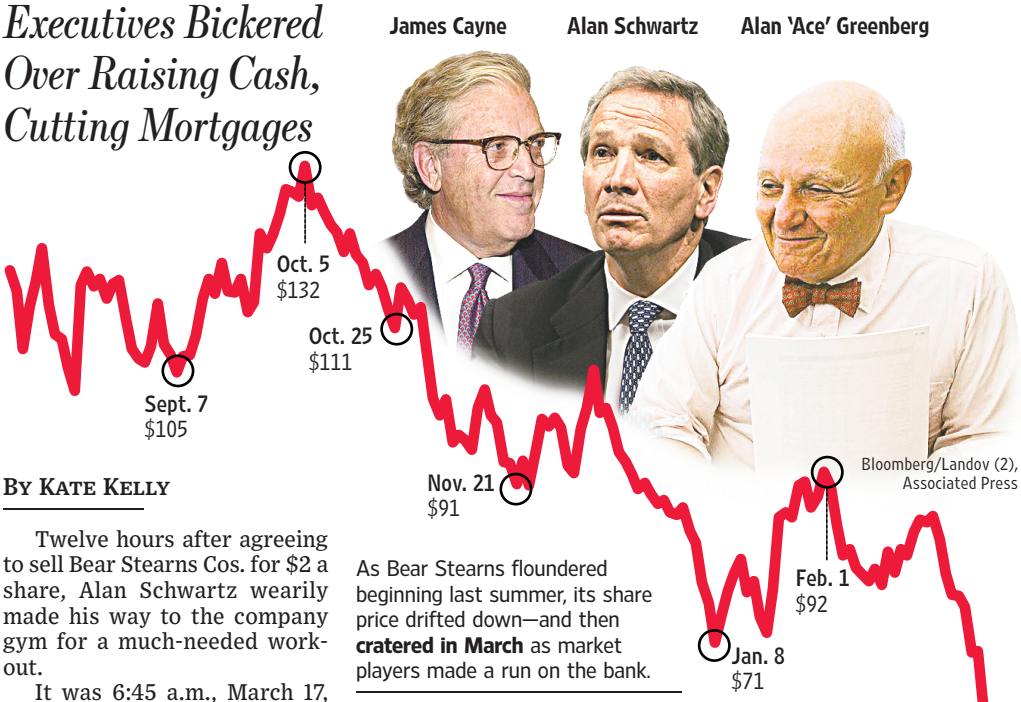
Lost Opportunities Haunt Final Days of Bear Stearns

Executives Bickered Over Raising Cash, Cutting Mortgages



Bloomberg/Landov (2), Associated Press

As Bear Stearns floundered beginning last summer, its share price drifted down—and then **cratered in March** as market players made a run on the bank.

By Kate Kelly

Twelve hours after agreeing to sell Bear Stearns Cos. for $2 a share, Alan Schwartz wearily made his way to the company gym for a much-needed workout.

It was 6:45 a.m., March 17, and Bear Stearns's chief executive had slept little since hammering out the ugly details of his fire-sale deal with J.P. Morgan Chase & Co.

When Mr. Schwartz, already dressed in his business suit, trudged into the locker room, Alan Mintz, still in his sweaty gym clothes, made a beeline for the boss.

"How could this happen to 14,000 employees?" demanded the 46-year-old senior trader, thrusting his face uncomfortably close to Mr. Schwartz's. "Look in my eyes, and tell me how this happened!"

Two and a half months later, Mr. Schwartz still isn't quite sure. To Mr. Mintz and others, he has blamed a market tsunami he didn't see coming. He told a Senate committee last month: "I just simply have not been able to come up with anything, even with the benefit of hindsight, that would have made a difference."

But many who lived through the seven tense months before the deal say Bear Stearns imploded because it was at war with itself. Buffeted by the most treacherous market forces in a generation and hobbled by indecision, the firm's leaders missed opportunities that might have been able to save the 85-year-old brokerage.

THE FALL OF BEAR STEARNS
First of Three Parts

Those missteps are expected to have a lasting impact beyond the people who once worked at Bear Stearns or owned its stock. Unlike Wall Street meltdowns in decades past—from Drexel Burnham Lambert Inc. to Long-Term Capital Management—the Bear Stearns collapse spurred direct intervention from the Federal Reserve. That step is likely to increase the central bank's role in solving future financial catastrophes and bring securities firms further regulation in the bargain.

As shareholders prepare to approve the deal on Thursday—at a price that angry investors forced up to about $10 a share—interviews with more than two dozen current and former Bear Stearns executives, directors, traders and others involved in the action paint the first detailed picture of the fractious last weeks before the Fed helped underwrite J.P. Morgan's purchase of the trading powerhouse.

Months before regulators pressured the firm to sell itself, nervous traders futilely begged Mr. Schwartz and his predecessor, James Cayne, to raise more cash and slash Bear Stearns's huge inventory of mortgages and the bonds that backed them.

At least six efforts to raise billions of dollars—including selling a stake to leveraged-buyout titan Kohlberg Kravis Roberts & Co.—fizzled as either Bear Stearns or the suitors turned skittish. And repeated warnings from experienced traders, including 59-year Bear Stearns veteran Alan "Ace" Greenberg, to unload mortgages went unheeded.

Top executives resisted, in part, because they were concerned the moves would upset the delicate calculus of appearances and perceptions that is as important on Wall Street as dollars and cents. If Bear Stearns be-

Please turn to page A17

THE FALL OF BEAR STEARNS

Missed Opportunities Haunt the Final Days of Bear Stearns

Continued from Page One
trayed weakness, they worried, skittish customers would pull their money out of the firm, and other financial institutions would refuse to trade with it.

Instead of managing these fickle forces, though, a brokerage whose culture and fortune were rooted in the trading floor's steely manipulation of risk was swamped by them.

Early Warnings

An August conference call fails to calm investors.

An early harbinger of the debacle to come appeared the first Friday in August. Bear Stearns executives hosted a conference call that day meant to reassure investors. The brokerage's stock had fallen sharply after the late-July collapse of two internal hedge funds tied to subprime mortgages, home loans made to the riskiest borrowers.

Mr. Cayne and his top financial lieutenants touted the firm's strong cash holdings—$11.4 billion, according to company officials—and new longer-term borrowing agreements. They also pointed out that Bear Stearns itself actually had few subprime holdings. But executives' comments about the bleak state of the market for interest-bearing securities stoked investors' fears, helping spur a broad rout in stocks and driving Bear Stearns's own shares to a 12-month low of $106.55.

Later that day, word leaked out that Warren Spector, Bear Stearns's co-president and chief of the division that oversaw the two failed hedge funds, was being forced out by Mr. Cayne.

Amid the mounting bad news, a lifeline appeared: Mr. Schwartz, then Bear Stearns's co-president, and Henry Kravis, KKR's fearsome founder, had a conversation about the buyout firm possibly purchasing 20% of Bear Stearns.

By Sunday, Bear Stearns's sleek, black tower in midtown Manhattan bustled with activity.

About 8:30 a.m., a team from KKR assembled in the investment-banking department on the 43rd floor to begin dissecting the firm's books. Buying a piece of Bear Stearns was attractive to KKR as an entree into the lucrative brokerage business at a time when prices were cheap. For Bear Stearns, it was a chance to raise $2 billion or more in capital and gain a crucial seal of approval by putting an *éminence grise* like Mr. Kravis on its board—a move Mr. Schwartz hoped would silence Bear Stearns's critics.

Within two weeks, though, the talks would fall apart because each side had concerns. Among other things, Messrs. Schwartz and Cayne feared a deal might turn off Bear Stearns clients that competed with KKR.

While Bear Stearns's mortgage team fielded questions from KKR that Sunday, the firm's risk officers were meeting in the sixth-floor executive offices with staffers from the Securities and Exchange Commission. The regulators had traveled from Washington to make sure Bear Stearns had access to the day-to-day loans it needed to fund its trading operation. After scrutinizing the firm's $400 billion balance sheet well into the afternoon, the regulators agreed to reconvene with Bear Stearns managers for daily briefings until the market crisis passed.

Elsewhere in the building that afternoon, Bear Stearns's board was deliberating over Mr. Spector's resignation. Not everyone was convinced it was the right move—including Mr. Schwartz, who had expressed his objections privately to Mr. Cayne. But Mr. Cayne was adamant.

The collapse of the hedge funds had exposed the then-73-year-old CEO to criticism inside and outside of the company for being disengaged and for brushing off warning signs. Early on, he seemed unconcerned. Mr. Cayne said the funds weren't Bear Stearns's money: It belonged to big institutions, wealthy individuals and lenders who all knew the risks going in. Soon, though, the lenders forced Bear Stearns to extend one of the portfolios $1.6 billion of its own money to keep it afloat.

A glib and gruff former scrap-iron salesman from Chicago with a penchant for cigars, golf and cards, Mr. Cayne had often taken off Thursday afternoons and Fridays that summer to play golf near his New Jersey vacation home. In mid-July, when the funds were melting down, both he and Mr. Spector had spent more than a week in Nashville, Tenn., competing in a bridge tournament. Mr. Cayne, who declined to be interviewed for this article, was said by people close to him to be particularly angry that Mr. Spector, who with his partners won the event, had been away from the office at such a sensitive time.

Bear Stearns's board—12 men largely handpicked by Mr. Cayne—approved Mr. Spector's departure. Mr. Schwartz, a longtime investment banker more accustomed to rubbing shoulders with clients like Walt Disney Co.'s Robert Iger than to monitoring trades or capital levels, was named sole president.

Messrs. Spector and Schwartz had been promoted to co-presidents and co-chief operating officers in 2001. Mr. Cayne, the CEO, had leaned on them to keep their divisions running smoothly.

Now, Mr. Schwartz, a former star pitcher at Duke University, had to carry a heavier burden. At age 57, he had little experience in the bond and mortgage businesses that made up an outsized share of Bear Stearns's revenue. But he decided to manage the firm's capital-market division himself rather than hiring a replacement for Mr. Spector.

Mr. Schwartz moved to tighten oversight of the company's trading. He also began keeping daily tabs on the bond markets. Several times a week, he sat down with traders who had bet a lot of the firm's money, questioning them about strategy and results.

In the weeks after rejecting KKR's approach, Bear Stearns received other offers of capital. J. Christopher Flowers, a former Goldman Sachs Group Inc. partner, had met with some of Bear Stearns's senior managers about the possibility of taking a 20% stake. But the meeting left Bear Stearns's representatives concerned that Mr. Flowers simply was trying to gauge their desperation. The next day, they told the Flowers team they weren't interested.

Instead, Bear Stearns executives began working on what Messrs. Schwartz and Cayne saw as a more compelling option: a joint venture with Citic Securities Co. They reasoned a deal with the Chinese investment bank would bring in money and help increase Bear Stearns's miniscule presence in Asia. Smarting from criticism of his hands-off style, Mr. Cayne spent the Labor Day weekend on a whirlwind trip to Beijing to discuss terms with Citic executives.

Into early autumn, the mortgage market continued to slump. Housing prices had plunged, and most major financial firms were slashing the value they placed on holdings backed by home loans.

Bear Stearns—with its immense stockpile of mortgages and related securities—was particularly vulnerable. Despite months of price declines, those holdings were valued at about $56 billion—a large portfolio for a firm its size. Still, SEC staffers—who now were phoning in for weekly Wednesday-evening conference calls with the firm—appeared comfortable. By Thanksgiving, some senior regulators were calling in less frequently.

ILLUSTRATIONS BY TIM BOWER

'We've Got to Cut!'

'Ace' Greenberg argues to dump mortgage inventory.

Inside Bear Stearns, though, skirmishes about its mortgage holdings at times grew heated. Some veteran traders insisted that Tom Marano, the head of mortgages, needed to trim his portfolio. Among them were Wendy de Monchaux, who as head of proprietary trading invested Bear Stearns's own money, and Steve Meyer, co-head of stock sales and trading.

"Cut the positions, and we'll live to play another day," Ms. de Monchaux said often, invoking one of the firm's venerable maxims. But Mr. Schwartz, still boning up on the details of the mortgage markets, urged caution.

For some of the assets, the market was frozen, Mr. Schwartz reasoned, so selling was out of the question. On others, he had mixed feelings. He didn't want to unload tens of billions of dollars worth of valuable mortgages and related bonds at distressed prices, creating steeper losses.

Mr. Schwartz believed the portfolio at least should be better protected from further price declines. Spearheaded by Mr. Marano, a bearded 46-year-old trader with a Grateful Dead tattoo on his right shoulder, the mortgage team unfurled a hedging strategy known as "the chaos trade."

The trade was a deeply pessimistic bet—essentially a method for making money if the mortgage and financial markets cratered. The traders bet that the ABX, a family of indexes made up of securities backed by subprime mortgages, would fall. They made similar moves on indexes tracking securities backed by commercial mortgages. Finally, they placed a series of bets that the stocks of major financial companies with exposure to mortgages, including Wells Fargo & Co., Countrywide Financial Corp. and Washington Mutual Inc., would decrease in value as well.

Late in September, with Bear Stearns and other financial stocks rallying, members of the firm's executive and risk committees gathered in Mr. Cayne's smoky, dark and secluded sixth-floor offices to discuss the hedges. Negotiations for Allianz SE's Pacific Investment Management Co. to take a nonequity stake of as much as 10% in Bear Stearns had recently fallen apart. That cost the brokerage a chance for capital and a coveted endorsement of Bear Stearns's creditworthiness.

Mr. Cayne had just returned from the hospital where he'd been treated for an infection, and he looked thin and drawn. Mr. Greenberg, the firm's storied trader and former CEO, took center stage. As head of the risk committee, he had been reviewing the Wells Fargo and other negative stock bets. He wasn't happy. The financial-stock hedges were too risky, he warned, and should be closed out immediately. Moreover, he wanted the mortgage inventory slashed.

"We've got to cut!" Mr. Greenberg demanded. Ms. de Monchaux and Mr. Meyer concurred.

Oklahoma-bred and Missouri-educated, Mr. Greenberg was the embodiment of the "PSDs"—poor, smart employees with a deep desire to get rich, upon whom the firm had been built. Mr. Greenberg, who ran the firm for 15 years before Mr. Cayne nudged him aside, was known on Wall Street for his voluminous memos, in the voice of a fictional character, urging traders on issues large ("it doesn't pay to get too arrogant") and small (save paper clips to cut costs).

But it was Mr. Greenberg's trading style that had most defined Bear Stearns: Sell losing trading positions—quickly. Mr. Greenberg still recalled what his father, an Oklahoma City clothier, told him: "If something isn't moving, sell it today because tomorrow it will be worth less."

The hedges had made close to half a billion dollars and stood to make more as the stocks continued to fall. But since they had first employed the chaos trade, Mr. Marano and his team had been hectored almost daily by complaining phone calls from colleagues. Some of Bear Stearns's more superstitious traders even objected to the strategy's name: They were tempting fate by invoking chaos.

Faced with the fierce divide among his top executives, Mr. Schwartz, who was generally supportive of the chaos trade, decided to abandon it. He wanted specific pessimistic plays that would offset specific optimistic bets, rather than the broader hedges Mr. Marano had employed. Frustrated, Mr. Marano ordered the trades undone.

As October dawned, Messrs. Cayne and Schwartz had high hopes that a deal with Citic would bolster Bear Stearns's fortunes. On Oct. 22, Bear Stearns announced a joint venture in Asia that included a $1 billion cross-investment between the two companies. If regulators approved, Bear Stearns could count on getting $1 billion in the first half of 2008. But it would spend the same amount over a longer period for a complementary stake in Citic.

Investors weren't impressed. Bear Stearns shares rose meagerly but backtracked days later.

Over the next few weeks, Bear Stearns's competitors disclosed losses from bad mortgage-related bets. Merrill Lynch & Co. announced a loss amid write-downs of $8 billion; Morgan Stanley revealed losses of nearly $4 billion.

To outsiders, it was beginning to look as if Bear Stearns had navigated the crisis relatively deftly. Inside the firm, that view wasn't as prevalent. Its mortgage holdings were still hefty, and its bond business was reeling.

The firm continued to explore ways to raise money, hiring investment banker Gary Parr of Lazard Ltd. to try to bolster the firm's prime-brokerage business, which handled trading and lending to hedge funds and other big clients. Mr. Schwartz had also discussed a merger with hedge fund Fortress Investment Group.

Neither effort would bear fruit.

Time to Move On

Alan Schwartz tells James Cayne he needs to step down as CEO.

In late November and early December, tension mounted as Bear Stearns executives contemplated a bonus pool down significantly from a year earlier. Executives in the stock division blamed their counterparts in bonds.

"Why should we pay those guys anything?" Mr. Meyer, the stock sales and trading executive, at one point demanded in a compensation meeting.

Things only got testier when Bear Stearns announced abysmal fourth-quarter results on Dec. 20. Dragged down by a drop in the value of its mortgage inventory, the company reported its first quarterly deficit since it opened for business in 1923. The bond division, always the firm's cash cow, had a loss of $1.5 billion for the quarter.

At lunchtime the next day, as employees prepared for the holidays, Bear Stearns received bleak news. An email from Pimco, the influential bond fund, said it had become uneasy about the financial sector in general. And the fund wanted to immediately unwind several billion dollars of trades it had agreed to with Bear Stearns.

"This doesn't make any sense," Jim Egan, Bear Stearns's co-head of global sales, said in a hastily arranged conference call with William De Leon, a Pimco risk manager, and William Powers, a Bear Stearns alumnus and Pimco managing director. How could a snap decision throw cold water on such a long-standing relationship with such little warning? If Pimco planned to take such drastic action, Mr. Egan and his colleagues added, the decision should be made "corner office to corner office."

Messrs. De Leon and Powers ultimately agreed to hold off on dramatic moves until January, when they'd have a chance to sit down with senior Bear Stearns executives. But before hanging up, Mr. Powers issued a stern, if familiar, warning: "You need to raise equity," he said.

Many Bear Stearns veterans began pushing hard for Mr. Cayne's ouster, arguing the firm needed a more engaged leader. The dissatisfaction had been building since the summer. It grew after a Nov. 1 story in The Wall Street Journal documenting Mr. Cayne's frequent absences from the office for golf and bridge during the worst of the summer's hedge-fund crisis. The article also mentioned that Mr. Cayne had used marijuana in the past. He told employees in an email the same day that he hadn't "engaged in inappropriate conduct."

Mr. Schwartz was reluctant to push Mr. Cayne out. He had led the company through some great years, Mr. Schwartz believed, and could be trusted to step down on his own.

"Stand calm," he told the protesters. "We've got it under control."

Several top managers began joking that they should hold a sit-in in Mr. Schwartz's 42nd-floor office until he agreed to unseat Mr. Cayne as CEO.

Investors were growing impatient, too. Bear Stearns's fourth-largest shareholder—Bruce Sherman, chief executive of money manager Private Capital Management Inc.—was agitating for a change at the top.

Shortly after the New Year, Mr. Schwartz stopped by Mr. Cayne's office. The pressure inside and outside of the firm for his departure had become too great, he told his boss. It was time to move on.

- **Today: Missed Opportunities.** As the firm's fortunes spiraled downward, executives squabbled over raising capital and cutting its inventory of mortgages.
- **Part Two: Run on the Bank.** Executives believed they were about to turn a corner, but rumors and fear sent clients, trading partners and lenders fleeing.
- **Part Three: Deal or No Deal?** The Fed pressured Bear Stearns to sell itself, but a misstep in the hastily drawn agreement nearly scuttled the deal.

WSJ.com

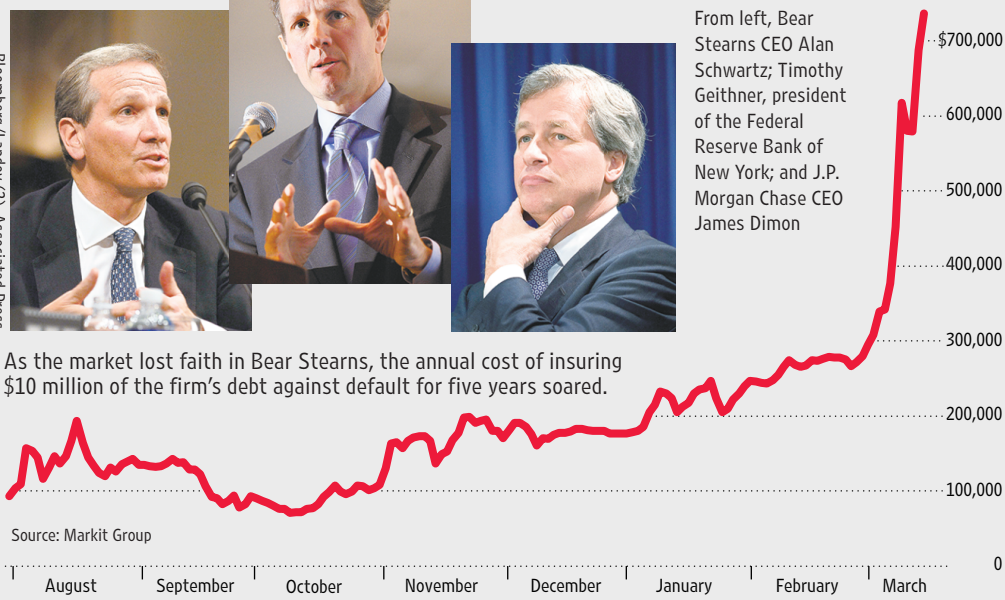
ONLINE TODAY: Review biographical details of the major players in the Bear Stearns deal and see complete coverage of the deal and the credit crunch, at **WSJ.com/BearStearns**.

Fear, Rumors Touched Off Fatal Run on Bear Stearns

Executives Swung From Hope to Despair in the Space of a Week

Bloomberg/Landov (2), Associated Press

From left, Bear Stearns CEO Alan Schwartz; Timothy Geithner, president of the Federal Reserve Bank of New York; and J.P. Morgan Chase CEO James Dimon



As the market lost faith in Bear Stearns, the annual cost of insuring $10 million of the firm's debt against default for five years soared.

Source: Markit Group

THE FALL OF BEAR STEARNS
Second of Three Parts

By Kate Kelly

The 40 top Bear Stearns Cos. executives listening to Alan Schwartz over lunch had spent the morning of March 13 watching the firm's stock plunge. Rumor on Wall Street had it Bear Stearns was strapped for cash.

The chief executive, surrounded by the comforting luster of wood paneling in a 12th-floor dining room, calmly assured his lieutenants that Bear Stearns would weather the storm.

"This," he said, "is a whole lot of noise."

Out in the audience, Michael Minikes wasn't so sure. The 65-year-old Bear Stearns veteran had spent much of that week fielding calls from worried clients. Some had yanked large sums from their Bear Stearns accounts. The worst news had come when Renaissance Technologies Corp., a major hedge fund and trading client, said it was shifting more than $5 billion to competitors.

"Do you have any idea what is going on?" Mr. Minikes asked, cutting off his boss. "Our cash is flying out the door. Our clients are leaving us."

It was the beginning of a frantic 72 hours that would bring the Wall Street firm to its knees and threaten the stability of the global financial system. Interviews with more than two dozen current and former Bear Stearns executives, directors, traders and others involved show how quickly a company that took 85 years to build could unravel.

By the end of business that Thursday, so many clients had pulled their money from Bear Stearns that the firm had run through $15 billion in cash reserves. Lenders such as Fidelity Investments were refusing to replenish the financing Bear Stearns needed to open the next morning. Fellow brokerages Deutsche Bank AG, Goldman Sachs Group Inc. and others were being inundated by requests from clients who wanted to get out of trades with Bear Stearns.

By 7 p.m., things had gotten so bad that Mr. Schwartz interrupted J.P. Morgan Chase & Co. CEO James Dimon's 52nd birthday celebration to gauge his interest in buying Bear Stearns.

The brokerage's sudden fall was a stark reminder of the fragility and ferocity of a financial system built to a remarkable degree on trust. Billions of dollars in securities are traded each day with nothing more than an implicit agreement that trading partners will pay up when asked. When investors became concerned that Bear Stearns wouldn't be able to settle its trades with clients, that confidence evaporated in a flash.

Trading partners, eager to

Please turn to page A13

THE FALL OF BEAR STEARNS

Fear and Rumors Touched Off Fatal Run on Bear Stearns

Continued from Page One
avoid losses, began to disappear almost as quickly. That further fueled rumors of trouble. Some partners, spotting a chance to profit, made bets against Bear Stearns, helping accelerate its demise. Regulators have been investigating whether there was a coordinated effort to fan negative rumors by those betting on Bear Stearns's downfall.

A Gathering Storm...

Troubles interrupt Alan Schwartz's meeting with Disney's Robert Iger.

March had begun on a quiet note for Mr. Schwartz. He had spent months grappling with employees angry about Bear Stearns's handling of the credit crisis. But he was heartened by the way the firm's first-quarter earnings were shaping up: Preliminary figures indicated that it had made profit of more than $1 a share.

Mr. Schwartz was convinced that restive investors would calm down when the figures were released later in the month. In the meantime, the career investment banker advised clients such as Microsoft Corp. on its proposed $45 billion bid for Yahoo Inc.

On Thursday, March 6—as Bear Stearns's shares, which had been as high as $131.58 in October, fell below $70—Mr. Schwartz felt comfortable enough to proceed with plans to speak that evening about the telecommunications industry to the board of Verizon Communications Inc., one of his key clients, at the luxurious Breakers hotel in Palm Beach, Fla. He planned to stay through the weekend, preparing for Bear Stearns's annual media conference, to be held at the same oceanfront resort starting Monday.

The opening day of the conference brought with it a cascade of bad news. First, Moody's Investors Service, a credit-rating firm, downgraded a number of mortgage-backed securities issued by a Bear Stearns affiliate, reflecting concerns that the home loans underlying them were at a greater risk of default by borrowers. Bear Stearns's shares skidded, ending the day at $62.30.

More quietly, Dutch financial-services firm Rabobank Group, one of Bear Stearns's European lenders, told the brokerage at about 11:30 a.m. that it wouldn't renew a $500 million loan coming due later that week. That meant Rabobank, which was concerned about the overall market, was unlikely to renew an additional $2 billion credit agreement set to expire the next week. Bear Stearns, like other securities firms, depends on continuous loans to fund its daily operations. Though Bear Stearns's overall financing from other banks totaled $119 billion, the Rabobank decision signaled that lenders were getting antsy.

A good measure of just how pessimistic Wall Street had become about Bear Stearns that Monday was the cost of certain private financial contracts known as credit-default swaps—a big, barely regulated market where one party, for a price, assumes the risk that a bond or loan will go bad.

On Friday, March 7, the annual cost of a five-year contract to protect against default on $10 million of Bear Stearns debt rose to $458,000—a sum far higher than what investors were paying to insure against repayment failure by rivals such as Lehman Brothers Holdings Inc. and Goldman.

By Monday, that contract's cost jumped to $626,000. Funds and other financial players were betting that Bear Stearns could run out of cash.

The growing gloom spurred some of Bear Stearns's trading partners to try to get out of transactions with the firm. Hedge-fund clients were calling the New York securities branch of Deutsche Bank to ask if the German firm, in exchange for a fee, would buy contracts the funds had signed with Bear Stearns to buy or sell securities. Deutsche Bank agreed to many of these so-called novation requests, but charged more than usual to do so.

Inside Bear Stearns's Madison Avenue headquarters, executives hurried to put out the fires. Chief Financial Officer Samuel Molinaro Jr. and his team began phoning trading partners to check out and quell rumors. The executives emphasized that Bear Stearns had plenty of cash—about $18 billion—to work with, leaving no shortage of money to repay lenders or settle trading contracts.

Down in Palm Beach, Mr. Schwartz was worried about the chaos back home. As he and Walt Disney Co. CEO Robert Iger prepared for a session the next day, Mr. Schwartz was interrupted repeatedly by visits from colleagues and phone calls from Manhattan seeking advice on how to combat the mounting rumors. But Mr. Schwartz was in a box: If he left the conference too hastily, it would betray panic to important, powerful clients such as Mr. Iger and CBS Corp. CEO Leslie Moonves. And, even if he flew back to New York, Mr. Schwartz felt there was little he could do.

Late in the day, Bear Stearns issued a news release, quoting Mr. Schwartz as saying that the company's "balance sheet, liquidity, and capital remain strong."

'Let's Stay Focused'...

Bruce Lisman climbs on a desk to calm his traders.

It did little good. Before Tuesday, March 11, dawned, ING Groep NV told Bear Stearns that it was pulling about $500 million in financing. Staffers at the Dutch bank said ING's management wanted to keep their distance until the dust settled.

As the day progressed, dire rumors kept Bear Stearns's traders distracted, worrying about both their jobs and their savings. Some had a big chunk of their personal wealth tied up in the firm's stock—about half their annual bonus, which comprised the bulk of their annual compensation and took several years to vest.

In the middle of the afternoon, Bruce Lisman, the usually taciturn 61-year-old co-head of Bear Stearns's stock division, climbed atop a desk near his fourth-floor office and demanded his traders' attention. "Let's stay focused," he bellowed. "Keep working hard. Bear Stearns has been here a long time, and we're staying here. If there's any news, I'll let you know, if and when I know it."

Amid the turmoil, Alan "Ace" Greenberg, Bear Stearns's 80-year-old former boss, attempted to break the tension in a lighter way. Wearing his trademark bow tie, Mr. Greenberg, who still trades, performed magic tricks to amuse colleagues. At their request, he also reprised a scene from company lore: He practiced a golf swing on the trading floor, just as he had on Black Monday 1987, when world markets crashed. Mr. Greenberg, who doesn't play the game, had famously pretended to swing a club and loudly announced he was taking the next day off.

There was nothing that could ease the anxiety of clients and trading partners worried about what would happen if their money got locked up in a failing company. Adage Capital Management pulled some of their money out of Bear Stearns's prime-brokerage division, which lends money and processes trades for large clients.

Hedge funds flooded Credit Suisse Group's brokerage unit with requests to take over trades opposite Bear Stearns. In a blast email sent out that afternoon, Credit Suisse stock and bond traders were told that all such novation requests involving Bear Stearns and any other "exceptions" to normal business required the approval of credit-risk managers.

A distorted version of the directive got around to traders at other firms, who began telling associates that Credit Suisse's internal memo warned its traders not to engage in any transactions with Bear Stearns.

Bear Stearns executives believed another public statement was needed. Arrangements were made for Mr. Schwartz to appear from Florida on business network CNBC.

Minutes after 9 a.m. on Wednesday, Mr. Schwartz told the cable-TV audience, "Some people could speculate that Bear Stearns might have some problems...since we're a significant player in the mortgage business. None of those speculations are true."

But before he could get through his talking points—which included mentioning the firm's strong cash reserves and indicating to investors that Bear Stearns would have a profitable first quarter—Mr. Schwartz was interrupted by breaking news from New York: Gov. Eliot Spitzer, having been linked to patronizing prostitutes, was resigning. Mr. Schwartz was dismayed, but got a chance to make his points after the news break.

Afterward, Bear Stearns shares wavered slightly before rising above $66, where they stayed until midafternoon. But prime-brokerage clients continued to pull their money. At midday, the CEO flew home as planned.

Back in New York, he gathered senior executives to discuss how to save the firm. Gary Parr, a Lazard Ltd. investment banker who had done some work for Bear Stearns, was summoned from the Brooklyn theater where he was watching Patrick Stewart play "Macbeth." At intermission, he hailed a cab and headed to Madison Avenue.

Mr. Schwartz also called H. Rodgin Cohen, chairman of the law firm Sullivan & Cromwell, who was home in Irvington, N.Y. Though Bear Stearns hadn't yet seen disastrous outflows of money, Mr. Schwartz said he didn't know what the next day would bring. "I should call the Fed," Mr. Cohen responded.

At about 10:45 p.m., Mr. Cohen called Timothy Geithner, president of the Federal Reserve Bank of New York. He urged the Fed to accelerate a special program for lending to investment banks that was set to begin March 27, and to use its power to lend cash directly to investment banks, which aren't regulated by the Fed.

The latter move would allow Bear Stearns to use its inventory of mortgages and the securities backed by them as collateral to borrow from the Fed's discount window, which was usually reserved for short-term borrowing by commercial banks. Access to that cash would assure it could pay off lenders and trading partners.

"I think I've been around long enough to sense a very serious problem, and this seems like one," Mr. Cohen told Mr. Geithner. He replied, "If he's worried, Alan needs to call me."

Early Thursday morning, Mr. Schwartz called Mr. Geithner to brief him on the situation. But he didn't ask for immediate help, saying he hoped to find longer-term financing through other means.

Shortly before 12:30 that day, Bear Stearns executives began to gather on the 12th floor for a weekly lunch to discuss market issues. The group of about 20 up-and-coming managers, called the President's Advisory Council, had been informed in an email that Mr. Schwartz would be there to discuss "the environment."

The chief executive's presence drew about 20 alumni from previous councils, too. Trays of grilled chicken and sandwiches were laid out on one side of the room, but all eyes were on Mr. Schwartz when he began speaking at about 12:45 p.m.

But the air went out of his reassurances after Mr. Minikes interrupted him to complain that the firm was hemorrhaging cash and clients. Some of the executives drifted out to help with the Renaissance Technologies defection from the firm; others headed back to the trading floor. Word got around that D.E. Shaw & Co. was pulling about $5 billion, joining a list of other hedge-fund clients running for the exits. Many at Bear Stearns spent the afternoon paralyzed as rumors spread.

Searching for Salvation...

Pleas from Bear end James Dimon's birthday dinner.

Around 7 p.m., some of Bear Stearns's top executives gathered in Mr. Molinaro's sixth-floor conference room. The 50-year-old CFO—as always, immaculately dressed, with his salt-and-pepper hair just so—had come to the firm in 1986 as an accountant and, now, was confronting its demise.

"What are my options?" Mr. Molinaro asked Robert Upton, Bear Stearns's treasurer.

Mr. Upton recited the damage from numbers scratched on a yellow legal pad: Since the previous Friday, the firm had nearly exhausted its $18.3 billion in cash reserves, leaving it with $5.9 billion. But it still owed Citigroup Inc. $2.4 billion. Mr. Molinaro buried his head in his hands. Mr. Schwartz looked ashen and left abruptly.

Just a few blocks away on East 48th Street, Mr. Dimon, the J.P. Morgan CEO, was celebrating his birthday with his family at the Greek restaurant Avra. The banker, who could be painfully blunt, was annoyed when his cellphone rang. It was reserved only for immediate family and business emergencies. Reluctantly, he picked up.

It was Mr. Parr, the Lazard banker representing Bear Stearns. He asked if Mr. Dimon could speak with Mr. Schwartz. Moments later, Mr. Schwartz called. "Let's do something," he told Mr. Dimon, who was now on the sidewalk outside. Mr. Dimon couldn't fathom making a deal that night, but he agreed to try to help.

Bear Stearns's offices were then filling up with lawyers. The firm's usual corporate counsel, Cadwalader, Wickersham & Taft LLP, sent over a large team, and dozens of bankruptcy specialists were also called in. The attorneys fanned out over a suite of rooms on the sixth floor: One large group prepared a bankruptcy filing; the other worked on various rescue scenarios involving cash infusions from other parties.

Mr. Schwartz arranged an emergency board meeting to brief directors that Thursday night. It was late, so most phoned in. James Cayne, who'd remained as chairman after stepping down as CEO Jan. 8, missed part of the discussion because he was playing in a bridge tournament at a Detroit hotel.

Directors authorized an emergency bankruptcy filing, but Mr. Schwartz still held out hope that a rescue could be arranged. A bankruptcy filing for Bear Stearns—with its nearly 400 different subsidiaries—would be immensely complicated. If the firm could make it through Friday, executives believed, they could come up with a more tenable fix to their problems.

Around midnight, Matt Zames, a senior J.P. Morgan trader, arrived with a team to look over Bear Stearns's books. The group appeared stunned by its financial position. "We need to talk to the Fed," said Mr. Zames. "Where are they?" Bear Stearns officials directed them down the hall to the firm's legal library, where officials from the New York Fed had been gathered for several hours.

Back in Mr. Molinaro's sixth-floor conference room, he and Mr. Schwartz, who hadn't had time for dinner, ate slices of cold pizza out of the box under a picture recalling flush times: A lithograph of The Wall Street Journal marked the day in 1999 that the Dow Jones Industrial Average hit 10,000 with the headline, "If This Is a Bubble, It Sure Is Hard to Pop."

By early Friday morning March 14, Bear Stearns's managers were running out of steam. No clear solution had yet emerged. It appeared to some that the firm might go under that day. Bear Stearns's financing team—whose job it was to replenish the firm's operational funding by making new lending agreements each morning—began dutifully dialing creditors. On the sixth floor, there was talk of ordering breakfast from Dunkin' Donuts.

At 5 a.m., Mr. Geithner convened a conference call with top government officials, including Federal Reserve Chairman Ben Bernanke and Treasury Secretary Henry Paulson Jr., to discuss the fallout from allowing the brokerage to collapse. They saw ripples spreading to thousands of firms world-wide that would involve trillions of dollars and take days to sort out. As the meeting wore on past the hour mark, Mr. Geithner warned that time was running out. Certain important credit markets were about to open. "What's it going to be?" he demanded.

At about 6:45 a.m., Bear Stearns officials received an email from Stephen Cutler, J.P. Morgan's general counsel. It was the draft of a news release announcing that the bank had agreed to provide Bear Stearns with financing "as necessary" for up to 28 days.

The money underwriting the rescue was coming from the Fed, which was also bearing the risk of the loan. It was the first time since the Great Depression that the Fed had made a loan like this to an entity other than a bank. It would provide the bailout through J.P. Morgan, because as a commercial bank the firm already had access to the Fed's discount window and was under the central bank's supervision.

Inside the sixth-floor conference room where Messrs. Molinaro, Upton and others had huddled, executives cheered and exchanged high-fives. They thought they had four weeks to sort out their problems.

— Greg Ip contributed to this article.

Series at a Glance

- **Part One: Missed Opportunities.** As the firm's fortunes spiraled downward, executives squabbled over raising capital and cutting its inventory of mortgages.
- **Today: Run on the Bank.** Executives believed they were about to turn a corner, but rumors and fear sent clients, trading partners and lenders fleeing.
- **Part Three: Deal or No Deal?** The Fed pressured Bear Stearns to sell itself, but a misstep in the hastily drawn agreement nearly scuttled the deal.

WSJ.com

ONLINE TODAY: Review biographical details of major players in the Bear Stearns deal, read the first article in this series and see complete coverage of the deal, at **WSJ.com/BearStearns**.

ILLUSTRATIONS BY TIM BOWER

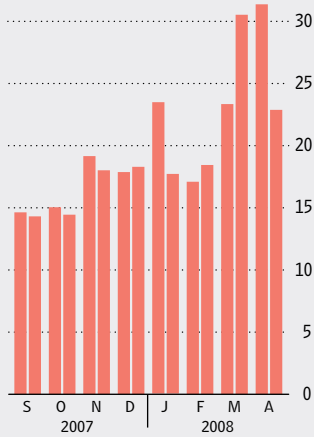
Bear Stearns Neared Collapse Twice in Frenzied Last Days

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

UPI/Landov (Paulson), UPI/NewsCom

Treasury Secretary Henry Paulson Jr. (above), J.P. Morgan CEO James Dimon (center), and Bear Stearns CEO Alan Schwartz

As the troubles at Bear Stearns came to a head, market players ramped up their bets against the company's stock. Short-interest positions, in millions ►



Note: Data reported twice a month
Source: Factset via WSJ Market Data Group

By Kate Kelly

THE FALL OF BEAR STEARNS
Last of Three Parts

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

Please turn to page A14

THE FALL OF BEAR STEARNS

Bear Stearns Neared Collapse Twice in Frenzied Last Days

Continued from Page One

agreed to a price of about $10 a share, which stockholders are poised to approve at a meeting Thursday.

Sign of Weakness...

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

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.

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.

A Quick Sale...

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

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.

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.

"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.

An Angry Time...

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

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.

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.

Series at a Glance

- **Part One: Missed Opportunities.** As the firm's fortunes spiraled downward, executives squabbled over raising capital and cutting its inventory of mortgages.
- **Part Two: Run on the Bank.** Executives believed they were about to turn a corner, but rumors and fear sent clients, trading partners and lenders fleeing.
- **Today: Deal or No Deal?** The Fed pressured Bear Stearns to sell itself, but a misstep in the hastily drawn agreement nearly scuttled the deal.

WSJ.com

ONLINE TODAY: Review biographical details of major players in the Bear Stearns deal, read the first two articles in this series and see complete coverage of the deal at **WSJ.com/BearStearns**.

ILLUSTRATIONS BY TIM BOWER