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1601 Connecticut Avenue, N.W., Suite 701, Washington, D.C. 20009 • 202-462-5755 • Fax 202-328-2430

Recent Developments

New York Court Rejects Shareholder Challenge to JPMorgan Rescue of Bear Stearns

Marc Wolinsky, Ian Boczko, & Garrett B. Moritz

Wachtell, Lipton Rosen & Katz

In a thorough, 44-page decision, Justice Herman Cahn of the New York State Supreme Court today[1] granted a motion for summary judgment dismissing a shareholder challenge to the fairness of JPMorgan's rescue of Bear Stearns. The decision is a strong endorsement of the protections that the business judgment rule affords to directors faced with the challenges posed by the ongoing credit crisis. *In re Bear Stearns Litigation*, No. 600780/08.

The suit grew out of the March 16, 2008, agreement under which JPMorgan agreed to acquire Bear Stearns. The deal was struck over a weekend; the timing was driven by the fact that Bear was facing a "run on the bank" and would have had to file for bankruptcy if a deal was not arranged before Asian markets opened. Over the following week, the deal was renegotiated to increase the consideration from \$2 to \$10 per share. As part of the revised deal, Bear agreed to sell JPMorgan 95 million shares of Bear stock, representing 39.5% of the company's voting power. JPMorgan requested and the Bear board agreed to the stock sale to enhance the likelihood that shareholder approval would be obtained and thus assure Bear's customers and counterparties that they could continue to do business with Bear. JPMorgan also guaranteed certain of Bear's trading obligations in order to reassure customers and counterparties.

While NYSE Rule 312.03 would normally require shareholder approval for a sale of this magnitude, the Bear board relied on NYSE Rule 312.05 to go forward without a vote. That rule permits bypassing a vote if the company's audit committee finds that the delay would "seriously jeopardize" the company's financial viability. The merger agreement also included other "deal protection" measures, including an option to purchase Bear's headquarters building.

The court rejected all of the plaintiffs' challenges to the deal, holding that the business judgment rule applied and that, under that rule, the court could not second-guess the board:

> In response to a sudden and rapidly-escalating liquidity crisis, Bear Stearns' directors acted expeditiously to consider the company's limited options. They attempted to salvage some \$1.5 billion in shareholder value and averted a bankruptcy that may have returned nothing to the Bear Stearns' shareholders, while wreaking havoc on the financial markets. The Court should not, and will not, second guess their decision.

The court specifically ruled that the Bear board was justified in agreeing to sell JPMorgan the 95 million shares in order to make sure that the deal would close; according to the court, these provisions were "essential to ensure JPMorgan's willingness to undertake what it perceived as significant risks involved in guaranteeing Bear Stearns' obligations, and to assure customers and counterparties that the deal would go through."

As the credit crisis continues and evolves, boards will continue to face serious challenges. The *Bear Stearns* opinion confirms, however, that directors that act diligently and in good faith should not have exposure for their actions.

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[1] This memo was originally released December 4, 2008.

