

THE WALL STREET JOURNAL

WSJ.com

BUSINESS | DECEMBER 29, 2008

The Weekend That Wall Street Died

Ties That Long United Strongest Firms Unraveled as Lehman Sank Toward Failure

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With his investment bank facing a near-certain failure, [Lehman Brothers Holdings Inc.](#)'s chief executive officer, Richard Fuld Jr., placed yet another phone call to the man he thought could save him.

Mr. Fuld was already effectively out of options by the afternoon of Sunday, Sept. 14. The U.S. government said it wouldn't fund a bailout for Lehman, the country's oldest investment bank. Britain's Barclays PLC had agreed in principle to buy the loss-wracked firm, but the deal fell apart. [Bank of America Corp.](#), initially seen as Lehman's most likely buyer, had said two days earlier that it couldn't do a deal without federal aid -- and by Sunday was deep in secret negotiations to take over Lehman rival Merrill Lynch & Co.

Desperate to avoid steering his 25,000-person company into bankruptcy proceedings, Mr. Fuld dialed the Charlotte, N.C., home of Bank of America Chairman Kenneth D. Lewis. His calls so far that weekend had gone unreturned. This time, Mr. Lewis's wife, Donna, again picked up, and told the boss of Lehman Brothers: If Mr. Lewis wanted to call back, he would call back.

Mr. Fuld paused, then apologized for bothering her. "I am so sorry," he said.

His lament could also have been for the investment-banking model that had come to embody the words "Wall Street." Within hours of his call, Lehman announced it would file for bankruptcy protection. Within a week, Wall Street as it was known -- loosely regulated, daringly risky and lavishly rewarded -- was dead.

As Mr. Fuld waged his increasingly desperate bid to save his firm that weekend, the bosses of Wall Street's other three giant investment banks were locked in their own battles as their firms came under mounting pressure. It was a weekend unlike anything Wall Street had ever seen: In past crises, its bosses had banded together to save their way of life. This time, the financial hole they had dug for themselves was too deep. It was every man for himself, and Mr. Fuld, who declined to comment for this article, was the odd man out.

For the U.S. securities industry to unravel as spectacularly as it did in September, many parties had to pull on many threads. Mortgage bankers gave loans to Americans for homes they couldn't afford. Investment houses packaged these loans into complex instruments whose risk they didn't always understand. Ratings agencies often gave their seal of approval, investors borrowed heavily to buy, regulators missed the warning signs. But at the center of it all -- and paid hundreds of millions of dollars during the boom to manage their firms' risk -- were the four bosses of Wall Street.

Details of these CEOs' decisions and negotiations, many of them previously unreported, show how they sought to avert the death of America's giant investment banks. Their efforts culminated in a round-the-clock weekend of secret negotiations and personal struggles to keep their firms afloat. Accounts of these events are based on company and other documents, emails and interviews with Wall Street executives, traders, regulators, investors and others.

Summer Clouds

Earlier this year, when the financial crisis claimed its first victim, Bear Stearns Cos., the surviving masters of Wall Street thought the eye of the storm had passed. Bear Stearns, the smallest of Wall Street's big five stand-alone investment banks, imploded just months after bad subprime bets sunk two internal hedge funds. In March 2008, the government brokered Bear Stearns's sale to [J.P. Morgan Chase & Co.](#)

After Bear Stearns's brush with death, the Federal Reserve for the first time allowed investment houses to borrow from the government on much the same terms as commercial banks. Many on Wall Street saw investment banks' access to an equivalent of the Fed "discount window" as a blank check should hard times return. But it would also be the first step in giving the government more say over an industry that had until then been lightly regulated.

In April, Morgan Stanley's CEO, John Mack, told shareholders the U.S. subprime crisis was in the eighth or ninth inning. The same month, Goldman Sachs Group Inc.'s chief executive, Lloyd Blankfein, said, "We're probably in the third or fourth quarter" of a four-quarter game.

Messrs. Mack and Blankfein had some reason to be confident. Mr. Mack had been late to steer Morgan into mortgage trading, and relatively early to sell assets and raise cash. Goldman, under Mr. Blankfein, had even less direct exposure to subprime investments. Mr. Blankfein also took comfort in a stockpile of government bonds and other securities his firm held in case it ran into deep funding problems. By the second quarter, Goldman had increased this store of funds more than 30% from earlier in the year, to \$88 billion.

Problems were more acute at Merrill Lynch and Lehman.

John Thain, a former Goldman Sachs president and New York Stock Exchange head, had arrived at Merrill Lynch in December 2007. He moved quickly to cut costs, putting the corporate helicopter up for sale and replacing the fresh flowers on a Merrill floor used by nine or so executives -- an estimated annual expense of \$200,000 -- with fakes.

More monumentally, Mr. Thain faced \$55 billion in soured mortgage assets that Merrill had acquired under his predecessor. Within weeks of his arrival, he had raised more than \$12 billion in much-needed capital, including \$5 billion from Singapore's state investment company, Temasek Holdings, at \$48 a share.

Some of those early deals would end up being costly. With his would-be investors driving a hard bargain, Mr. Thain promised Temasek and others that if Merrill sold additional common stock at a lower price within a year, the firm would compensate them. Within months, after taking a big write-down on a portfolio of mortgage debts that Merrill sold for pennies on the dollar, the firm had to raise more cash at \$25 a share. Merrill issued additional shares to pay off its earlier investors, diluting its common shares by 39%. The dilution essentially cost shareholders about \$5 billion, well above the previously reported \$2.5 billion cost of shares issued to Temasek.

Lehman, now the smallest of the major Wall Street firms, also faced billions of dollars in write-downs from bad mortgage-related investments. In June, Lehman reported the first quarterly loss in its 14 years as a public company. Under Mr. Fuld, Lehman raised capital. But critics say Mr. Fuld was slow to shed bad assets and profitable lines of business. He pushed for better terms with at least one investor that ended up driving it away.

Mr. Fuld had faced challenges to his firm before. Since taking Lehman's reins in 1994, he expanded the 158-year-old bond house into lucrative areas such as investment banking and stock trading. Over the years, he had tamped unfounded rumors about the firm's health and vowed to remain independent. "As long as I am alive this firm will never be sold," Mr. Fuld said in December 2007, according to a person who spoke with him then. "And if it is sold after I die, I will reach back from the grave and prevent it."

In the summer of 2008, Mr. Fuld remained confident, particularly given the security of the Fed's discount window. "We have access to Fed funds," Mr. Fuld told executives at the time. "We can't fail now."

Friday, Sept. 12

By Friday, Sept. 12, failure appeared to be an option for Lehman.

Over that week, confidence in Lehman plunged. The firm said its third-quarter losses could total almost \$4 billion. Lehman's clearing bank, J.P. Morgan, wanted an extra \$5 billion in collateral. Lehman's attempts to raise money from a Korean

bank had stalled. Credit agencies were warning that if Lehman didn't raise more capital over the weekend, it could face a downgrade. That would likely force the firm to put up more collateral for its outstanding loans and increase its costs for new loans.

If Mr. Fuld couldn't find an investor for Lehman by Sunday night, the fiercely independent boss could be forced to steer his firm into bankruptcy proceedings.

Earlier that week, Mr. Fuld had approached Bank of America's Mr. Lewis about buying Lehman. A U.S. Treasury official, meanwhile, had contacted Barclays of Britain to suggest it consider taking a stake in Lehman. Mr. Fuld's top executives spent Friday shuttling between the two suitors' law firms.

Lehman was also exploring a third option: The night before, veteran bankruptcy lawyer Harvey Miller of Weil, Gotshal & Manges had secretly begun cobbling together a bare-bones bankruptcy filing for the firm.

Lehman's troubles were putting the rest of Wall Street on notice.

In a Merrill Lynch conference room in downtown Manhattan that morning, Mr. Thain was on a call with Merrill's board of directors, discussing how to address the chaos. "Lehman is going down, and the [short sellers] are coming after us next," warned Merrill director John Finnegan. "Tell me how this story is going to end differently."

Merrill would be fine, Mr. Thain said. "We are not Lehman," he responded, noting the firm held valuable assets, including its stake in [BlackRock](#), a profitable asset-management firm.

But Merrill's clients, too, were beginning to pull out money. The firm's stock was sinking. Executives, including Merrill President Gregory Fleming, were nervous.

Mr. Fleming believed he'd identified the ideal partner for Merrill. Bank of America, with a strong balance sheet and retail operations, would mesh well with Merrill's securities franchise and 16,000-strong brokerage force. Mr. Fleming worried that Bank of America could buy Lehman instead.

Mr. Fleming called a long-time lawyer for Bank of America, Edward Herlihy of Wachtell, Lipton, Rosen & Katz. "You have to talk to us," Mr. Fleming said. He was told that Merrill's Mr. Thain would have to approach Bank of America's Mr. Lewis. "I know," Mr. Fleming responded. "I'm gonna try."

At 5 p.m. Friday, after a day of massive client withdrawals at Lehman, Mr. Thain's phone rang. It was the Treasury. "Be at the Fed at 6 p.m.," Mr. Thain was told.

Soon after, Mr. Thain gathered along with Morgan's Mr. Mack and Goldman's Mr. Blankfein at the New York Federal Reserve in downtown Manhattan, in a room once used to cash coupons on

Treasury bills. The three men were greeted by the masters of the world's biggest economy -- Federal Reserve Chairman Ben Bernanke, Treasury Secretary Henry Paulson, New York Fed Chief Timothy Geithner and Securities and Exchange Commission chief Christopher Cox. It was a signal moment for the Wall Street firms, which after years of being monitored by the SEC would all soon come under the regulatory watch of a newly powerful Fed.

The federal officials told the Wall Street chiefs to return in the morning. If the mess at Lehman could be fixed, it would be the job of the Wall Street bosses. There would be no public bailout.

An industry-led solution wouldn't be without precedent. In the market panic of 1907, financier J.P. Morgan persuaded fellow bankers to help fund a bailout for failing rivals. Competitors united again in 1998, putting up money to insulate the financial system from the failure of hedge fund Long Term Capital Management.

But now, Mr. Fuld's problems at Lehman were possibly beyond repair.

By that night, Bank of America's team had concluded that Lehman's real-estate portfolio was worse than expected -- and as a result, the firm's liabilities likely exceeded its assets. "We need government assistance, and we are not getting it," the bank's top deal maker, Greg Curl, told his group. Some of the negotiators prepared to fly back early the next morning to headquarters in Charlotte.

Mr. Lewis hadn't come to New York for the Lehman talks. He called Mr. Fuld from Charlotte, telling him that Bank of America couldn't do a deal without federal help. "We will keep a team in New York in case things change," Mr. Lewis told him.

Saturday, Sept. 13

Mr. Fuld arrived at Lehman's office at 7 a.m. on Saturday, wearing a blue suit and tie. The talks with Barclays were still moving. If the government could be moved, there could also be hope for a Bank of America deal.

Merrill, meanwhile, was beginning its own pursuit of Bank of America.

At his home in Rye, N.Y., Mr. Thain was getting dressed for a day at the New York Fed when his phone rang. It was Merrill's president, Mr. Fleming.

"John, you really need to call Ken Lewis," Mr. Fleming said.

"Get me his number," said Mr. Thain, who added it to his papers for the day.

Mr. Thain's black SUV pulled up in front of the New York Fed just before 8 a.m. Top executives from all four investment banks -- minus Lehman's Mr. Fuld -- were there.

Federal officials broke Messrs. Thain, Mack and Blankfein and their top aides into groups. One studied the potential fallout from a Lehman failure. Another was charged with putting a value on Lehman's controversial real-estate investments. A third group, which included Mr. Thain and Morgan's Mr. Mack, was supposed to discuss an industry-led bailout for Lehman.

Lehman's president, Bart McDade, walked the group through the embattled firm's books. Mr. McDade did not respond to requests for comment for this article.

Mr. Mack questioned Wall Street's ability to repair markets. The firms could try to backstop Lehman, he argued, but there was no guarantee they wouldn't have to rescue another rival later. "If we're going to do this deal, where does it end?" he said.

As Mr. McDade discussed Lehman's position, Mr. Thain had an epiphany: "This could be me sitting here next Friday."

Mr. Thain pushed his chair back and left the group to caucus with top Merrill officers. "Lehman is not going to make it," he told them.

Mr. Thain stepped to a sidewalk behind the New York Fed and called the Bank of America chief at his home in Charlotte. "I can be there in a few hours," Mr. Lewis said.

Members of Bank of America's deal team, exhausted from scrutinizing Lehman's books, had just landed in Charlotte. Mr. Lewis ordered them back to New York.

Up in Lehman's midtown office, Mr. Fuld was also dialing Mr. Lewis's North Carolina home. His calls went unreturned. "I can't believe that son of a bitch won't return my calls," he told a top adviser.

Lehman's bankruptcy team, meanwhile, was rolling into action. Shortly before noon, Mr. Miller, the Weil Gotshal bankruptcy head, sent an email to several partners. Lehman's name didn't appear in the email. Its subject line read: "Urgent. Code name: Equinox. Have desperate need for help on an emergency situation."

Throughout the day, Mr. Miller's attorneys, working with Federal Reserve officials and their attorneys, began seeking information from Lehman. But with Lehman's top officials tied up at the Fed and in Barclays negotiations, the lawyers were hard-pressed to get the details they needed.

"We were a distraction to the Lehman people," said Lori Fife, a Weil partner. "It felt like it was just a fire drill."

Later that afternoon, Merrill's chief executive met Bank of America's CEO, Mr. Lewis, in the bank's corporate apartment in the Time Warner Center. In a one-on-one meeting overlooking Central Park, the two men agreed that it looked like Lehman would be forced into bankruptcy.

Mr. Thain made his opening offer. "How about buying a 9.9% stake" in Merrill, he proposed.

Mr. Lewis said the bank doesn't tend to buy minority stakes. He suggested Bank of America could buy the whole firm.

"I am not here to sell Merrill Lynch," Mr. Thain responded.

"Well, that is what I want," Mr. Lewis countered.

The two parted with an agreement to keep talking.

Lehman's talks with Barclays, meanwhile, were moving forward at the New York Fed, under the eye of government officials.

"Shouldn't I be there?" Mr. Fuld said to Lehman President Mr. McDade and to attorney Rodgin Cohen of Sullivan & Cromwell LLP, a longtime adviser.

What Mr. Fuld appeared not to know was that some top government officials had instructed key Lehman representatives at the Fed building to keep Mr. Fuld away that weekend. The federal officials had explained that Mr. Fuld -- not only Wall Street's longest-serving boss, but a director of the New York Fed -- could be an unnecessary distraction and a lightning rod for criticism.

At the Fed meetings, much of the talk was on the sidelines. When Mr. Thain returned to the New York Fed from his discussions with Mr. Lewis, Merrill advisers told him they had been approached by top Goldman executives. The rival house was interested in taking a 9.9% stake in Merrill and offered to extend a \$10 billion line of credit.

Mr. Thain was digesting the news when he was approached by Mr. Mack of Morgan Stanley. "We should talk," Mr. Mack said. The bosses of Merrill and Morgan agreed to meet that evening. Soon, Mr. Thain and two advisers were en route to the Upper East Side apartment of a Morgan co-president.

Mr. Thain drank a Diet Coke as the Morgan and Merrill executives talked. Both sides felt there were benefits to merging. Mr. Thain indicated he needed a deal quickly. The meeting ended without a firm plan. "We have a board meeting Tuesday and can get back to you soon," Mr. Mack said before the group broke up.

As Mr. Thain and his advisers left the apartment, the Merrill chief suggested he had faint hopes for a deal with Morgan Stanley. "I don't think they share our sense of urgency," he said.

Merrill's talks with Bank of America, however, were on track at the bank's law firm, Wachtell Lipton. Merrill's team was camped out on Wachtell's 34th floor. Bank of America's team was on the 33rd. Around midnight, Mr. Lewis left the law firm for his apartment in the Time Warner Center. Pizza arrived at Wachtell at 3 a.m.

At Lehman's offices that evening, Mr. Fuld still hadn't heard back from Mr. Lewis. Attorneys from Weil were poring through

documents, drawing up what would be the largest bankruptcy in U.S. history.

But in a rare piece of good news for Lehman, Barclays had agreed to buy Lehman, as long as it didn't have to take on its soured real-estate assets. Lehman's asset-management division would also be spun off. The Fed indicated that a syndicate of banks and brokers had agreed in principle to put up enough capital to support a separate company that would hold Lehman's bad real-estate assets.

Sunday, Sept. 14

A few hours later, at 8 a.m., Mr. Thain arrived at the Time Warner Center for a second one-on-one meeting in Mr. Lewis's corporate apartment. Over coffee, Mr. Thain made his case for a strong price for Merrill despite its stock's recent fall.

At the same time, Merrill officials were huddled with Goldman bankers. Some members of Merrill's team doubted that Goldman could save their firm by taking a 9.9% stake. Pete Kelly, a top Merrill lawyer, also had his reservations about letting rival Goldman see his firm's books. Still, the sides set a late-morning meeting at Merrill's offices.

At 9 a.m., the chiefs of finance arrived again at the New York Fed for a second day of meetings. By the time Mr. Thain arrived, the Merrill chief had a number of options in his back pocket.

Rolling up to the meetings at around the same time was Goldman's chief, Mr. Blankfein. A Goldman aide, referring to days of meltdowns and meetings, carped to Mr. Blankfein: "I don't think I can take another day of this."

Mr. Blankfein retorted: "You're getting out of a Mercedes to go to the New York Federal Reserve -- you're not getting out of a Higgins boat on Omaha Beach," he said, referring to the World War II experience of a former Goldman head. "So keep things in perspective."

At Lehman that morning, Mr. Fuld told his board of directors to gather at the firm's offices. By noon, he expected, the board would be able to approve Lehman's sale to Barclays.

One hurdle remained: To ink a Lehman deal, Barclays needed a shareholder vote. There was no way to get one on a Sunday. Barclays would need the U.S. or British government to back Lehman's trading balances until a vote could be held.

Government approval never came, though there are diverging views on why. Some blame the U.S. government for refusing to commit resources. Others say the British government refused to entertain a deal they worried would expose England to unnecessary risk.

Lehman's president, Mr. McDade, and Mr. Cohen, the attorney, called Mr. Fuld from the New York Fed. Passing Mr. McDade's cellphone back and forth, they broke the Barclays news.

Mr. Fuld postponed his board meeting. He made one more call to Charlotte, answered by Mr. Lewis's wife.

By midafternoon, word emerged that Bank of America was in talks with Merrill Lynch. Mr. Cohen, the attorney, broke the news to Mr. Fuld. "I guess this confirms our worst fears," Mr. Fuld said.

At the Fed, the Lehman executives and their bankruptcy attorneys faced roughly 25 officials from the Fed, Treasury and SEC. The Lehman officials pleaded for federal aid to keep Lehman afloat. But with Barclays and Bank of America off the table, Federal officials wanted a plan in place to soothe markets before trading opened in Asia.

A senior Fed official asked Mr. Miller, the Weil veteran who'd been involved in bankruptcy filings of companies including Bethlehem Steel and Marvel Entertainment, if Lehman was ready to file.

"No," Mr. Miller answered.

"You need more of a plan to prepare to do this," Mr. Miller continued. Lehman had tens of billions of dollars in derivative positions with countless parties. Unless these trades were unwound in an orderly way, it could shock all corners of the financial market. "This will cause financial Armageddon," he said.

Now, Merrill's Mr. Thain needed his own deal more than ever. With a Morgan tie-up looking like a long shot, Merrill focused its attentions on Goldman and Bank of America.

Tempers at Merrill flared as two rival teams pored over the firm's records. Merrill's head of strategy Peter Kraus, a Goldman alumnus hired by Mr. Thain, wanted to pull some of the firm's due-diligence staff away from the Bank of America project to look at Goldman's offer. "We need some people down here," Mr. Kraus said.

"We have a great deal in hand, and need to finish doing this deal," retorted Mr. Fleming, Merrill's president. A few minutes later, Mr. Thain called Mr. Fleming, telling him to send some people to work on the Goldman offer.

Mr. Fleming and Bank of America's lead negotiator, Mr. Curl, hammered out a price. Bank of America would buy Merrill for \$29 a share.

Mr. Fleming informed Mr. Thain. At 6 p.m., Merrill's top managers and directors gathered in person and by phone.

"When I took this job this was not the outcome I intended," Mr. Thain told directors. After the board meeting broke up after 8 p.m., Mr. Thain called the chief of Bank of America. "The decision was unanimous," Mr. Thain told Mr. Lewis. "You have a deal."

A more somber scene was playing out at Lehman. Directors, who

had been camped at the Midtown offices all day, gathered at around 8 p.m. in the firm's board room. Weil lawyers and Lehman executives summarized the Fed meeting to the frustrated board.

"They bailed out Bear," said Roland Hernandez, the former CEO of Spanish-language TV network Telemundo and a longtime Lehman board member. "Why not us?"

One of Mr. Fuld's assistants broke in to hand him a note: The SEC chairman wanted to address Lehman's board by speakerphone.

Mr. Cox, criticized for his allegedly minor role in the government's bailout of Bear Stearns, had been reluctant to call Lehman. The SEC chief finally called from the New York Fed, surrounded by several staffers, at the urging of Mr. Paulson, the Treasury secretary.

"This is serious," said Mr. Cox. "The board has a grave matter before it," he said.

John D. McComber, a former president of the Export-Import Bank and a Lehman director for 14 years, asked: "Are you directing us to authorize" a bankruptcy filing?

The SEC chief muted his phone. A minute later, he came back on the line. "You have a grave responsibility and you need to act accordingly," he replied.

As the meeting wrapped up around 10 p.m., Mr. Fuld, his suit jacket now off, leaned back in his chair. "I guess this is goodbye," he said. Lehman would file about four hours later.

Just a few blocks away, Merrill and Bank of America executives met to toast their deal. "I look forward to a great partnership with Merrill Lynch," Mr. Lewis said around midnight, a glass of champagne in hand.

The End

Rather than soothing markets, Lehman's bankruptcy filing roiled them -- slamming trading partners that had direct exposure to the firm and sowing fears that Wall Street's remaining giants weren't safe from failure. Shares of Morgan and Goldman plunged. In the credit-default swap market, the price of insurance against defaults of Morgan and Goldman soared.

Hedge funds sought to withdraw more than \$100 billion in assets from Morgan Stanley. The firm's clearing bank, Bank of New York Mellon, wanted an extra \$4 billion in collateral.

Morgan's chief, Mr. Mack, negotiated a cash infusion from Japan's [Mitsubishi UFJ Financial Group](#). Fed and Treasury officials, concerned that a deal could be derailed by a declining Morgan share price, asked if Mr. Mack had other options. One regulator suggested Morgan Stanley consider selling itself to J.P. Morgan -- from which it had been famously split, 73 years earlier, amid

post-Depression banking reform laws.

"We're going to get Mitsubishi done. There is no Plan B," Mr. Mack told one regulator.

Morgan did the deal. But investor fears remained. By Thursday, Fed officials were urging Morgan to become a commercial bank. Such a move would require Morgan to scale back its bets with borrowed money, run the risk of selling lucrative business lines and accept new onsite regulation from the Fed.

Mr. Mack consented, and the following weekend, Morgan Stanley formally ceased to be a securities firm.

The same weekend, Mr. Blankfein convened top lieutenants on his 30th-floor office. After 139 years as a securities firm, he said, Goldman, too, would also reshape itself as a commercial bank. Within hours, the era of Wall Street's giants was over.

—Dan Fitzpatrick contributed to this article.

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