November 1, 2012

Memo accompanying Americans for Financial Reform letter to the Chairs of the Residential Mortgage Backed Securities Task Force

JPMorgan made its deal to acquire Bear Stearns more than 4-1/2 years ago, in March 2008, and closed on the transaction in May of that year. JPMorgan paid about $1.2 billion in value of JPMorgan stock for the acquisition. Another part of the negotiated purchase price, and a significant term of the merger agreement, was the assumption by JPMorgan of Bear Stearns' liabilities. The $1.4 billion Bear Stearns headquarters building at 383 Madison Avenue was included among the assets that JPMorgan acquired for that purchase price. JPM's acquisition of Bear Stearns was facilitated by a $29 billion non-recourse loan from the Federal Reserve.

JPMorgan sought in March 2008 to lock up its deal with various bid protections and open market stock purchases designed to keep other potential bidders from buying Bear Stearns out from under JPM.

JPMorgan's complaint that it was forced by the Fed into a shotgun wedding with Bear Stearns is contradicted by the very terms of the merger deal that it negotiated. If JPM was reluctant to make the purchase in 2008, as it now suggests, the best way for it to have structured its deal would have been to encourage competitive bidding leading to a higher or better bid that would have taken JPM off the hook.

Instead, JPMorgan sought and obtained various deal protections that would make its purchase of Bear Stearns all but inevitable. These protections suggest that Morgan saw an opportunity to acquire Bear Stearns on fire sale terms, and did not want to let it get away. The bid protections negotiated for and obtained by JPM included 'no shop' provisions prohibiting Bear from actively soliciting other proposals, or from discussing or negotiating with other potential partners without giving JPMorgan notice and an opportunity to match the terms:

- "No Shop" – The agreements contained a "'no solicitation' clause which prohibited Bear Stearns from actively soliciting alternative proposals,"[1] and "no shop" and other lock-up provisions that kept Bear Stearns from discussing or negotiating higher bids with other potential merger partners or purchasers of Bear Stearns' stock or assets unless it gave JPM notice and the name of the other bidder and terms of the alternative bid, after which JPM could match that better bid.

- Headquarters Purchase Option/Breakup Fee - JPMorgan was granted an option to purchase Bear Stearns' New York headquarters building, having a value at that time of about $1.4 billion, for a bargain price of $1.1 billion.[2] The headquarters

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[1] *Matter of Bear Stearns Litigation*, 23 Misc. 3d 447, 454, 870 N.Y.S.2d 709, 2008 WL 5220514 (Sup.Ct.N.Y.Cty. 2008).

[2] http://www.paulhastings.com/assets/publications/916.pdf,, p. 8, citing Alex Frangos, "J.P. Morgan's Good Office Deal? Bear Skyscraper Deal Looks Like a Bargain on Paper, But There Are Catches," WSJ, 3/18/08, p. C3. Estimates of the value of the headquarters building at the time varied, but all were at or above the $1.1 billion option

option was *in addition* to JPM's right to acquire the headquarters building if the merger deal went through and closed, and was designed to keep other bidders away and to give JPM a valuable asset at a bargain price no matter what happened later. Specifically, JPM could exercise the option to buy the headquarters building --- for $300 million less than its estimated value --- *even if the merger with JPM did not go through because Bear Stearns' shareholders rejected the merger or Bear Stearns' Board exercised any "fiduciary out" provisions in the Merger Agreement*. The effect of this option alone was to force any higher bidder to make a topping bid of *at least $300 million more* than the JPMorgan bid for its competing bid to constitute a higher or better bid, and to give JPM an effective $300 million breakup fee if Bear Stearns' assets went to a higher bidder. JPM had a year to exercise the headquarters option, and thus even had protection against any downside risk if JPM thought that the value of the building might decrease. Valuing the breakup fee at $300 million based on the value of the headquarters building option, and the $1.2 billion ($10 per share) price paid by JPM for Bear, the breakup fee was 25% of the purchase price.

- Restrictions on Competing Bids - Additional restrictions on competing bids, which required any competing bid to be for 100% of Bear Stearns' stock or assets and to provide for payment to Bear Stearns in cash and/or securities.[3] These provisions precluded Bear Stearns' Board from considering offers from any number of bidders for business lines or parts of Bear Stearns, the aggregate value of which may well have exceeded the value of JPMorgan's bid, and barred consideration of higher bids that provided for payment over time.

- No Right of Bear Stearns to Terminate if Shareholders Did Not Approve – The agreements included a striking provision that Bear Stearns' Board, even if it did obtain a higher or better bid, *could not terminate the merger agreement* and related agreements with JPM, but could only *change its recommendation to shareholders* that they vote to accept the JPM merger bid.

- Renegotiation Covenant – Bear Stearns was required, if its shareholders rejected the JPM merger, to negotiate a restructured transaction with JPM and resubmit that transaction to Bear Stearns' shareholders for approval.

- Poison Pill Waiver - Bear Stearns waived its "poison pill" rights under section 203 of Delaware corporation law.[4]

- Acquisition of Bear Stearns Shares Prior to the Shareholder Vote – JPM also was given a stock option in the original agreements, to purchase 19.9% of the shares of Bear Stearns for $2 per share. When the original March 16 deal was

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price. See http://therealdeal.com/blog/2008/03/17/jpmorgan-could-make-bear-stearns-building-its-new-hq/ ($1.2 billion). JPM itself estimated the value of the building at between $1.1 and $1.4 billion. http://en.wikipedia.org/

[3] *Matter of Bear Stearns Litigation*, 23 Misc. 3d at 454.

[4] *In re Bear Stearns Companies, Inc. Shareholder Litigation*, 2008 WL 959992 *2-3 (Del.Ch.).

> renegotiated by JPMorgan in the days that followed, "JPMorgan proposed that Bear Stearns issue a sufficient number of additional shares to give JPMorgan a two-thirds common stock interest and, thus, increase the certainty that the merger would close."[5] Bear Stearns rejected this proposal, and instead agreed that, in place of the 19.9% option, JPM could purchase 39.5% of Bear Stearns stock at $10 per share *prior to the shareholder vote*.[6] JPM, stymied by its inability to get through negotiations with Bear the right to acquire two-thirds of its stock prior to the shareholder vote, then displayed its continuing ardor to consummate the Bear Stearns deal by voluntarily purchasing 10% of Bear Stearns' outstanding shares in the open market.[7]

JPM, far from being hesitant about wedding Bear Stearns 4-1/2 years ago, as it now suggests, barred the door to its competitors and ran to the altar. The bid protections and the 39.5% stock deal gave JPM a virtual lock-up on its merger with Bear Stearns, chilled any competitive bidding by other parties, and gave JPM a huge breakup fee in the form of the headquarters stock option in the event that any better bid emerged.

JPM's open market purchases of Bear Stearns stock following its entering into the revised merger agreement --- purchases which JPM was under no obligation whatsoever to make --- underscore JPM's 2008 enthusiasm for the deal. In the shareholder litigation that followed the signing of the merger agreement, the New York Supreme Court Judge trying the case found that: "[h]ad the 39.5% block of shares issued to JPMorgan been excluded, the merger would still have passed with 52% of the vote. However, if all of JPMorgan's shares had been excluded, including the 10% of the outstanding shares purchased on the open market, the measure would have failed with a 42.7% vote. The merger closed on May 30, 2008."[8]

A New York Times story from March 2008 recounting the deal emphasizes Jamie Dimon's eagerness to proceed. "Dimon's race to cut a deal for Bear began around 6 p.m. Thursday, [March 13, 2008] when Alan Schwartz, Bear's chief executive, called with startling news: Bear had been driven to the brink of bankruptcy by what amounted to a bank run."[9]

Dimon immediately dispatched his investment banking co-heads to assemble the team for "a possible takeover." Dimon "'was driving the process - it was an extraordinary thing to watch,' said a senior executive involved in the deal." By early Saturday morning March

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[5] *Matter of Bear Stearns Litigation*, 23 Misc. 3d at 455.

[6] *In re Bear Stearns Companies, Inc. Shareholder Litigation*, 2008 WL 959992 *3. The March 24 amendment, pursuant to which JPM upped its pre-shareholder vote stake to 39.5%, did give Bear the ability to terminate the merger agreement if the shareholders voted against and also deleted the renegotiation covenant. http://investor.shareholder.com/jpmorganchase/secfiling.cfm?filingID=898822-08-319. Commentators noted at the time that the latter modifications to the deal protections were made to give the merger deal a better chance of surviving scrutiny by the Delaware courts, and that the 39.5% stake that also was effectuated by the amendment made it "all but impossible for a competing purchaser to succeed." http://www.paulhastings.com/assets/publications/916.pdf,, pp. 6-7, 9.

[7] *Matter of Bear Stearns Litigation*, 23 Misc. 3d at 456.

[8] *Id.*

[9] http://dealbook.nytimes.com/2008/03/18/rallying-the-house-of-morgan/.

15, about 40 bankers had been assembled in JPM's headquarters boardroom, which served as the war room for the takeover. Driven by JPM's investment banking heads, the "group divided into teams, each charged with assessing an aspect of Bear, and began heading across the street to Bear's headquarters to scour the books. More than 200 bankers ultimately joined in this task."[10]

JPM and Dimon had good strategic reasons to purchase Bear Stearns. "For years, the JP Morgan Chase management had fretted that the bank was weak in the equity market and prime brokerage activities compared with rivals. Bear was strong in both."[11] And JPM's acquisition of Bear Stearns was described at the time as "a transformative deal for Jamie Dimon."[12]

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[10] http://dealbook.nytimes.com/2008/03/18/rallying-the-house-of-morgan/.
[11] Tett, Gillian, *Fool's Gold*, p. 219.
[12] http://dealbook.nytimes.com/2008/03/18/rallying-the-house-of-morgan/, quoting David Hendler, financial services industry analyst at CreditSights.