ask, "Is there anything I can do?"

"There's such concern that you're short that I wouldn't even go there," Mr. Marano said.

"I'm not short," Mr. Griffin insisted. Any doubters could visit Citadel, he said, and review its trading positions themselves.



Tim Bower

Citadel CEO Kenneth Griffin denies to a Bear Stearns executive that he is betting against the firm's stock.

Bear Stearns's shares continued to fall. By day's end, nearly 190 million of the firm's shares had changed hands -- 17 times the daily average -- and the price had fallen 47% to \$30 a share.

Bear Stearns Chief Financial Officer Samuel Molinaro Jr. -- tired and in the same suit he'd left home in 36 hours before -- had stopped at a Mobil gas station on the Merritt Parkway for a cup of coffee on his way home to New Canaan, Conn., when Mr. Schwartz phoned him that Friday night with the bad news.

Messrs. Paulson and Geithner wanted a deal to sell Bear Stearns in place by early Sunday evening when Asian markets opened for business.

"You've got to be kidding me," Mr. Molinaro said. "I thought we had 28 days."

"So did I," Mr. Schwartz replied. "Now we have to get a deal done this weekend." By 8 a.m. the next morning, the two men were back at the office meeting with J.P. Morgan executives.

The Bear Stearns and J.P. Morgan buildings, less than a block from each other, were hives of activity. As J.P. Morgan and Flowers furiously conducted due diligence, Bear Stearns's directors met periodically throughout the day in Mr. Molinaro's sixth-floor conference room.

Early that afternoon, Flowers presented a tempting proposal: It would buy 90% of the company for \$3 billion in cash, or roughly \$28 a share. But the deal was contingent upon Flowers lining up a consortium of lenders to provide \$20 billion to finance Bear Stearns's continuing operations.

Hours later, J.P. Morgan said it might be willing to pay between \$8 and \$12 a share. That would value the company at between \$945 million and \$1.4 billion.

At J.P. Morgan, more than 200 of the bank's top managers were holding round-the-clock discussions in a suite of offices on the eighth floor of the bank's Park Avenue building. Food was brought in; executives grabbed sleep on couches.

There were misgivings about consummating the lightning-quick deal, but on Sunday morning, J.P. Morgan sent Bear Stearns a rough draft of a merger plan with the share price left blank.

Shortly after 8 a.m., Mr. Schwartz gathered the roughly 50 Bear Stearns employees who were in the building to help the firm's suitors sift through its financial records. Flowers was having difficulty lining up operating funds. He knew the J.P. Morgan bid was likely to win out and wanted to manage expectations about the price.

"We have a deal," he told the group, "but you're not going to like it."

Then, at about 10 a.m., J.P. Morgan suddenly withdrew its offer. Buying the brokerage after such a brief review of its books was simply too risky, the bank told Gary Parr, the investment banker representing Bear Stearns.

The bank had gotten cold feet after its senior managers returned to Park Avenue from assessing Bear Stearns's books. Besides losing clients, the firm was facing a rash of lawsuits from the collapse of two hedge funds the previous summer, and its large mortgage portfolio left it widely exposed to further problems in the housing market.

A deal with Flowers wasn't looking any more likely. By midday Sunday, the buyout firm knew it would be impossible to raise \$20 billion fast enough to keep Bear Stearns operating. Flowers now toyed with alternatives: It asked Mr. Parr if Bear Stearns's large rivals would consider buying the firm's prime-brokerage business, a prized asset that processed and financed trades with big clients. Perhaps then, Flowers reasoned, it could proceed with a purchase of Bear Stearns's core bond and stock units. Those deals never materialized.



Tim Bower

Bear Stearns CFO Samuel Molinaro finds out that the federal government wants his firm sold in two days.

Soon, though, J.P. Morgan was back, floating the price of \$4 a share. Under the plan, the Federal Reserve would take responsibility for \$30 billion in hard-to-trade securities on Bear Stearns's books, with potential for both profit or loss.

Bear Stearns directors were getting angry. How could the deal price go from \$8 to \$4 in a few hours? Chairman James Cayne -- himself a large shareholder and the firm's chief executive for 14 years until forced out in January -- was irate.

"Let's play the bankruptcy card," he said to the group as they discussed the bid in a conference room high in the Madison Avenue tower.

A large team from the law firm Cadwalader, Wickersham & Taft was already in the building, preparing for a potential Chapter 11 filing, which technically would allow Bear Stearns time to work out its problems with creditors. But the option would have been suicidal: Under changes to the bankruptcy code made in 2005, regulators would wrest control of the firm's customer accounts, leaving it with little or no business. Many of Bear Stearns's pending trades in investments known as derivatives, which are tied to underlying assets like stocks and bonds, would be subject to seizure by creditors.

The start of the business day in Asia loomed at 6 p.m. New York time. If the firm filed for bankruptcy, it would have to notify its Asian trading desks before markets there opened.

Throughout the weekend, the Fed's Mr. Geithner had been consulting Mr. Paulson, a former investment banker who had run Goldman Sachs Group Inc. for seven years before becoming Treasury secretary. After they talked on Sunday afternoon, they decided that Mr. Paulson should call J.P. Morgan CEO James Dimon.

He reached Mr. Dimon, who put the call on the speakerphone in his Park Avenue office. The bank was mulling a price of \$4 or \$5 a share.

"That sounds high to me," Mr. Paulson said. "I think this should be done at a low price."

Given the unprecedented level of government involvement in rescuing the troubled firm, the secretary was leery of appearing to bail out Wall Street investors at a time when homeowners were losing their houses to foreclosure in record numbers. He also was concerned about "moral hazard," the danger that too generous a price would encourage future risky behavior.

By midafternoon, as Bear Stearns directors hashed out these issues, Mr. Parr took a call from Doug Braunstein, head of investment banking at J.P. Morgan. "The number's \$2," Mr. Braunstein told him.



Tim Bower

J.P. Morgan CEO James Dimon tries to woo upset Bear Stearns employees.

"You surely don't mean that," Mr. Parr replied. After years of advising companies, he no longer reacted emotionally to bad news on a deal negotiation, but he knew how tough the revised price would be for his clients to swallow when he returned to the boardroom.

"I need to interrupt and give an update from J.P. Morgan," he told the Bear Stearns directors, relaying matter-of-factly what he'd been told.

Directors were shocked. Mr. Cayne said there was no way he would approve the \$2 deal.

Mr. Schwartz didn't want to buck the Treasury and the Fed. He also knew that as the CEO of a company incorporated in Delaware, he was obliged by law to consider the interests of creditors over shareholders if his company faced insolvency. Besides, he had employees to think about, and he didn't want the company's workers to face abruptly canceled paychecks and padlocked offices the

next morning.

"Two dollars is better than nothing," he told directors. He spent 30 minutes arguing his case. A price of \$2 and the right for shareholders to vote, he explained, was better than a price of zero and a bankruptcy filing. He also pointed out the untold consequences a bankruptcy could have on world markets -- a scenario Bear Stearns directors didn't want to be held responsible for.

Mr. Schwartz looked around the room to each board member. "Do I have anyone who's opposed?" he asked. No one spoke. At about 6:30 p.m., the deal was unanimously approved. Bear Stearns's advisers notified J.P. Morgan, which scheduled a conference call for investors to discuss the deal at 8 p.m.

The Bear Stearns CEO, exhausted and deflated, did not participate.

At about 7 p.m., when [The Wall Street Journal's Web site broke the news](#) of the \$2 price, people at rival firms were stunned. Morgan Stanley CEO John Mack and his financial team -- who were preparing for the firm's upcoming earnings announcement -- wondered aloud whether \$2 was a typo and should have read \$20.

Late Sunday night, as lawyers raced to finalize the merger agreement, executives of the New York Fed convened a call for Wall Street CEOs. So many people were dialing in that officials were repeatedly interrupted by the announcement of new participants.

Messrs. Geithner and Dimon led off with some brief remarks, noting that J.P. Morgan would be guaranteeing Bear Stearns's debts and that if the pact hadn't come together, the market impact may have been catastrophic. During the question-and-answer session, Citigroup Inc.'s new CEO, Vikram Pandit, spoke up.

Mr. Pandit -- who did not initially identify himself -- asked a shrewd but technical question: How would the deal affect the risk to Bear Stearns's trading partners on certain long-term contracts?

The query irked Mr. Dimon. "Who is this?" he snapped. Mr. Pandit identified himself as "Vikram." Offended that Mr. Pandit was taking up time with what he considered granular inquiries, Mr. Dimon shot back, "Stop being such a jerk." He added that Citigroup "should thank us" for staving off further mayhem on Wall Street.

In the next few hours, Mr. Dimon would have a bigger reason to be annoyed. The hurried deal had a loophole that could give angry Bear Stearns investors powerful leverage to seek a higher price: J.P. Morgan had pledged to finance Bear Stearns's trades for a year -- even if shareholders rejected the deal.



Review biographical details of the major players in the Bear Stearns deal.

It was the beginning of another long week. By Tuesday morning, J.P. Morgan's lawyers were arguing with their counterparts at Bear Stearns over the yearlong guarantee.

"Don't you understand that we have a problem?" Mr. Dimon asked Mr. Schwartz the next time the two talked. "Shareholders may vote this down!"

Mr. Schwartz, who had been taking a beating over the low price, knew an opening when he saw one. "What do you mean, 'we' have a problem?"

It was a rare moment in his three months as CEO when something wasn't Mr. Schwartz's problem. He was inclined to make some concessions, he told his advisers, but not without a higher offer.

On Wednesday evening, Mr. Dimon visited Bear Stearns to talk with hundreds of restive managers in the firm's second-floor auditorium. He knew he needed to placate this important group of stockholders, who along with directors owned about 30% of the firm.

Hostile audiences were unusual these days for Mr. Dimon. J.P. Morgan had largely avoided many of the pitfalls that were sinking other banks, and now the 52-year-old banker had become the go-to executive for frustrated regulators.

The Queens, N.Y.-born son of a Greek immigrant stockbroker, Mr. Dimon began his career under Sanford Weill, as the famed deal maker snapped up troubled companies to stitch together Citigroup. Mr. Dimon, widely seen as Mr. Weill's heir-apparent, was later ousted, though, after repeated clashes with Mr. Weill and his daughter, then an executive at the bank. Mr. Dimon moved on to Chicago's Bank One Corp., where he slashed costs and sacked managers he viewed as ineffective. In 2004, he arranged the sale of Bank One to J.P. Morgan for \$58 billion and quickly rose to chairman and CEO of the combined bank.

Standing on the dais with two senior lieutenants, Mr. Dimon tried to strike a conciliatory tone.

Bear Stearns's "shotgun marriage" to J.P. Morgan "is not the sort of thing we set out to do," he told the audience. Noting the pain for Bear Stearns managers facing the prospect of unemployment and big losses on their Bear Stearns stock, he added: "We can't begin to imagine how difficult this is."

In the tense question-and-answer session that followed, Ed Moldaver, a stocky, 40-year-old broker, stood up.

"This isn't a shotgun marriage," he said. "This is more like a rape."

As some in the room shook their heads and muttered uncomfortably, Mr. Dimon stared stonily at the crowd.

Around 9 p.m. the next day, Bear Stearns lawyer H. Rodgin Cohen -- Sullivan & Cromwell chairman -- was running on his treadmill at home in Westchester County, N.Y., when an executive from J.P. Morgan called.

"This has been a disaster for everyone," the executive said. He wanted an assurance that Bear Stearns would agree to allow J.P. Morgan to hold 51% of Bear Stearns's shares as part of the deal. That way, they'd control enough votes to approve the deal without having to persuade any disgruntled investors. Delaware courts, however, had frowned upon an acquirer being given an option to buy such a large stake without shareholder approval. To ensure court approval, J.P. Morgan would have to opt for something lower.

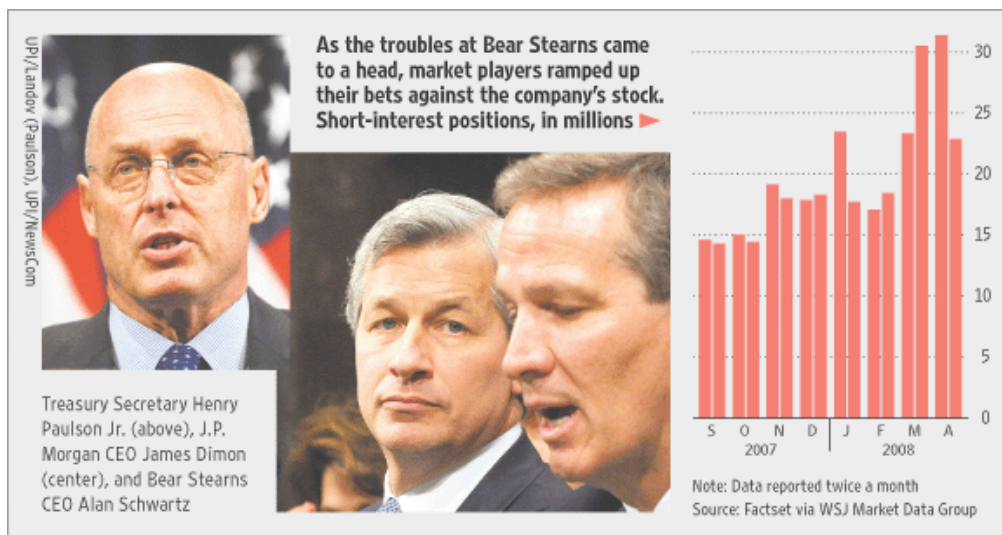
The next day, March 21, was Good Friday. J.P. Morgan turned up the heat, telling Mr. Cohen that if Bear Stearns didn't make the desired concessions, the bank didn't see how it could provide funding for the brokerage to trade the following Monday. In an ugly replay of the weekend before, Bear Stearns was imperiled again.

If J.P. Morgan wouldn't guarantee Bear Stearns's trades on Monday, the firm would most likely have to file for bankruptcy protection.

But this time around, Bear Stearns's business was so weak, it wasn't eligible for a Chapter 11 reorganization filing. Instead it faced a Chapter 7 liquidation, in which a court-appointed trustee would take over the firm, likely throwing out management and launching a sale of its assets to repay debts.

The firm's directors talked briefly about suing J.P. Morgan to continue the financing. But they quickly realized their position was untenable. With Bear Stearns's core business eroding, how would regulators and investors react to a Chapter 7 filing and a new spate of litigation? They decided it was time to talk to the government again.

While Mr. Cohen telephoned his contacts at the New York Fed, Mr. Schwartz called Kevin Warsh, a former investment banker at Morgan Stanley who had been a member of the Federal Reserve Board for two years. "We're under a perceived threat," Mr. Schwartz told Mr. Warsh, explaining that J.P. Morgan appeared to be playing hardball in order to garner a bigger chunk of Bear Stearns's shares. While Bear Stearns was prepared to renegotiate, Mr. Schwartz said, it needed a higher price. Mr. Warsh pressed him for details on the firm's situation but declined to take sides.



On Easter morning, Mr. Schwartz called Mr. Dimon. "There's a psychological limit here," he said. Bear Stearns's directors needed a sale price in the double digits to feel comfortable. "Don't come

back to me at \$9.99," he cautioned Mr. Dimon.

With tension so high between the two sides, Messrs. Geithner and Paulson were concerned that, far below the markets' radar, Bear Stearns was again becoming a threat to the financial system. In a call to Mr. Dimon, Mr. Paulson reluctantly agreed to bless a higher price.

Before markets opened the next morning, J.P. Morgan countered with a final bid: about \$10 a share, valuing the brokerage at \$1.2 billion, for 39.5% of the firm's stock. To make it palatable to the Fed, J.P. Morgan assumed responsibility for the first \$1 billion of any potential losses, reducing the government's exposure to \$29 billion.

The deal was approved, markets opened smoothly and most investors remained happily unaware of the week's turmoil. Yet for Bear Stearns, the federal government and J.P. Morgan, it was an unsatisfying denouement in many ways.

Bear Stearns investors took their lumps, if not as painful as Mr. Paulson had envisioned. The Fed got stability in the markets, but at a risk of tens of billions of dollars and by setting an uncomfortable precedent. And J.P. Morgan picked up prized clients, talented Bear Stearns employees and a sleek new building at a bargain price, but now faces at least \$9 billion in liabilities and the chore of integrating two wildly different cultures.

But the Dow did not plunge 2,000 points, other trading houses did not fail and the global financial system, while wheezing, did not collapse.

If there were hazards, moral and otherwise, lurking in the deal, the future would have to sort them out.

—Greg Ip, Robin Sidel and David Enrich contributed to this article.

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### **Corrections & Amplifications**

J.C. Flowers & Co., a leveraged-buyout company, on March 15 proposed to buy 90% of Bear Stearns Cos. in a deal that would have generated about a billion new Bear Stearns shares. This May 29 page-one article didn't take into account the new shares, and incorrectly valued the Flowers bid at \$28 a share. The share price Flowers proposed was between \$2 and \$2.60.

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