Case Study of the Merger between Bank of America and Merrill Lynch

Robert J. Rhee[†]

The financial crisis of 2008 has posed innumerable problems in law, policy, and economics. A key event in the history of the financial crisis was Bank of America's acquisition of Merrill Lynch. Along with the fire sale of Bear Stearns and the bankruptcy of Lehman Brothers, the rescue of Merrill Lynch confirmed the worst fears about the financial crisis. Before this acquisition, Bank of America had long desired a top tier investment banking business, and Merrill Lynch represented a strategic opportunity to acquire a troubled but premier franchise of significant scale.[1] As the financial markets continued to unravel after execution of the merger agreement, this golden opportunity turned into a highly risky gamble. Merrill Lynch was losing money at an astonishing rate, an event sufficient for Bank of America to consider seriously invoking the merger agreement's material adverse change clause.[2] The deal ultimately closed, but only after the government threatened to fire Bank of America's management and board if the company attempted to terminate the deal. The government took this coercive action to save the financial system from complete collapse. The harm to the financial system from a broken deal, officials feared, would have been unthinkable. The board's motivation is less clear. Like many classic corporate law cases, the factors influencing the board and management were complex. This case study examines these complexities, which raise important, unresolved issues in corporate governance and management.

In 2008, three major investment banks—Bear Stearns, Lehman Brothers, and Merrill Lynch—collapsed or were acquired under distress, and these events played a large part in triggering the global financial crisis.[3] In March, Bear Stearns

---

[†] Associate Professor of Law, University of Maryland School of Law; J.D., The George Washington University; M.B.A., University of Pennsylvania (Wharton); B.A., University of Chicago.

[1] Bank of America formed from the acquisition of BankAmerica by NationsBank in 1998. NationsBank was an aggressive, acquisitive bank under the leadership of Hugh McColl, whom Ken Lewis would ultimately succeed as chief executive officer ("CEO"). Before the acquisition of BankAmerica, NationsBank had sought an investment banking franchise, and following this strategy acquired in 1997 Montgomery Securities, a midsized San Francisco-based investment bank. Peter Truell, *Nationsbank Confirms a $1.2 Billion Deal for Montgomery*, N.Y. TIMES, July 1, 1997, at D5. The acquisition of Merrill Lynch is a continuation of Bank of America's ambition in investment banking.

[2] *See infra* Part I (describing the events surrounding the acquisition of Merrill Lynch and the testimonies of key principals).

[3] *See generally* Robert J. Rhee, *The Decline of Investment Banking: Preliminary Thoughts on the Evolution of the Industry 1996–2008*, 5 J. BUS. L. & TECH. (forthcoming 2010) (discussing the collapse of the investment banking sector). At the time, there were only five full service, independent investment banks left after the industry consolidation of the 1990s and the repeal of the Glass-Steagall Act. *Id.* The banks were Goldman Sachs, Morgan Stanley, Merrill Lynch, Lehman Brothers, and Bear Stearns. *Id.*

had already agreed to be sold in a fire sale to JPMorgan Chase.[4] This sale was a harbinger of the worst to come. By late summer, many of the largest, most important domestic and foreign financial institutions faced extraordinary peril, including Citigroup and American International Group ("AIG"), two of the largest American financial institutions at the time.[5] On September 15, Lehman Brothers announced its bankruptcy, and Bank of America ("the Bank") and Merrill Lynch ("Merrill") announced their merger.[6] If the fall of Bear Stearns was the first major tremor in the financial markets, the bankruptcy of Lehman Brothers triggered a seismic change from market disturbance to market failure. The pending merger between the Bank and Merrill subsequently got caught in this tectonic shift. Like everything else affected by the market meltdown, the merger's fate faced great uncertainty and the events leading to the ultimate closing of this landmark deal constitute a major episode of the history of Wall Street and the financial crisis of 2008.

A. *Acquisition in Crisis*

The merger proxy recounts the extraordinary circumstances under which this acquisition was struck.[7] On Saturday, September 13, Ken Lewis and John Thain, the CEOs of the Bank and Merrill, respectively, met to discuss a strategic relationship.[8] Thain proposed a 9.9 percent minority investment in Merrill, but Lewis wanted a whole acquisition.[9] Lewis quickly got his way, and they agreed on an acquisition. Due diligence commenced that day and continued well into Sunday night.[10] During these frantic two days, the two parties negotiated the terms of the merger.[11] The deal was structured as a stock exchange with Merrill shareholders getting 0.8595 shares of the Bank's stock for each share of Merrill stock.[12] This constituted a hefty 70 percent premium over the previous Friday's closing share

---

[4] The purchase price was about $10 per share. *See* Kahan & Rock, *supra* note **Error! Bookmark not defined.**, at 716-21 (describing the circumstances surrounding the deal). A year before, Bear Stearns shares traded at $170 per share. Andrew Ross Sorkin & Landon Thomas, Jr., *JPMorgan Acts to Buy Ailing Bear Stearns at Huge Discount*, N.Y. TIMES, Mar. 24, 2008, at A1.
[5] *See* Joe Nocera, *36 Hours of Alarm and Action as Crisis Spiraled*, N.Y. TIMES, Oct. 2, 2008, at A1 (describing the crisis and the troubles of financial institutions).
[6] Andrew Ross Sorkin, *Bids to Halt Financial Crisis Reshape Landscape of Wall St.,* N.Y. TIMES, Sept. 15, 2008, at A1.
[7] BANK OF AM. CORP. & MERRILL LYNCH & CO., MERGER PROXY 49-51 (Nov. 3, 2008) [hereinafter "MERGER PROXY"].
[8] *Id.* at 49. Lewis has been the Bank's chief executive officer since 2001. During the period analyzed here, mainly from September 2008 to January 2009, he was also the chairman of the board. On April 29, 2009, he was replaced by Walter Massey as chairman, though he remained a board member. Press Release, Bank of Am., *Bank of America Announces Results of Annual Meeting* (Apr. 29, 2009). Thain was appointed chief executive officer of Merrill in December 2007. He resigned from Merrill shortly after the merger closed in January 2009. Julie Creswell & Louise Story, *Merrill Lynch's leader gets the ax*, HOUSTON CHRONICLE, Jan 23, 2009, at A1. Subsequently, Lewis also announced his early resignation. *See* WILLIAM D. COHAN, HOUSE OF CARDS: A TALE OF HUBRIS AND WRETCHED EXCESS ON WALL STREET 109 (2009).
[9] MERGER PROXY, *supra* note 15, at 49.
[10] *Id.* at 49-50.
[11] *Id.* at 50.
[12] *Id.* at 5.

prices of the two companies,[13] and valued Merrill at a multiple of 1.8x tangible book value.[14] In late Sunday afternoon, the financial advisers informed the Bank's board about the results of the due diligence and provided their fairness opinions.[15] The boards of the two banks unanimously approved the merger.[16] The merger agreement was signed on early Monday morning.[17]

The loss of Bear Stearns, Lehman Brothers and Merrill—three of only five full-service, independent investment banks remaining on Wall Street at the time—in rapid succession was inconceivable only a few months before.[18] By the time the Merrill acquisition was announced on Monday, September 15, the stock market crash was well underway. The S&P 500 index was down 24 percent from its October 2007 historic highs.[19] A few weeks later, in October 2008, the equity market fell off the cliff and the S&P 500 index was down 43 percent from the year before.[20] The stock market crash reflected broader economic problems such as the crash of the housing market, severe disturbances in the credit markets, illiquidity contagion among financial institutions, global recession, and increasing unemployment.[21] The most troubling and dangerous of these factors was a liquidity crisis in the credit markets, including commercial paper, repo, and money markets that fund operating cash flow for many businesses.[22] Investment banks were not immune, and indeed they were especially vulnerable to a disturbance in the credit market because of their highly leveraged balance sheets.[23] An inability to fund working capital had the potential to wreck havoc by impairing the flow of credit even in healthy, nonfinancial sectors of the economy.[24] According to Ben Bernanke, a prominent scholar of the Great Depression and current Chairman of the Federal Reserve, "the financial shocks that hit the global economy in September and October were the worst since the 1930s, and they helped push the global economy

---

[13] *Id.* at 53. On September 12, 2008, the Bank's stock price closed at $33.74 and Merrill's stock closed at $17.05, implying a deal value of $29 per share of Merrill stock. *Id.* at Letter to Shareholders. Subsequently, on October 30, the Bank stock closed at $22.78 and Merrill's stock, which by this time was closely pegged to the Bank's stock price, was $17.78. *Id.* at 8.

[14] *Bank of America Buys Merrill Lynch, Creating Unique Financial Services Firm*, Bank of America Press Release (Sept. 15, 2008), *available at* http://www.ml.com/?id=7695_7696_8149_88278_106886_108117.

[15] Merger Proxy, *supra* note 15, at 51.

[16] *Id.*

[17] *Id*.

[18] *See generally* Rhee, *supra* note 11 (discussing the demise of Bear Stearns, Lehman Brothers, and Merrill Lynch, and generally the problems independent investment banks confronted during the financial crisis).

[19] On October 9, 2007, the S&P 500 closed at 1565.15. On September 15, 2008, it closed at 1192.7. Index price information is available on http://finance.yahoo.com.

[20] On October 10, 2008, the S&P 500 closed at 899.22. On March 9, 2009, the index closed at 676.53, down 57 percent from the historic high on October 9, 2007. Index price information is available on http://finance.yahoo.com.

[21] *See generally* MARK ZANDI, FINANCIAL SHOCK: GLOBAL PANIC AND GOVERNMENT BAILOUTS—HOW WE GOT HERE AND WHAT MUST BE DONE TO FIX IT (FT Press 2009).

[22] Conrad de Aenlle, *It Couldn't Get Worse, But It Did*, N.Y. TIMES, Oct. 12, 2008 at BU19 (noting that credit markets were seizing up and investors were withdrawing money from the commercial paper market). *See also* Carter Dougherty & Katrin Bennhold, *Credit Squeeze Takes Hold in Europe,* N.Y. TIMES, Oct. 11, 2008, *available at* http://www.nytimes.com/2008/10/11/business/worldbusiness/11crunch.html.

[23] Rhee, *supra* note 11.

[24] *Id.*

into the deepest recession since World War II."[25] This crisis prompted the federal government to take unprecedented intervention in the market.

On October 3, 2008, President George W. Bush signed the Emergency Economic Stabilization Act of 2008 into law.[26] This centerpiece legislation of the financial crisis authorized the Troubled Asset Relief Program ("TARP"), a $700 billion fund available to the U.S. Treasury Department ("the Treasury") to buy troubled assets from financial institutions.[27] Shortly thereafter, the Treasury used TARP to inject $125 billion in capital in the form of preferred shares and warrants into nine leading financial institutions, including the Bank and Merrill.[28] With respect to the Bank, the federal government purchased 600,000 shares of nonvoting preferred stock and warrants to purchase over 73 million shares of common stock.[29] However, the government did not acquire substantial voting control over the Bank.[30]

On November 3, 2008, the Bank issued the merger proxy with information dated as of October 30.[31] The proxy identified as a risk factor the possibility that changing market conditions may ultimately affect the deal economics.[32] Among other things, it warned that changes in the operations and prospects, general market and economic conditions "may significantly alter the value of Bank of America or Merrill Lynch or the prices of shares of Bank of America common stock or Merrill Lynch common stock by the time the merger is completed."[33]

---

[25] *Semiannual Monetary Policy Report to the Congress Before the H. Comm. Financial Servs.*, 111th Congr. (July 21, 2009) (statement of Ben S. Bernanke, Chairman, Board of Governors for the Fed. Reserve System) [hereinafter "Bernanke Testimony of July 21, 2009"]. Bernanke was a professor of economics at Princeton University before his appointment as chairman of the Federal Reserve. He testified that without the massive government intervention the economy would probably have collapsed. He provided this chilling assessment:

> I think you would've had a very good chance of a collapse of the credit system. Even what we did see, with perhaps the failure of Lehman was for example, commercial paper rates shot up and availability declined. Many other markets were severely disrupted, including corporate bond markets. So even with the rescue and even with the stabilization that we achieved in October, there was a severe increase in stress in the financial markets. My belief is that if we had not had the money to address the global banking crisis in October we might very well have had a collapse of the global banking system that would've created a huge problem in financial markets, and in the broad economy that might've lasted many years.

Id.

[26] 12 U.S.C. §§ 5201 et seq. (2008).

[27] *Id.* § 5225.

[28] On October 28, 2008, these capital injections were made: Bank of America ($15 billion), Bank of New York Mellon ($3 billion), Citigroup ($25 billion), Goldman Sachs ($10 billion), JPMorgan Chase ($25 billion), Morgan Stanley ($10 billion), State Street ($2 billion), Wells Fargo ($25 billion), Merrill Lynch ($10 billion). Troubled Asset Relief Program Transaction Report (Nov. 17, 2008), *available at* http://www.financialstability.gov/latest/reportsanddocs.html. Preferred stock is equity capital that has priority over common stock, and is usually characterized by a priority on dividends and assets upon liquidation relative to common stock. BLACK'S LAW DICTIONARY 1553 (9th ed. 2009). Warrants are stock options issued by the company. *Id.* at 1555.

[29] Bank of Am. Corp., Current Report (Form 8-K) Item 1.01 & A-7 (Oct. 31, 2008).

[30] The 73 million shares would constitute a small percentage of shares. *See* Bank of Am. Corp., Annual Report (Form 10-K), at 2 (over 5 billion shares of common stock issued and outstanding as of December 31, 2008).

[31] MERGER PROXY, *supra* note 15.

[32] *Id.* at 23-26.

[33] *Id*. at 24.

On November 5, 2008, Merrill reported in its third quarter 10-Q an $8.25 billion pretax loss from continuing operations.[34] The 10-Q disclosed difficult market conditions that could adversely affect financial results.[35] A day later, the Bank also issued its 10-Q, which provided similar warnings, including "Merrill Lynch's ability to mitigate its risk by selling or hedging its exposures is also limited by the market environment, and its future results may continue to be materially impacted by the valuation adjustments applied to these positions."[36] These disclosures simply stated the obvious. The common experience of all investors in the equity markets, including shareholders of both Merrill and the Bank, would have suggested that the financial markets were highly volatile.

In late November 2008, the Federal Reserve approved the merger under the Bank Holding Act,[37] and on December 5, the shareholders of the Bank and Merrill voted in favor of the deal.[38] Thereafter, in early December while the acquisition was still pending, Lewis learned that Merrill was accruing enormous losses from its investments in toxic assets.[39] On December 14, he advised the board of this development.[40] This unexpected news gave the Bank serious pause about closing the acquisition. Lewis considered exercising the merger agreement's material adverse change clause ("MAC"), which if legally exercised would have allowed the company to terminate the deal based on a material change in events after the signing of the merger agreement but before closing.[41]

On December 17, Lewis told Henry Paulson, then Treasury Secretary, and Bernanke that the Bank was considering invoking the MAC.[42] Lewis told them that the estimated losses at Merrill were $12 billion for the fourth quarter of 2008, a

---

[34] Merrill Lynch & Co., Quarterly Report (Form 10-Q), at 4 (Nov. 5, 2008).
[35] Merrill cautioned that "[t]he challenging conditions that existed in the global financial markets during the first half of the year continued during the third quarter of 2008"; that this "adverse market environment [had] intensified towards the end of the quarter, particularly in September, and was characterized by increased illiquidity in the credit markets, wider credit spreads . . . and concerns about corporate earnings and the solvency of many financial institutions"; that "[t]urbulent market conditions in the short and medium-term will continue to have an adverse impact on our core businesses"; and that "our businesses must contend with extreme volatility and continued deleveraging in the market." *Id.* at 82-83.
[36] Bank of America Co., Quarterly Report (Form 10-Q), at 175-77 (Nov. 6, 2008). The 10-Q also disclosed: that "difficult market conditions have adversely affected our industry"; that there has been "significant write-downs of asset values by financial institutions"; and that "lack of confidence in the financial markets has adversely affected our business, financial condition and results of operations." *Id.*
[37] *Bank Of America And Merrill Lynch: How Did A Private Deal Turn Into A Federal Bailout? Part II, Before the H. Comm. on Oversight and Government Reform*, 111th Congr. (June 25, 2009) (statement of Ben S. Bernanke, Chairman, Board of Governors for the Fed. Reserve System).
[38] *Id*.
[39] *In re Executive Compensation Investigation: Bank of America-Merrill Lynch Before the Attorney General of the State of New York* 11-12 (Feb. 26, 2009) (examination of Kenneth Lee Lewis, Chief Executive Officer, Bank of America) (identifying the period as December 5 through 14), *available at* http://www.oag.state.ny.us/media_center/2009/apr/pdfs/Exhibit%20A%20to%204.23.09%20letter.pdf [hereinafter "Lewis Testimony Before the New York Attorney General"].
[40] *Id*. at 13.
[41] *Id*. at 37.
[42] Bernanke was appointed to a four-year term as the chairman of the Board of Governors of the Federal Reserve on February 1, 2006. Paulson was the Treasury Secretary from July 2006 to January 2009 under the Bush Administration. Before this, he was the CEO of Goldman Sachs.

staggering $3 billion increase from previous estimate of just six days before.[43] These losses were stunning.[44] Paulson and Bernanke strongly advised Lewis against terminating the Merrill deal because they believed that this would lead to adverse consequences, including the insolvency of Merrill, litigation against the Bank, and the injection of more systemic risk and uncertainty into the capital market.[45] The Federal Reserve believed that if the deal fell through, Merrill could not have survived as an independent firm and would have collapsed like Bear Stearns and Lehman Brothers.[46] It feared that Merrill's collapse would have continued a domino effect to other systemically-important financial institutions.[47]

On December 21, Lewis talked to Paulson again about exercising the MAC. During this crucial conversation, Paulson threatened to fire the Bank's board and management if the company sought to terminate or renegotiate the merger.[48] Such termination or renegotiation of the deal would have jeopardized the merger or delayed its closing.[49] Lewis took this message back to the board.[50]

On December 22, the board met to discuss whether it was still in favor of proceeding with the Merrill acquisition.[51] The board minutes show that Lewis in his CEO capacity reported to the board these key points of the call with Paulson:

> (i) first and foremost, the Treasury and Fed are unified in their view that the failure of the Corporation to complete the acquisition of Merrill Lynch would result in systemic risk to the financial services system in America and would have adverse consequences for the Corporation;
>
> (ii) second, the Treasury and Fed stated strongly that were the Corporation to invoke the material adverse change ("MAC") clause in the merger agreement with Merrill Lynch and fail to close the transaction, *the Treasury and Fed would remove the Board and management of the Corporation*;
>
> (iii) third, the Treasury and Fed have confirmed that they will provide assistance to the Corporation to restore capital and to protect the Corporation against adverse impact of certain Merrill Lynch assets; and
>
> (iv) fourth, the Fed and Treasury stated that the investment and asset protection promised could not be provided or completed by scheduled closing date of the merger, January 1, 2009; that the merger should close on schedule, and that the Corporation can rely on the Fed and Treasury

---

[43] Lewis Testimony Before the New York Attorney General, *supra* note 47, at 40.
[44] In an e-mail, Paulson described the losses as "breath-taking." Michael R. Crittenden, *Fed Emails Bash BofA Chief in Tussle over Merrill Deal*, WALL ST. J., June 11, 2009, at A1. Another internal e-mail from a senior vice president at the Federal Reserve reads, "Merrill is really scary and ugly." Paul Tharp, *Lewis Ticks 'Em Off: Jittery BofA Head Keeps Silence Before Congress*, N.Y. POST, June 12, 2009, at 31.
[45] *See infra* Part I.B. (discussing the roles of both Paulson and Bernanke).
[46] Merrill's deterioration was significant, and "all but ensure[d] that the firm could not survive as a stand-alone entity without raising substantial new capital (and/or government support) that is unlikely to be available given the uncertainty about its prospects," Phil Mattingly, *Did Bank of America Get Stong-Armed in Merrill Deal?*, C.Q. TODAY, June 10, 2009, *available at* http://www.cqpolitics.com/wmspage.cfm?docID=news-000003140207.
[47] *Id.*
[48] Lewis Testimony Before the New York Attorney General, *supra* note 39, at 52.
[49] *Id*.
[50] *Id*.
[51] *Id.* at 53.

to complete and deliver the promised support by January 20, 2009, the date scheduled for the release of earnings by the Corporation.[52]

At the board meeting, Lewis communicated the management's recommendation not to invoke the MAC.[53] This recommendation was based on, among other things, "instruction from the Fed and Treasury not to exercise the MAC" and the government's verbal assurance of financial assistance through TARP to support the Bank and provide some downside protection against declining asset values.[54] One board member, called to testify before Congress, recalled the following from the board meeting:

> [Lewis] expressed the fact that the government thought it would be a major mistake for us to walk away. They thought it would be very dangerous systemically and very dangerous and not positive at all for the Bank of America. . . . He expressed the sentiment and there was another session later in the month, that the government would provide financing. There was nothing in writing, but it was from very senior officials of the government that one would believe would follow through. The details were not reviewed with the board. . . . *The issue was relatively clear to me. In a perfect world, it would have been better to walk away*.[55]

With respect to the board's inability or disinclination to "walk away" from Merrill, this board member "express[ed] remorse for all shareholders" who took the financial loss.[56]

Based on the considerations presented to the board, it decided not to invoke the MAC, renegotiate the merger price with Merrill, or inform shareholders of Merrill's losses ahead of planned disclosure.[57] The minutes purport to document the basis for this decision:

> Discussion ensued, with the Board clarifying that [it] was not persuaded or influenced by the statement by the federal regulators that the Board and management would be removed by the federal regulators if the Corporation were to exercise the MAC clause and fail to complete the acquisition of Merrill Lynch. The Board concurred it would reach a decision that it deemed in the best interest of the Corporation and its shareholders without regard to this representation by the federal regulators.[58]

---

[52] Minutes of Special Meeting of Board of Directors of Bank of America Corporation, at 2 (Dec. 22, 2008) (emphasis added) [hereinafter "Board Minutes of Dec. 22, 2008"], *available at* http://www.oag.state.ny.us/media_center/2009/apr/pdfs/Exhibit%20B%20to%204.23.09%20letter.pdf.

[53] *Id.* at 2-3.

[54] *Id.*

[55] *Bank of America and Merrill Lynch: How Did A Private Deal Turn Into A Federal Bailout? Before the H. Comm. on Oversight and Government Reform*, 111th Cong. 16-17 (Nov. 17, 2009) (statements of Brian Moynihan, President of Consumer and Small Business Banking, Bank of Am., Charles Gifford, Member, Bank of Am. Bd. of Dirs., Thomas May, Member, Bank of Am. Bd. of Dirs., and Timothy Mayopolous, Former General Counsel, Bank of Am.) (emphasis added) [hereinafter "Gifford et al. Testimony"]

[56] *Id.* at 15. This testimony sought to explain an email in which the board member wrote, "Unfortunately, it's [sic] also screw[s] the shareholders." *Id.* While the language in this private email is crude, it provides an unvarnished assessment of the effect on shareholders.

[57] Board Minutes of Dec. 22, 2008, *supra* note 60, at 2-3. The minutes provide: "Mr. Lewis stated the purpose of the special meeting is to insure that the Board is in accord with management's recommendation to complete the acquisition of Merrill Lynch & Co., Inc. ('Merrill Lynch'), as scheduled on January 1, 2009, pursuant to the [merger agreement] . . . after due consideration of the undertakings and admonishments of the federal regulators." *Id.* at 1.

[58] *Id.* at 3.

While self-consciously professing its independence, the board made a considered decision (the deliberate decision not to invoke a MAC), and thereby decided to close the Merrill merger as planned.[59]

On January 1, 2009, ten days after the Bank's board meeting, the acquisition of Merrill closed.[60] Other than the original merger proxy, there was no supplemental disclosure to shareholders on Merrill's deteriorating financial condition before closing.[61]

On January 16, the Bank disclosed that losses from Merrill were over $15 billion for the fourth quarter ended December 31, 2008.[62] This was over $3 billion more than the $12 billion estimate Lewis had learned in mid-December, but the information had not been disclosed to shareholders.[63] The Bank also disclosed that it would receive an additional $20 billion in TARP funds (an investment of preferred stock with an 8 percent dividend), and would receive insurance protection from market exposure of $118 billion in assets, primarily exposure from Merrill's portfolio.[64]

B. *Reflections of the Principal Actors*

Like the fire sale of Bear Stearns and the bankruptcy of Lehman Brothers, the acquisition of Merrill was a key event in the history of Wall Street and the financial crisis.[65] This deal also became controversial.[66] Without the involvement of Paulson and Bernanke, there was a possibility that the Bank would have invoked the MAC and thereby compromised or complicated the deal. Controversy surrounding the government's role in the merger ensued when Lewis was called to testify before the New York Attorney General's office.[67]

---

[59] *Id*.

[60] Press Release, Bank of Am. Corp., Bank of America Completes Merrill Lynch Purchase (Jan. 1, 2009). Based on the stock price, the deal closed at a value of $29.1 billion. Bank of Am. Corp., Quarterly Report (Form 10-Q), at 9 (May 7, 2009).

[61] *See infra* note 86 and accompanying text.

[62] Bank of Am. Corp., Current Report (Form 8-K), at 2 (Jan. 16, 2009).

[63] *See supra* note 47 and accompanying text.

[64] Bank of Am. Corp, Current Report (Form 8-K), at 2 (Jan. 16, 2009).

[65] The demise of these three firms marks the end of Wall Street's era of independent investment banks. During the 1990s, leading up to the repeal of the Glass-Steagall Act, independent investment banks had been acquired by large commercial banks. *See generally* ALAN D. MORRISON & WILLIAM J. WILHELM, JR., INVESTMENT BANKING: INSTITUTIONS, POLITICS, AND LAW (2007) (discussing the business of investment banking and historical industry trends). Each of these firms was acquired by a commercial bank: Bear Stearns by JPMorgan Chase, investment banking assets of Lehman Brothers by Barclays, and Merrill Lynch by Bank of America. Today, only Goldman Sachs and Morgan Stanley remain independent, pure investment banks even though they converted to bank holding companies in 2008. Goldman Sachs Group, Inc., Annual Report (Form 10-K), at 1-2 (Nov. 28, 2008); Morgan Stanley & Co., Annual Report (Form 10-K), at 1 (Nov. 30, 2008).

[66] Louise Story & Jo Becker, *Bank Chief Tells of U.S. Pressure to Buy Merrill Lynch*, N.Y. TIMES, June 11, 2009, at B1; Zachary Kouwe, *Paulson Expected to Face Hard Questioning on Merrill Deal*, N.Y. TIMES, June 15, 2009, at B3; Edmund L. Andrews, *Bernanke Defends His Role in Merrill Sale*, N.Y. TIMES, June 25, 2009, at B1.

[67] The attorney general's office was investigating agreements on executive bonuses associated with the merger. *See infra* note 110.

Lewis testified that the federal government played a coercive role in the merger.[68] The government disapproved of terminating the deal or delaying the closing to renegotiate price.[69] Paulson threatened that if the Bank backed out of the deal with Merrill the government "could" or "would" fire the management and board.[70] Lewis believed that the government had the power to carry out its threat.[71] Upon being threatened, he suggested that the Bank and government "deescalate this for a while."[72] Absent the federal government's threat, Lewis wanted to invoke the MAC, but felt he had no choice in the matter.[73] He thought that "it was in the best interest to go forward as had been instructed" because "if [the government] had felt that strongly, then that should be a strong consideration for us to take into account."[74] As far as shareholders, their interest could not be isolated from systemic risk considerations; the best interests of the country and shareholders were intertwined.[75] While going forward with the deal meant a short-term loss for shareholders, Merrill still filled strategic necessities and over the long term would still benefit shareholders.[76]

After this testimony, the New York Attorney General's office wrote to Congress and informed it of questions "about the transparency of the TARP program, as well as about corporate governance and disclosure practices at Bank of America."[77] This prompted the congressional testimonies of Lewis, Bernanke, and Paulson.[78] While their testimonies differ in shades, they largely support Lewis's account of events.

Lewis reaffirmed his prior testimony that Paulson's threat did not impress him so much as the seriousness of a situation that could have led the government to threaten a company and CEO in good standing.[79] The exercise of the MAC would have posed risks, including litigation risk and the risk of losing government support during a financial crisis.[80] According to Lewis, closing the deal was the better option.[81] He added that the "target was to [complete the merger] so that we

---

[68] *See* Lewis Testimony before the New York Attorney General, *supra* note 47, at 52).
[69] Bank of Am., Current Report (Form 8-K), at 90-91 (Jan. 16, 2009).
[70] *Id.* at 52.
[71] *Id.* at 54.
[72] *Id.* at 52.
[73] *Id.* at 58, 96.
[74] *Id.* at 97, 151.
[75] Bank of Am., Current Report (Form 8-K), at 82-83 (Jan. 16, 2009).
[76] *Id.* at 86.
[77] Letter from Andrew Cuomo, Att'y Gen., State of N.Y., to Sen. Christopher Dodd, Chairman, Sen. Comm. on Banking, Housing, & Urban Affairs; Rep. Barney Frank, Chairman, H. Fin. Servs. Comm.; Mary L. Schapiro, Chair, Sec. Exch. Comm'n; and Elizabeth Warren, Chair, Cong. Oversight Panel (Apr. 23, 2009).
[78] *Bank of America and Merrill Lynch: How Did A Private Deal Turn Into A Federal Bailout? Before the H. Comm. on Oversight and Government Reform*, 111th Cong. (June 11, 2009) (testimony of Kenneth Lee Lewis, Chief Executive Officer, Bank of America), (Morning Session, June 11, 2009) [hereinafter "Lewis Testimony Part I"]; (testimony of Lewis) (Afternoon Session, June 11, 2009), at 2 ["Lewis Testimony Part II"]; (testimony of Ben S. Bernanke, Chairman, Fed. Reserve Board) (June 25, 2009) [hereinafter "Bernanke Testimony"]; (testimony of Henry Paulson, former Secretary of the Treasury) (July 16, 2009) [hereinafter "Paulson Testimony"]; (prepared testimony of Paulson (July 16, 2009), at 3 [hereinafter "Paulson Prepared Testimony"].
[79] Lewis Testimony before the New York Attorney General, *supra* note 78, at 8, 19.
[80] *Id.* at 30.
[81] *Id.* at 7, 9.

didn't damage the economy anymore."[82] The Merrill acquisition was "in the best interests of the financial system, the economy and the country" because the collapse of Merrill, "on the heels of Lehman's failure, could have caused systemic havoc or necessitated an AIG-style government bailout."[83] Shareholder interest was inextricably intertwined with the financial system; harm to the financial system would have inflicted harm to the company as well.[84] Furthermore, the acquisition had strategic value and promised long-term reward.[85] Merrill's losses would push the profitability of the deal toward a longer time horizon and affected short-term shareholder value.[86] As for disclosure, the government did not ask the board to withhold any disclosure to shareholders.[87] Merrill's losses were not disclosed before the deal closed because there was no agreement on its timing.[88]

For his part, Paulson confirmed that he threatened to fire the board and management.[89] He testified that the exercise of the MAC would have demonstrated "a colossal lack of judgment and would jeopardize Bank of America, Merrill Lynch, and the financial system."[90] He and Bernanke believed that invoking a MAC would have been detrimental to both the Bank and the financial system.[91] Lawyers at the Federal Reserve believed that the Bank did not have sound legal basis to exercise the MAC.[92] The market would have viewed the legal merit of invoking the MAC as "quite low" and both Merrill and the Bank would have been adversely affected by the possibility of detrimental litigation.[93] In justifying his threat, Paulson added that "it's a pretty logical conclusion that maybe even the regulator would be irresponsible . . . if they didn't hold [the Bank and Merrill] accountable."[94] This statement implies that the board and management of the Bank would have been replaced if they had proceeded with an ill-advised legal stratagem to abort the merger.

---

[82] *Id.* at 33. *See also* Paulson Testimony, *supra* note 86, at 18 (confirming Lewis's recollection).

[83] Lewis Testimony Before the New York Attorney General, *supra* note 78, at 6-7. Lewis was criticized in the media for putting the interest of the country over that of shareholders. *See* Sinclair Stewart, *The Merrill Takeover: Patriotic Bumbling? Bank of America's CEO Cites Loyalty to Country, After Huge Losses, Investors Wonder if His Motive was Misguided*, GLOBE & MAIL, Jan. 17, 2009, at B4.

[84] Lewis Testimony Before the New York Attorney General, *supra* note 78, at 12.

[85] *Id.* at 7, 31.

[86] *Id.* at 23, 31.

[87] Lewis Testimony Part II, *supra* note 86, at 2.

[88] Lewis Testimony before the New York Attorney General, *supra* note 78, at 33-34.

[89] Paulson Testimony, *supra* note 86, at 21-22; Paulson Prepared Testimony, *supra* note 86, at 3. With respect to Bernanke's role, he testified that, "I did not threaten him" and "I didn't tie it directly to replacing him or the board." Bernanke Testimony, *supra* note 86, at 47, 53. Nor did he instruct Paulson to communicate the threat. *Id.* at 14; Paulson Prepared Testimony, *supra* note 86, at 5. In his memoir, Paulson wrote of the incident: "I got back to Ken later and again emphasized to him that the government would not let any systemically important institution fail; that exercising the MAC would show a colossal lack of judgment by BofA; that such an action would jeopardize his bank, Merrill Lynch, and the entire financial system; and that under such circumstances, the Fed, as BofA's regulator, could take extreme measures, including the removal of management and the board." HENRY PAULSON, JR., ON THE BRINK: INSIDE THE RACE TO STOP THE COLLAPSE OF THE GLOBAL FINANCIAL SYSTEM 429-30 (2010).

[90] Paulson Prepared Testimony, *supra* note 86, at 4.

[91] Bernanke Testimony, *supra* note 86, at 17, 31, 51; Paulson Prepared Testimony, *supra* note 86, at 3.

[92] Paulson Prepared Testimony, *supra* note 86, at 3.

[93] *Id.* at 11.

[94] Paulson Testimony, *supra* note 86, at 37.

Bernanke and Paulson distinguished their obligations as regulators from the board's duty to shareholders. They testified that SEC disclosure obligations were the company's responsibility.[95] The government's disclosure obligation is to the public, set forth in TARP, which the government satisfied.[96] Bank supervisory practice did not permit a regulator to impose an obligation on a financial institution to financially injure itself for the public interest.[97] Conversely, regulators did not have a duty to protect the pecuniary interest of shareholders or bondholders vis-à-vis the soundness of the financial institution and the markets or more broadly the public welfare. In administering TARP, the Treasury Secretary must take into consideration various factors including the protection of taxpayers, stability of the financial markets, long-term viability of financial institutions, and efficient use of funds.[98]

Bernanke and Paulson echoed Lewis's assessment of the public role the Bank served in stabilizing the financial market: Merrill would have collapsed without a takeover; a renegotiation of the purchase price would have created uncertainty in the market; the failure of Merrill, which was bigger than Lehman Brothers, would have destabilized the financial market even further.[99]

On the issue of whether the Bank's shareholders were forced "to take a bullet," Paulson testified:

> [S]ome have opined that government officials involved in examining the Bank of America Merrill Lynch merger—myself included—allowed concerns about systemic risk to our nation's financial system to outweigh concerns about potential harm to Bank of America and its shareholders. That simply did not happen. In my view, and the view of the numerous government officials working on the matter, the interests of the nation and Bank of America were aligned with respect to the closing of the Merrill Lynch transaction. An attempt by Bank of America to break its contract to acquire Merrill Lynch would have threatened the stability of our entire financial system *and* the viability of both Bank of America and Merrill Lynch.[100]

Bernanke added: "I think it was a very successful transaction. It helped stabilize the financial markets. It put two companies back on a healthy path. It protected our economy. And it was a good deal for taxpayers. . . . And it achieved public objectives that were very important."[101] Thus, both Paulson and Bernanke forcefully defended their conduct and argued that government action produced positive effects on the two companies and the financial markets.

C. *Merger Execution and Fiduciary Duty*

As a preliminary manner, the Bank poorly executed the Merrill acquisition. The disclosure and procedural issues stand out: were the board and the

---

[95] *Id.* at 25.
[96] Bernanke Testimony, *supra* note 86, at 3, 36-37.
[97] *Id.* at 16.
[98] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 37.
[99] Bernanke Testimony, *supra* note 86, at 34, 50; Paulson Prepared Testimony, *supra* note 86, at 3.
[100] Paulson Prepared Testimony, *supra* note 86, at 3.
[101] Bernanke Testimony, *supra* note 86, at 21.

shareholders properly informed by the management, advisers, and the merger proxy, respectively, when each approved the acquisition? Only findings of facts or admissions on the extent of knowable information and the scienter at the time can resolve these issues. I comment no further on the disclosure and federal securities issues.[102] I assume that, as Lewis's testimony suggests, the Bank learned of the accelerating pace of Merrill losses after the shareholder vote on December 5, 2008, and that disclosure of material facts up to this point, including the merger proxy, containing financial information dated October 30, was proper and thus the shareholder vote was not tainted by faulty disclosure. Trial on these issues may later prove these assumptions wrong, but the disclosure issue is tangential to the thesis of this Article, which advances a theory of fiduciary exemption and a broader comment on shareholder primacy.

The duty of care with respect to the merger execution on September 13-15 is also tangential. This issue is relevant here only insofar as the quality of the due diligence may explain in part the board's later consideration to terminate the deal, the event leading to the government's involvement in the Bank's corporate governance. To develop this thought, I assess the duty of care issue.

A board's decision must be informed and made in good faith. This requirement calls into question the board's initial approval of the merger. The Delaware standard for the duty of care is gross negligence.[103] With an informed decision based on proper due diligence, the business judgment rule would protect the board's decision to approve the merger.[104] The decision of the Bank's board constituted a high-risk strategic decision, and Delaware courts would not engage in ex post analysis of an informed, good faith judgment made under uncertainty even if the merger was poorly executed or the outcome was poor.[105]

---

[102] As of the writing of this Article, issues pertaining to the disclosure issue are rapidly developing. On August 3, 2009, the Bank settled for $33 million with the SEC on charges concerning misleading and false disclosure to shareholders with respect to executive bonuses paid out as a part of the Merrill acquisition. Zachery Kouwe, *Bank of America Settles S.E.C. Suit Over Merrill Deal*, N.Y. TIMES, Aug. 3, 2009, at B1. However, the federal district court disapproved the settlement and ordered the case for trial. Sec. Exch. Comm'n v. Bank of Am. Corp., 653 F. Supp. 2d 507 (S.D.N.Y. 2009). The opinion is notable for the tone of the court's indignation: "Overall, indeed, the parties' submissions, when carefully read, leave the distinct impression that the proposed Consent Judgment was a contrivance designed to provide the S.E.C. with the facade of enforcement and the management of the Bank with a quick resolution of an embarrassing inquiry—all at the expense of the sole alleged victims, the shareholders." *Id.* at 510. Subsequently, the Bank and the SEC revised the proposed settlement to $150 million, but in a hearing the federal court suggested that this amount may still be too small and proposed a range of $300 to $600 million. Louise Story, *Judge Questions Bank of America's New Deal with S.E.C.*, N.Y. TIMES, Feb. 8, 2010. The shareholder derivative lawsuit in the Delaware Chancery Court alleges a breach of fiduciary duty based on a failure to inform shareholders of Merrill's losses. Derivative Complaint, *supra* note 7, at ¶¶ 11-16. Moreover, on February 4, 2010, the New York Attorney General filed civil fraud charges against the Bank, Lewis and Joseph Price (the Bank's chief financial officer at the time). Louise Story, *Cuomo Sues Bank of America, Even as It Settles with S.E.C.*, N.Y. TIMES, Feb. 4, 2010. *See* Cuomo v. Bank of Am. Corp. et al., Complaint (Sup. Ct. N.Y., Feb. 4, 2010).

[103] Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985).

[104] *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (noting that the business judgment rule protects "directors of a corporation [who] acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.").

[105] *See* In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996) (reasoning that upon the proper application of the business judgment rule there is no ex post review of actions that were "substantively wrong, or degrees of wrong extending through 'stupid' to 'egregious' or 'irrational' . . .").

However, the board's decision was not an informed one because the procedure used to approve the Merrill acquisition was highly flawed. The facts in the seminal decision, *Smith v. Van Gorkom*,[106] are informative. There, the target company was undergoing a sale process.[107] The board was found to have violated the duty of care based on several factors: a failure to adequately inform itself of vital aspects of the deal, including the intrinsic value of the company; approving the sale after only two hours of consideration; and failure to read the deal documents because they were unavailable at the board meeting.[108] The Delaware Supreme Court held that these facts were sufficient to prove the board's gross negligence.[109]

The publicly available facts suggest that the Bank's board was grossly negligent in the process used to approve the Merrill acquisition. Indeed, the board's negligence is qualitatively worse than the simple negligence in *Van Gorkom*.[110] The obvious problem is the quality of the due diligence. The merger agreement states that due diligence on the deal was conducted over a period of a day and a half (Saturday afternoon to Sunday evening), about thirty hours.[111] Such a short time period could not have been sufficient to conduct adequate due diligence on a business as big and complex as Merrill Lynch in normal times, let alone in a time of extreme market volatility and crisis. Is it plausible that the Bank adequately reviewed within a matter of a few hours asset quality, liabilities, trading positions, risk management structures, values at risk, along with many other facets of the business? The answer is certainly not. The two companies probably engaged armies of internal and external lawyers, accountants, and bankers, and there was probably frantic activity during the weekend, creating an illusion of due diligence. But raw manpower can only do so much in a short time period; reasonable due diligence entails contemplation and assimilation of information learned.[112]

The choice of financial advisers, no small decision, is also informative. Merrill used its own investment bankers who delivered the fairness opinion.[113] The Bank hired two financial advisers who delivered fairness opinions: J.C. Flowers &

---

[106] 488 A.2d 858 (Del. 1985); *see also* Gantler v. Stephens, 965 A.2d 695, 713 n.54 (Del. 2009) (holding that shareholder ratification subjects "the challenged director action to business judgment review, as opposed to 'extinguishing' the claim altogether . . . .").
[107] *Van Gorkom*. 488 A.2d at 873.
[108] *Id.* at 874.
[109] *Id*. at 884.
[110] *See* William T. Allen et al.,, *Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law*, 56 BUS. LAW. 1287, 1300 (2001) (arguing that the facts in *Van Gorkom* may have shown negligence but not gross negligence); Sean Griffith, *Good Faith Business Judgment: A Theory of Rhetoric in Corporate Law Jurisprudence*, 55 DUKE L.J. 1, 14 (2005) ("The majority of commentators now agree that on the merits the evidence does not support the conclusion that the Trans Union board had been grossly negligent.").
[111] This time is calculated from the time Lewis and Thain discussed a merger (Saturday, 2:30 p.m.) to the time of the announcement of the deal (Sunday, 9:23 p.m.), less one hour for lag time in organizing due diligence and other down time. Derivative Complaint, *supra* note 7, at ¶¶ 64, 71.
[112] I draw from my own experience of conducting due diligence as an investment banker on complex, multi-billion dollar potential acquisition of an investment bank in 2000. My recollection was that approximately 70 people were involved to varying degrees in the due diligence, which took several weeks to complete.
[113] MERGER PROXY, *supra* note 15, at Appendix E. Query how objective this fairness opinion could have been given the management's and board's support of the deal.

Co., a private equity firm, and Fox-Pitt Kelton Cochran Caronia Waller ("FPK"), a boutique investment bank specializing in financial institutions.[114] A deal like the merger of the Bank and Merrill would be a landmark transaction on Wall Street with huge investment banking fees (J.C. Flowers and FPK received a total of $20 million in fees).[115] The advisory work on these kinds of deals are usually handled by top-tier investment banking firms, such as Goldman Sachs, Morgan Stanley, UBS Warburg, Credit Suisse First Boston, JPMorgan Chase, or other comparable firms. Why use one's own investment bankers as Merrill did, and a private equity firm and a boutique investment bank as the Bank did for such a large complex deal?

One can speculate on several plausible explanations. J.C. Flowers had experience in restructuring of financial institutions. It was involved in attempting to rescue Bear Stearns only a few months before.[116] Because it is a private equity firm, it did not compete with Merrill or the Bank on capital markets and trading activities.[117] Both firms may have been concerned about competitors gaining intelligence on their assets and liabilities and trading book, which may have had enormous informational value during unprecedented market turmoil. This is not to impugn the honesty or professionalism of investment bankers, but only to suggest that the risk of harmful leaks, rumors, and misinformation may have been substantial and potentially fatal in volatile markets. Even so, the companies could have used other investment bankers who were not competitors in capital market activities, such as Lazard, a premier boutique mergers and acquisition advisor with deep expertise in financial institutions.[118] Another plausible explanation for why the boards of the Bank and Merrill used these advisers is that perhaps the major investment banks did not want to run the risk of advising on this deal under these situational constraints. There may have been substantial liability as well as reputational risks associated with the merger. At the time, most large investment and money center banks were embroiled in their own fights for survival.[119] The prestige and the fees may not have been worth exposing themselves to the legal risks of issuing a fairness opinion under these constraints, necessitating the appointment of other financial advisers who were more willing to undertake the risks for the fees and the opportunity to work on a landmark deal.

Another point about due diligence is worth mentioning. It is standard protocol that when rendering fairness opinions for a deal, investment bankers do

---

[114] *Id.* at Appendices C & D. I note that I was a vice president of investment banking at FPK, where I worked from 1999 to 2001. At that time, it was a wholly-owned subsidiary of Swiss Reinsurance. Prior to this, I was also an M&A banker at UBS Warburg.
[115] *Id.* at 68.
[116] COHAN, *supra* note 16, at 85-88 (2009). J.C. Flowers was also involved in the turnaround of Japan's Long Term Credit Bank. *Id.* at 85.
[117] *See id*. Private equity firms make principal investments in firms or assets, which are held in a portfolio for longer durations. They typically do not engage in trading of securities in a broker-dealer capacity as full service investment banks do.
[118] Lazard advised Bear Stearns during its crisis and eventual merger with JPMorgan Chase. *Id.* at 73, 88-89.
[119] *See generally* ANDREW ROSS SORKIN, TOO BIG TO FAIL: THE INSIDE STORY OF HOW WALL STREET AND WASHINGTON FOUGHT TO SAVE THE FINANCIAL SYSTEM—AND THEMSELVES (2009) (describing how Morgan Stanley and Goldman Sachs were in peril during the financial crisis).

not independently assess the company's assets and liabilities.[120] Both the FPK and J.C. Flowers fairness opinion letters have such a disclaimer.[121] The specific disclaimer of non-verification of the company's assets and liabilities is a standard term in fairness opinions.[122] If the financial advisers were not analyzing the quality of the assets and liabilities, who were? While the fairness opinions spoke to the value of the firm based on market metrics, including transaction and comparable companies multiples and discounted cash flow ("DCF") analysis,[123] such top-down valuational analyses are largely worthless under the extenuating circumstances. The value drivers of the Bank-Merrill merger were not market metrics or theoretical outputs from a DCF model. They were instead the fair values of assets and liabilities, which could only have been determined by a bottom-up, independent assessment of the firm's internal books. The crisis posed unique valuational issues. For instance, in a failing market system the "fair value" may not necessarily have been the "fair market value" per mark-to-market pricing.[124] There could have been a significant divergence between the "hold" and the "sale" values of exotic and illiquid security with enormous uncertainty as to the former, thus discounting the latter value. Valuation would have required a bottom-up cash flow analysis of the individual assets and liabilities, and calculations of both the "hold" and the "sale" values. When markets are highly unstable or severely malfunctioning, the indices of price reflected in standard market and theoretical valuation techniques cannot possibly form the basis for a fairness opinion, and at

---

[120] *Cf.* Klang v. Smith's Food & Drug Ctr., Inc., 702 A.2d 150, 155-56 (Del. 1997) (holding that an investment banker need not calculate assets and liabilities separately in providing a solvency report to the board).

[121] The FPK fairness opinion letter provides the typical disclaimer on this specific point.

> In rendering our opinion, we have assumed and relied, without independent verification, upon the accuracy and completeness of all the information examined by, or otherwise reviewed or discussed with, us for the purposes of this opinion. We have not made or obtained an independent valuation or appraisal of the assets, liabilities (contingent, derivative, off-balance sheet or otherwise) or solvency of the Company or Merrill Lynch, including particularly any mark-to-market balance sheet adjustments resulting from the Merger, market conditions or otherwise. We relied solely upon information provided to us by the Company and other publicly available information with respect to Merrill Lynch's financial condition, results of operations and prospects.

MERGER PROXY, *supra* note 15, at Appendices D, D-1. Clearly, other aspects of this fairness opinion letter are custom tailored to the unique situation of this merger: for example, the specific reference to "contingent, derivative, off-balance sheet or otherwise." *Id.* J.C. Flowers fairness opinion also provides: "We have assumed and relied upon the accuracy and completeness of the information . . . provided by each of the Company and the Acquiror. We did not independently verify the accuracy or completeness of any such information, nor will we do so in the future, and we did not and do not assume any responsibility for doing so." *Id.* at Appendix C-1.

[122] *See, e.g.,* Fairness Opinion Letter of Fox-Pitt, Kelton, reproduced in Merger Proxy of Farm Family Holdings, at B-2 (Jan. 19, 2001) ("Fox-Pitt, Kelton has not assumed any responsibility for any independent valuation or appraisal of the assets and liabilities of Farm Family and has not been furnished with any such valuation or appraisal.").

[123] MERGER PROXY, *supra* note 15, at 63-68.

[124] Mark-to-market is an accounting rule that requires certain assets, such as securities, be stated at their fair value rather than historical cost. *See* Statements of Financial Accounting Standards No. 157, *Fair Value Measurements*.

least the use of the typical fairness opinion should not provide legal cover for a lack of common sense.[125]

Only a deal team with proper skills and sufficient time could have performed a bottom-up analysis of the internal books, which is the only way reasonable due diligence could have been done when there is a significant possibility that the target is a distressed financial institution. A few months before, JPMorgan Chase found itself in a similar situation with the rushed, crisis-precipitated acquisition of Bear Stearns. During due diligence occurring over a single weekend, resembling the circumstance of the Merrill acquisition, it appeared that JPMorgan Chase would not proceed with the deal.[126] A Bear Stearns board member commented on this apparent development: "If I were Jamie Dimon [JPMorgan Chase's CEO], I would have had some concerns myself because you never do a deal as big as that on one day's due diligence. What's the upside versus the downside?"[127] Notably, JPMorgan Chase continued with the Bear Stearns acquisition only with government financial support and risk sharing arrangements. To suggest that the Bank fully assessed Merrill within a matter of a few hours during extraordinary circumstances is a bridge too far.[128] The deviation from what is reasonable under the circumstances here is so great that executing the merger agreement while essentially blind to the underlying values of the assets and liabilities of a business as complex as Merrill meets the demanding standard of gross negligence and perhaps even reckless dereliction of duty.[129] This is a far greater transgression than Jason Van Gorkom's execution of the merger agreement at the Chicago Lyric Opera, which was largely a problem of optics.[130]

Although the Bank's board was grossly negligent in executing the acquisition, it would not be liable in fact. The decision in *Smith v. Van Gorkom*

---

[125] In analyzing the fairness opinion given in the Bear Stearns deal, William Cohan, a former investment banker, opined: "Given that the choice was between about $290 million for the 145.5 million Bear shares outstanding and nothing, Lazard's fairness opinion was not a hard one to give . . . rais[ing] the question of why corporate boards agree to pay so much money for a couple of pieces of paper that are of so little value." COHAN, *supra* note 16, at 109.

[126] *Id.* at 95.

[127] *Id.* (quoting Fred Salerno). JPMorgan Chase was able to proceed with the deal despite the problem of proper due diligence only because it received unprecedented financial assistance from the government, including among other things a $30 billion secured loan. *Id.* at 101.

[128] Edmund L. Andrews, *Bernanke Defends Role on Merrill*, N.Y. TIMES, June 26, 2009, at B1 (quoting a December 19, 2009 e-mail from Timothy P. Clark, Senior Adviser of the Division of Banking Supervision and Regulation at the Board of Governors of the Federal Reserve System, to senior officials at the Federal Reserve). "I always had my doubts about the quality of the due diligence they did on the [Merrill] deal." *Id.* (quoting a December 20, 2009 e-mail from Deborah P. Bailey, Deputy Director of the Banking Supervision and Regulation Division at the Board of Governors of the Federal Reserve System. "I think he is worried about stockholder lawsuits; knows they did not do a good job of due diligence and the issues facing the company are finally hitting home and he is worried about his own job after cutting loose lots of very good people." Lauren Tara LaCapra, *BofA CEO Lewis Not Off the* Hook, THESTREET.COM, June 25, 2009, *available at* http://www.thestreet.com/story/10526439/2/bofa-ceo-lewis-not-off-the-hook.html (quoting a December 23, 2009 e-mail from Mac Alfriend, Senior Vice President in the Supervision, Regulation, and Credit Department of the Federal Reserve Bank of Richmond).

[129] The failure of corporate governance probably led to the radical board and management changes at the Bank after the Merrill deal closed. *See infra* note 140.

[130] Smith v. Van Gorkom, 488 A.2d 858, 879 (Del. 1985).

resulted in the enactment of DGCL section 102(b)(7).[131] This statute allows for a provision in the certificate of incorporation eliminating or limiting the personal liability of a director for monetary damages for breach of the duty of care.[132] The Bank, a Delaware corporation, has such an exculpatory provision.[133]

With the deal execution in context, we can synthesize the operative facts concerning the Bank board's actions in mid-December 2008—*after*, as this Article assumes, the board, the Federal Reserve, and shareholders approved the deal.

The Merrill acquisition had a profound link to the financial markets. The government coerced the Bank's board and management to close the merger. This threat was credible because federal banking agencies have the power to remove a corporation's board and management upon a showing that they engaged in unsafe or unsound practice resulting in financial loss or probable loss.[134] The government was motivated by the need to stem further harm to the financial market, the most immediate problem being a collapse of Merrill on the heels of Bear Stearns and Lehman Brothers.

Lewis's and the board's motivations are more ambiguous. Viewed narrowly in terms of deal economics, closing the acquisition was financially bad for shareholders since the company assumed far greater, multi-billion dollar losses than it had expected.[135] Like many classic corporate law cases, the motivations of the board and Lewis, acting in his capacity both as CEO and chairman of the board, do not sort into tidy categories or neat characterizations. The episode is colored in shades of gray, and one must engage in some degree of plausible speculation.

The board minutes plainly state that the government's threat did not influence the board members,[136] though such self-serving notice, by itself, cannot be taken seriously. The cynic is sometimes wise. The board was aware of the potential for shareholder derivative or federal securities litigation. The board minutes state that Lewis recommended not invoking a MAC because the

---

[131] WILLIAM T. ALLEN ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 256-57 (3d ed. 2009).

[132] DEL. CODE ANN. tit. 8, § 102(b)(7) (2008).

[133] Amended and Restated Certificate of Incorporation, at ¶ 6 at 25, *available at* http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MjExMzB8Q2hpbGRJRD0tMXxUeXBlPTM=&t=1. Paragraph 6 provides: "To the fullest extent permitted by the General Corporation Law of the State of Delaware, as the same exists or may hereafter be amended, a director of the Corporation shall not be personally liable to the Corporation, its shareholders or otherwise for monetary damage for breach of his duty as a director."

[134] An appropriate federal banking agency can act "to remove [any institutional-affiliated party] from office or to prohibit any further participation by such party, in any manner, in the conduct of the affairs of any insured depository institution." 12 U.S.C. § 1818(e)(1) (2000). The banking authority must show unsafe conduct, injury or likelihood of injury to the bank, and moral turpitude or scienter. *Id.* The Federal Reserve is a federal banking authority under the statute. *Id.* § 1813(z). An institutional-affiliated party includes "any director, officer, employee." *Id.* § 1813(u). *See also* William J. Sweet, Jr. & Stacie E. McGinn, *Financial Holding Company Regulation*, 1206 PLI/CORP 465, 499 (Sept. 2000) ("In addition, the Federal Reserve has authority to remove or suspend officers, directors and employees."). Bernanke testified that the Federal Reserve can make or recommend changes in management, but it cannot do so "unconditionally" and must show that poor management damaged the company. Bernanke Testimony, *supra* note 78, at 21-22. As it turned out in 2009 at the time of writing this Article, many board members as well as Lewis subsequently resigned or announced their resignation after the deal closed and the dust from the controversy somewhat settled. *See infra* note 140 and accompanying text.

[135] *See supra* note 56 & accompanying text.

[136] Board Minutes of Dec. 22, 2008, *supra* note 60, at 3.

government told him not to do so, and he changed his mind only in response to Paulson's threat.[137] Internal e-mails at the Federal Reserve show that Lewis was concerned about lawsuits and sought to use the government's position as a legal defense. Scott Alvarez, the general counsel of the Federal Reserve, wrote in an e-mail:

> [Lewis] said he now fears lawsuits from shareholders for NOT invoking the MAC, given the deterioration at [Merrill]. I don't think that's very likely and said so. However, he still asked whether he could use as a defense that the govt ordered him to proceed for systemic reasons. I said no. It is true, however, that we have done analyses that indicate that not going through with the merger would pose important risks at [the Bank] itself. So here's my question: Can the supervisors formally advise him that a MAC is not in the best interest of his company? If we did, could he cite that in defense if he did get sued for not pursuing a MAC?[138]

In a subsequent e-mail, Alvarez wrote to Bernanke:

> All that said, I don't think it's necessary or appropriate for us to give Lewis a letter along the lines he asked. First, we didn't order him to go forward—we simply explained our views on what the market reaction would be and left the decision to him. Second, making hard decisions is what he gets paid for and only he has the full information needed to make the decision—so we shouldn't take him off the hook by appearing to take the decision out of his hands.[139]

These e-mails show that the consideration of legal risk was a significant factor in explaining the behavior of Lewis and the board. They also raise the possibility that the purported purpose of providing government aid can possibly be used as a defense to a charge of breach of fiduciary duty.

In light of Lewis's concern about litigation, it is possible that he considered terminating the deal, whether contractually sound or not, because Merrill's losses were exposing the failure of due diligence. This bad outcome called into serious question the competence of the management and the board.[140] Recall that the Bank had the superior bargaining leverage on September 13 when Lewis and Thain negotiated the deal, but nevertheless paid a 70 percent premium for Merrill, which would then go on to lose over $15 billion in the fourth quarter of 2008.

A flawed due diligence also may be the basis for another explanation. Faced with a badly executed and overpriced deal of his own fault, Lewis may have shrewdly tried to salvage a bad situation by threatening to invoke a MAC, legal basis notwithstanding. He coerced a frightened government to make financial commitments, which the Bank in fact got as a part of closing the Merrill deal.[141] In

---

[137] *See supra* Part I.A.

[138] E-mail of Scott Alvarez (Dec. 22, 2008), *available at* http://www.usatoday.com/money/_pdfs/09-0611-boa-fed-emails.pdf?loc=interstitialskip.

[139] *Id*.

[140] Bernanke questioned the management's and the board's competence. Bernanke Testimony, *supra* note 86, at 12-13, 23.

[141] *See* STEVEN M. DAVIDOFF, GODS AT WAR: SHOTGUN TAKEOVERS, GOVERNMENT BY DEAL, AND THE PRIVATE EQUITY IMPLOSION 268 (2009) ("This may have been Lewis' strategy all along—knowing the weakness of his [legal] claim he claimed a MAC to win government support."). Bernanke had suspected that Lewis was threatening to invoke the MAC as leverage to extract additional government financial aid, and only later did he

the end, the government also made sure that Lewis and the board paid a personal price for this deception.[142] This explanation suggests that invoking a MAC was not a serious possibility after all, but merely a stalking horse. There are no heroes in this tale, only people making imperfect decisions and exercising bad judgment in extraordinary times and market conditions.

The theory of covering up a badly executed deal finds additional support in internal machinations involving the Bank's senior managers. Timothy Mayopoulos, the Bank's former general counsel, testified to the events leading to his termination.[143] The timeline is telling. On November 12, 2008, he was given a written projection showing that Merrill would lose approximately $5 billion in the fourth quarter.[144] On November 20, the senior management, including Mayopoulos, concluded that the $5 billion projected loss need not be disclosed to shareholders.[145] On December 1, senior executives, including the chief financial officer ("CFO"), asked him to review the MAC clause in the merger agreement, and he advised that there was no MAC because, among other reasons, Merrill's performance was not disproportionately worse than other firms, including the Bank's.[146] On December 3, Mayopoulos learned that Merrill's losses were estimated to be $7 billion.[147] On December 9, he attended a board meeting and there learned that this estimate had increased to $9 billion.[148] On December 10, he was fired per Lewis's order.[149] Subsequently, Brian Moynihan assumed the role of

believe Lewis was genuinely concerned about the deterioration of Merrill's financial situation. Bernanke Testimony, *supra* note 86, at 23-24. In his memoir, Paulson seems to agree. PAULSON, *supra* note 89, at 429 ("Since we had been so clear about our commitment to a government support program, I doubted that Ken was just testing us."). But he also recalls that "Ken raised the idea of using the clause to renegotiate the terms of the deal with Merrill, and I answered that this would cause the same concerns as invoking the MAC to get out of the deal: it would create an extended period of uncertainty in a market that already was being driven by fear." *Id.*

[142] After the deal closed, the Federal Reserve required the Bank to review its top management, and the company made substantial changes to the board. Bernanke Testimony, *supra* note 86, at 13. Regulators imposed a secret sanction against the Bank that called for board restructuring (and perhaps other undisclosed conditions), and as a result the board composition has undergone a wholesale change. Dan Fitzpatrick, *U.S. Regulators to BofA: Obey or Else,* WALL ST. J., July 16, 2009, at C1 (noting that as of April 29, 2009, seven board members left and were replaced by four new board members). As of July 31, 2009, ten board members left. *Bank of America Exits Include 3 More Directors*, N.Y. TIMES, Aug. 1, 2009, at B2. When asked why Lewis was not replaced, Bernanke answered: "Our judgment at the time was that he could continue to lead the company . . . . Obviously, we'll continue to evaluate management and the board as we go forward and make sure that we're comfortable with the leadership at Bank of America." Bernanke Testimony, *supra* note 86, at 49. The practical reality was probably that replacing the board and management in the middle of a crisis may not have been the most prudent thing to do. Moreover, finding capable managers and directors may not be done so quickly. Ultimately, Ken Lewis also decided to resign early for reasons associated with the Merrill Lynch merger and conflicts with government regulators. Carrick Mollenkamp & Dan Fitzpatrick, *With Feds, BofA's Lewis Met His Match*, WALL ST. J., Nov. 9, 2009, at A1.

[143] *Bank Of America And Merrill Lynch: How Did A Private Deal Turn Into A Federal Bailout? Part IV, Before the H. Comm. on Oversight and Government Reform*, 111th Congr. (Nov. 17, 2009) (prepared statement of Timothy J. Mayopoulos, Former General Counsel, Bank of Am. Corp.).

[144] *Id.* at 5.

[145] *Id.* at 6.

[146] *Id.* at 4-5.

[147] *Id.* at 9.

[148] *Id.* at 10-11. Recall that the actual fourth-quarter loss would ultimately be $15.3 billion. *Id.*

[149] Mayopoulos Prepared Testimony, *supra* note 149, at 11.

general counsel, and he opined that the Bank has a valid case to invoke a MAC.[150] Presumably, with this new advice, Lewis was able to represent to Paulson during their December 17 conversation that he was considering invoking a MAC, whereas he could not credibly do so if his general counsel had advised him there was no MAC.[151]

Lewis's use of the MAC as leverage to coerce financial aid is the dark view of the board's motive. However, Lewis is only one board member, albeit the most important, and there are a number of other plausible explanations for the board's decision to close the deal. The board could have been intimidated and unduly influenced by the government. It could have decided to go through with the deal, as the minutes suggest, based on the best interest of the corporation and its shareholders. It could have exercised independent judgment and reasonably deferred to the expert advice of regulators based on broader considerations of systemic risk and public welfare, which were intimately related to the best interest of the company in the longterm though current shareholders suffered in the short term. Lastly, in a complex situation and under stress, perhaps the most likely explanation is that the board acted with mixed motive, taking all of these factors into consideration with each board member assigning different weights to them to come to a collective decision: their entrenchment interest, their desire to remedy a poorly executed deal, the pecuniary interest of shareholders, the long-term interest of the corporation, the financial markets, systemic risk, good faith belief in the expertise of regulators, and the public welfare.[152]

D. *Merger Closing and Fiduciary Duty*

If the merger execution was flawed, was the decision to close a flawed merger also problematic? In the December 22 board meeting, the Bank's board made three important decisions: (1) not to exercise the MAC; (2) not to renegotiate the purchase price; and (3) not to inform shareholders of accelerating losses at Merrill before closing of the deal.[153] Upon an informed decision, the board would

---

[150] Gifford et al. Testimony, *supra* note 63, at 15-16. Apparently, Moynihan had not practiced law in ten years and was not licensed at the time. *Id.* at 16. Effective January 1, 2010, he succeeded Lewis as the Bank's CEO. http://multivu.prnewswire.com/mnr/bankofamerica/41726/.

[151] There is some controversy concerning the advice that the Bank's outside counsel, Wachtell, Lipton, Rosen & Katz, gave to the company and regulators. Apparently, Wachtell advised the Bank on December 19, 2008, that it would be difficult, if not impossible, to terminate the deal with Merrill. Zach Lowe, *Wachtell Under Fire*, AMLAW DAILY, Oct. 23, 2009, *available at* http://amlawdaily.typepad.com/amlawdaily/2009/10/wachtell-under-fire.html. However, a few hours later, it told regulators that the Bank could legally terminate the deal. *Id.*

[152] Consider this testimony from one board member: "[F]or me the key decision was not the government threatening board seats because, if that were the key, then I would not be doing my fiduciary duty. The key was the uncertainty of the MAC, to litigate a MAC, to walk away and say we're not going to close. The uncertainty of whether we'd win was a lose-lose for the Bank of America shareholders." Gifford et al. Testimony, *supra* note 63, at 24.

[153] These decisions, technically inactions or omissions, come within the purview of the business judgment rule because the contrary action (exercising the MAC) was contemplated and rejected in favor of a conscious inaction leading to the scheduled closing of the deal. *See* Aronson v. Lewis, 473 A.2d 805, 813 (Del. 1984) ("[A] conscious decision to refrain from acting may nonetheless be a valid exercise of business judgment."); *cf.* In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 748 (Del. Ch. 2005) (stating that "in instances where directors

be entitled to the protection of the business judgment rule absent disloyalty or bad faith.[154] There would be a loyalty problem if, for example, the board decided not to renegotiate or terminate the deal based on a conflict of interest, such as the desire to avoid scrutiny of its initial flawed decision to approve the merger, or to entrench its interest by acquiescing to the government's demand to close the deal in response to a threat of removal. Let us proceed on the factual assumption that the board's decision was informed, but that the board was conflicted or not independent. The loyalty issue would still have a serious causation problem: that is, whether the board even had the legal option to invoke a MAC at this time.

Found in most merger agreements, a MAC allocates the risk of an adverse event between signing and closing, and is one of the most important clauses in a merger agreement.[155] The provision in the Bank-Merrill merger agreement defines a "material adverse effect" as "a material adverse effect on (i) the financial condition, results of operations or business of such party and its Subsidiaries taken as a whole . . . or (ii) the ability of such party to timely consummate the transactions contemplated by this Agreement."[156] This definition has a significant carve-out:

> "Material Adverse Effect" shall not be deemed to include effects to the extent resulting from . . . changes in . . . general business, economic or market conditions, including changes generally in prevailing interest rates, currency exchange rates, credit markets and price levels or trading volumes in the United States or foreign securities markets, in each case generally affecting the industries in which such party or its Subsidiaries operate and including changes to any previously correctly applied asset marks resulting there from . . . except . . . to the extent that the effects of such change are disproportionately adverse to the financial condition, results of operations or business of such party and its Subsidiaries, taken as a whole, as compared to other companies in the industry in which such party and its Subsidiaries operate . . . .[157]

This definition excludes changes in "general business, economic or market conditions, including changes generally in . . . credit markets and price levels or trading volumes in . . . securities market[s],"[158] but imports back into the definition of material adverse effect changes that are "disproportionately adverse . . . as compared to other companies in the industry."[159]

---

have not exercised business judgment, that is, in the event of director inaction, the protections of the business judgment rule do not apply"), *aff'd*, 906 A.2d 27 (Del. 2006) (en banc).

[154] The presumption of the business judgment rule applies when these two questions are answered affirmatively: Did the board reach its decision in good faith pursuant to a legitimate corporate interest? Did the board do so advisedly? Gantler v. Stephens, 965 A.2d 695, 706 (Del. 2009).

[155] DAVIDOFF, *supra* note 147, at 55-56. *See generally* Robert T. Miller, *The Economics of Deal Risk: Allocating Risk through MAC Clauses in Business Combination Agreements,* 50 WM. & MARY L. REV. 2007 (2009); Ronald J. Gilson & Alan Schwartz, *Understanding MACs: Moral Hazard in Acquisition*, 21 J. L. & ECON. & ORG. 330 (2005); Jonathan M. Grech, Comment, *"Opting Out": Defining the Material Adverse Change Clause in a Volatile Economy*, 52 EMORY L.J. 1483 (2003).

[156] The MAC is found in the merger agreement. MERGER PROXY, *supra* note 15, Appendix A-13 to A-14.

[157] *Id.*

[158] This carve-out from a MAC is typical. *See* DAVIDOFF, *supra* note 141, at 60 (noting that 89 percent of MACs exclude "change in the economy or business in general" and 70 percent exclude "changes in general conditions of the specific industry") (citations omitted).

[159] MERGER PROXY, *supra* note 15, Appendix A-13.

This carve-out most probably would cover the deterioration of asset quality on Merrill's portfolio. It is clear that the worsening condition of the capital markets directly caused Merrill's losses. This situation is specifically carved-out of the definition of material adverse effect. The Bank could have argued that Merrill had previously marked its assets incorrectly. However, this is a matter of past due diligence, and the MAC is a forward-looking provision addressing a change in condition after the signing. It would have been difficult to argue that Merrill's changes were disproportionately adverse as compared to other companies. Merrill was one of only five independent investment banks remaining after the industry consolidation of the 1990s, the others being Goldman Sachs, Morgan Stanley, Lehman Brothers, and Bear Stearns.[160] By the time Merrill was accruing the losses in question, Bear Stearns and Lehman Brother, two true peers of Merrill, had already succumbed to the crisis, and Goldman Sachs and Morgan Stanley were struggling to survive.[161] Most other major financial institutions with investment banking or trading activities, such as Citigroup, AIG, and UBS, were also highly distressed.[162] Importantly, as well, the Bank was also distressed, and Merrill's situation was arguably no more adverse than the Bank's.[163] By this time as well, the government forced the leading financial institutions, including Merrill and the Bank, to accept TARP funding.[164] Extreme distress in financial condition was the norm in the investment banking and financial institutions sector, which is not surprising given that their distress triggered the worldwide economic crisis.[165]

The MAC was written into the merger agreement on September 14-15, 2008, at a time when the financial markets were becoming highly unstable.[166] The merger consideration was a stock exchange, which meant that the market values of

---

[160] In the post-Glass-Steagall Act era, most investment banks were acquired by large commercial banks: for example, UBS Warburg and Credit Suisse First Boston. The acquisition of Bear Stearns by JPMorgan Chase, Merrill by the Bank, and Lehman Brothers by Barclays continue this trend. Currently, there are only two pure investment banks, Goldman Sachs and Morgan Stanley, and these firms have converted to bank holding companies in 2008 during the height of the financial crisis. Rhee, *supra* note 11, at 603.

[161] *See generally* SORKIN, *supra* note 127.

[162] *See* Eric Dash & Julie Creswell, *Citigroup Saw No Red Flags Even as It Made Bolder Bets*, N.Y. TIMES, Nov. 23, 2008, at A1; Gretchen Morgenson, *Behind Insurer's Crisis, Blind Eye to a Web of Risk*, N.Y. TIMES, Sept. 27, 2008, at A1; Nelson Schwartz & Julia Werdigier, *UBS to Write Down Another $19 Billion*, N.Y. TIMES, Apr. 2, 2008, at A1.

[163] On a comparative basis, the Bank's stock price underperformed Merrill's for the time period September 15 to December 31, 2008. On September 15, the closing stock prices were: the Bank $26.55, and Merrill $13.80. On December 31, the closing stock prices were: the Bank $14.08, and Merrill $15.83. There is much information incorporated into the stock, and one such factor here must be the assumption of Merrill's losses by the Bank through the merger, which partially explains the relative stock performance. Nevertheless, the point still holds that the Bank was not in a qualitatively superior position to Merrill during a systemic financial crisis the effects from which no financial institution escaped. *See infra* note 165 and accompanying text.

[164] *See supra* note 36 and accompanying text.

[165] The Bank's general counsel at the time did not believe that it had a MAC because the Bank was in similarly distressed stated: "[I]n order for there to be a material adverse change, there had to be an event that had occurred that had a disproportionate impact on Merrill Lynch in contrast to other companies in the industry, including Bank of America. And as I discussed with Mr. Price, the stock price of Bank of America had declined almost as much as Merrill Lynch's. Bank of America had gone out and raised substantial capital. It cut its dividend. Its earnings had been reduced. So basically, both companies had suffered significant downturns in their prospects in the time since the merger had been announced." Gifford et al. Testimony, *supra* note 63, at 17.

[166] MERGER PROXY, *supra* note 15, at 50-51.

both Merrill and the Bank were subject to fluctuations in the value of their assets. The parties clearly understood that market volatility would likely affect the deal price, but each party equally assumed this risk. Although Merrill suffered heavy losses, they were not a MAC as defined in the merger agreement. No Delaware case has upheld the exercise of a MAC, and this is the result of a deliberate policy choice.[167] The application of Delaware case law on material adverse change clauses suggests that the Bank's legal position was untenable.[168]

Without a material adverse event, the board could not have terminated the merger, or credibly renegotiated the price. In ordinary times, perhaps the Bank could have attempted to invoke the MAC to renegotiate the merger consideration even with a low probability legal hand.[169] Frivolous cases are sometimes settled for positive value, especially when the holder of the legal right is vulnerable.[170] But an attempt to do so in these circumstances would have injected significant systemic risk into the financial system as Paulson testified: "[I]t would be unthinkable for Bank of America to take this destructive action for which there was no reasonable legal basis and which would show a lack of judgment."[171]

Given the absence of a viable legal option, neither the shareholders nor the board could have taken any action to avoid the losses and thus the board had no fiduciary duty under state law to disclose the Merrill losses, however material, outside of whatever SEC obligations there were.[172] At the time, market volatility affected the values of assets and liabilities on a day-to-day, mark-to-market basis.[173] The internal estimations of Merrill's losses were changing day-to-day in swings of billions of dollars.[174] These wild swings in estimates caused the buyer's remorse. In this situation, the efficacy of disclosure wholly breaks down because one day's accurate disclosure could very well have been the next day's inaccurate information. What if the board disclosed a $12 billion estimated loss on a Monday, and on Friday this estimation increased to $15 billion? The board must have realized the potentially grave harm the corporation risked sustaining if it voluntarily disclosed certain financial information about Merrill's mounting losses.[175] Voluntary disclosure of bad news in an unstable market may have resulted in greater harm to both corporations and to a financial market already in peril. These were unprecedented times in the capital markets.

[167] Hexion Specialty Chems, Inc. v. Huntsman Corp., 965 A.2d 715, 738 (Del. Ch. 2008).
[168] *See id.*; In re IBP, Inc. S'holder Litig., 789 A.2d 14, 71 (Del. 2001) (contract governed by New York law); Frontier Oil v. Holly Corp., No. Civ. A. 20502, 2005 WL 1039027, at 34 (Del. Ch.).
[169] *See* DAVIDOFF, *supra* note 141, at 62 ("[T]he ambiguous wording of the MAC drives the parties toward settlement of their dispute, albeit at a lower, negotiated price.").
[170] *See* Robert Rhee, *Toward Procedural Optionality: Private Ordering of Public Adjudication*, 84 N.Y.U. L. REV. 514, 517 (2009).
[171] Paulson Prepared Testimony, *supra* note 86, at 5.
[172] Metro Commc'n Corp. BVI v. Advanced Mobilecomm Techs. Inc., 854 A.2d 121, 153 (Del. Ch. 2004) (internal quotation marks omitted). *See also* Malone v. Brincat, 722 A.2d 5, 12 (Del. 1998) ("The Directors of a Delaware corporation are required to disclose fully and fairly all material information within the board's control when it seeks shareholder action.").
[173] *See supra* text accompanying notes 51, 150, 151, 153,and 154
[174] *Id*.
[175] *See Malone*, 722 A.2d at 12; Stroud v. Grace, 606 A.2d 75, 85 (Del. 1992).

When Paulson threatened to fire the Bank's management and board, the threat created a potential loyalty problem. It is plausible that the board did not act independently and its members were conflicted. Under Delaware law, a director is independent if she decides on the merits of the transaction rather than on extraneous considerations.[176] Independence is inconsistent with dominion or control by an individual or entity interested in the transactions.[177] A director has a conflict of interest if she will be materially affected by a board's decision, in a manner not shared by the corporation and the shareholders.[178] Self-interest includes a desire for entrenchment.[179] It is not enough that a contrary decision could result in a loss of position; other facts indicting a disloyal motive must be shown.[180] A credible, articulated, direct threat of termination would probably suffice to show a potential loyalty problem.[181]

The facts established through testimony are: Lewis wanted to exercise the MAC;[182] Paulson threatened that to do so would result in the termination of the board and management; upon management's recommendation, which was based on "instructions" from the government, the board did not invoke the MAC. These facts plausibly suggest three scenarios: (1) Lewis and the board hoodwinked the government with the threat of invoking a low probability legal strategy with a high probability of large collateral harm if the threat was carried out in an effort to coax public financial aid; (2) upon reconsideration after receipt of the government's strongly termed advice, the board was persuaded by the government's rationale and they exercised independent judgment not to invoke a MAC consistent with the government's reasoning to proceed with closing the merger; or (3) the board lacked independence and simply acquiesced to the government's demand.

Negotiations ethics aside, the first decision advanced the Bank's financial health. The second decision would be an independent, informed business judgment, which may or may not have resulted in net financial harm to the company. These decisions would be entitled to the protection of the business judgment rule. The third decision would be tainted for lack of independence. The board would have rubber stamped a government order. However, the resulting decision would not be automatically void. Section 144(a)(3) of the DGCL shields a transaction or contract from voidability if it "is fair as to the corporation as of the time it is

---

[176] Seminaris v. Landa, 662 A.2d 1350, 1354 (Del. 1995); Aronson v. Lewis, 473 A.2d 805, 816. *See also* Rales v. Blasband, 634 A.2d 927, 935 (Del. 1993) ("[T]he board must be able to act free of personal financial interest and improper extraneous influences.").
[177] *Seminaris*, 662 A.2d at 1354; *Aronson*, 473 A.2d at 816; *Rales*, 634 A.2d at 935.
[178] *Seminaris*, 662 A.2d at 1354.
[179] Gantler v. Stephens, 965 A.2d 695, 706 (Del. 2009); Grobow v. Perot, 539 A.2d 180, 188 (Del. 1988), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954-55, 958 (Del. 1985).
[180] *Gantler*, 965 A.2d at 707.
[181] *Id*.
[182] Lewis represented to the board that he told federal regulators that the Bank would invoke a MAC and seek to renegotiate the transaction with Merrill. Minutes of Special Meeting of Board of Directors of Bank of Am. Corp., at 2 (Dec. 30, 2008), *available at* http://www.oag.state.ny.us/media_center/2009/apr/pdfs/Exhibit%20to%204_23.09%20letter.pdf [hereinafter "Board Minutes of Dec. 30, 2008"].

authorized, approved or ratified, by the board of directors, a committee or the shareholders."[183] Where there is a loyalty problem, the presumption of the business judgment rule does not apply and the transaction is actively scrutinized for fairness.[184]

The fairness inquiry would fail for lack of an injury.[185] The board's decision to close the deal was proper for the simple reason that there was no choice. Intentional or not, Lewis and the board incorrectly asserted the legality of invoking the MAC. Terminating or renegotiating the deal would have led to the losing side of a lawsuit. Such action would have damaged the financial market with adverse consequences on both firms.[186] The board would have run the risk of alienating the government and diminishing the company's ability to access financial aid, at least with the current board and management still in place. Whether or not the board was unduly influenced, its decision turned out to be fair and advanced the best interest of the company. This could be the unusual case in which the board took the correct action *because it was disloyal*. A plausible motive for attempting to invoke a weak case for a MAC was a desire to remedy a poorly executed and negotiated merger by renegotiating the merger consideration. This ill-advised legal strategy to fix a prior wrong could have produced an even worse outcome for the company. The government, acting in the best interest of the public welfare, forced the correct board action, an outcome possible only when the interests of the public and the corporation are aligned and a risky possibility of increasing the shareholder's pecuniary stake potentially conflicts with these interests.

What do we conclude from this case study? Legally, liability under Delaware corporate law is unlike because of exculpation for any duty of care violations, and because there simply was no injury to shareholders under an assumption that their vote for the merger was not tainted by faulty disclosure. More broadly, the case study reveals that there is a real possibility, though unlikely given the available facts, that shareholders "took a bullet" in terms of assuming large short-term losses to avoid the injection of more systemic risk into a crippled financial system, and that the company's management and board, prompted by government entreaties, were motivated in part at least to advance the public's interest in stabilizing a financial crisis over the shareholder's immediate pecuniary interest. This recital of the facts, currently known as of the writing of this Article, is important to show the contextual color of the regulatory and corporate decision making. This case study reveals an important aspect of corporate governance that thus far has not had an opportunity to be analyzed: that is, corporate governance is not always a purely private affair, but instead can be a public-private coordinated decision in times of national crisis or systemic risk.

---

[183] DEL. CODE ANN.tit. 8, § 144(a)(3) (2009).

[184] *See* Weinberger v. UOP, Inc., 457 A.2d 701, 710 (Del. 1983) ("[W]here [directors] stand on both sides of a transaction, [they have] the burden of establishing its entire fairness . . . .").

[185] *See* Dalton v. Am. Inv. Co., 490 A.2d 574, 585 (Del. Ch. 1985) (ruling against plaintiff on the ground that the alleged breach of fiduciary duty did not cause the challenged transaction giving rise to the plaintiff's injury).

[186] *See supra* note 97 and accompanying text.

QUESTIONS

1. What is the role of a private firm during a public crisis?

2. What are the responsibilities of a board during a public crisis?

3. What is the role of government in these situations?

4. Suppose that Bank of America had the legal option to terminate the merger with Merrill Lynch. What should the Bank of America board have done? What are the criteria by which the board makes its decisions?