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Whither Wachovia - Wells Fargo Wins the Battle for the Storied North Carolina Banking Institution

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WHITHER WACHOVIA? WELLS FARGO WINS THE BATTLE FOR THE STORIED NORTH CAROLINA BANKING INSTITUTION

BY FRANK A. HIRSCH JR.* AND JOSEPH S. DOWDY**

I. INTRODUCTION

In September 2008, Wachovia Corporation (Wachovia) was the fourth largest bank holding company in the United States based on assets and the third largest U.S. full-service brokerage firm based on financial advisors.[1] By the first weekend in October 2008, however, the 129-year old[2] financial giant unexpectedly became a casualty of the financial services market meltdown which started with the subprime market collapse in June 2007.[3] Facing a

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1. Ehrenhaus v. Baker, 2008 WL 5124899, 2008 N.C. Bus. C. 20, ¶ 54 (N.C. Super. Ct. 2008) (unpublished decision) (citing Top 50 Bank Holding Companies Summary Page, http://www.ffiec.gov/nicpubweb/nicweb/Top50form.aspx (last visited Dec. 2, 2008) and Proxy Statement-Prospectus dated 21 November 2008, at 88, *available* at http://www.nc businesscourt.net/TCDDotNetPublic/default. aspx?CID=2 (enter "Ehrenhaus" into the "Search" field; click "08CVS22632" hyperlink; click "Filing of Wachovia Corporation's Proxy Statement of Nov. 21, 2008" hyperlink)); *see also* Wachovia Company Facts As Of September 30, 2008, http://www.wachovia .com/inside/page/ 0,,132_148,00.html (last visited Jan. 17, 2009). As of September 50, 2008, the company reported holding $764.4 billion in assets and $418.8 billion in total deposits.

2. Wachovia National Bank was opened on June 16, 1879, in Winston, North Carolina. Wachovia Company History, http://www.wachovia.com/inside/page/0,,132_ 150,00.html (last visited Jan. 17, 2009). The Wachovia Loan and Trust Company opened on June 15, 1893, also in Winston, North Carolina. *Id.* The two companies merged in 1911. *Id.* According to information published by Wachovia, the merger created "the largest bank in the South and the largest trust operation between Baltimore and New Orleans." *Id.*

3. David Leonhardt, *Lesson From a Crisis: When Trust Vanishes, Worry*, N.Y. TIMES, October 1, 2008, at A1 (documenting the fall of Wachovia and the chronology of the credit crisis). One commentary explained the financial market meltdown as follows:

> The current, more serious stage of the crisis began in mid-September, after the collapse of Lehman Brothers and the Fed's takeover of the American International Group. Those events created a new level of fear. Banks cut back on making loans and instead poured money into Treasury bills, which paid almost no interest but also came with almost no risk. On the loans they did make, banks demanded higher interest rates.
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> . . . .
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> So why aren't some banks stepping into the void and taking advantage of the newly high interest rates to earn some profit?
> There are two chief reasons. One is fairly basic: bankers are nervous that borrowers who look solid today may not turn out to be so solid. Think back to 1930, when the American economy seemed to be weathering the storm.
> The second reason is a bit more complex. Banks own a lot of long-term assets (like your mortgage) and hold a lot of short-term debt (which is cheaper than long-term debt). To pay off this debt, they need to take out short-term loans.
>
> In the current environment, bankers are nervous that other banks might shut them out, out of fear, and stop extending that short-term credit. This, in a nutshell, brought about Monday's collapse of Wachovia and Glitnir Bank in Iceland. To avoid their fate, other banks are hoarding capital, instead of making seemingly profitable loans. And when capital is hoarded, further bank failures become all the more likely.

Id.

The subprime mortgage crisis resulted from lenders offering home loans to persons who were less-than-desirable credit risks during the housing boom:

> Subprime loans are designed for borrowers who have characteristics that suggest a poorer credit risk. Subprime borrowers pay higher interest rates, higher loan fees, or both, in order to compensate lenders for the greater risk of default. Only 14% of mortgages are subprime loans, yet subprime loans constitute over 64% of the loans in foreclosure.
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> . . . .
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> The vast majority of subprime mortgage loans are sold by the entity that originates the loan into the secondary market for "mortgage-backed securities." This shifting of risk from the originator of the loan to investors in securities comprised of these loans fueled the rapid expansion of the subprime market. Unfortunately, securitization has also likely encouraged many of the unfair and deceptive practices. The regulatory structures erected in previous generations, including disclosure requirements

tumbling stock price and a silent run on its deposits,[4] Wachovia encountered a liquidity crisis on September 28, 2008, to which the Federal Deposit Insurance Corporation (FDIC) responded by arranging a shotgun marriage to Citigroup, Inc. (Citigroup).[5] While most viewed the forced deal between Wachovia and Citigroup an assumed inevitability, on October 3, 2008, Wells Fargo & Co (Wells Fargo) swooped in and made a last-minute bid to acquire Wachovia for $15 billion, without government assistance, a bid which ultimately resulted in the merger of the two companies.[6]

The Wells Fargo acquisition of Wachovia did not occur without challenges. In *Ehrenhaus v. Baker*, the North Carolina

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> and bank supervision, do not fit well with and do not effectively control the problems created in a world of expansive mortgage lending, especially when that lending occurs through securitized financing.

Prentiss Cox, *Foreclosure Reform Amid Mortgage Lending Turmoil: A Public Purpose Approach,* 45 HOUS. L. REV. 683, 689-91 (2008).

The subprime mortgage crisis contributed to—and compounded the financial markets crisis.

> As noted by former Representative Jack Kemp (R-N.Y.), "the subprime mortgage meltdown exists because there was an abundance of liquidity and soaring property values in many areas of the country, which allowed for exuberant lenders to provide ill-advised subprime loans, particularly Adjustable Rate Mortgages, which represent about 60% of foreclosures." Now that the housing bubble has burst, and prices have begun to drop, "Americans' homes are in jeopardy because the value of their [homes are] less than their actual mortgages." While rising prices had afforded economically distressed homeowners the benefit of increasing home equity to ease the path to refinancing, many borrowers now face debts larger than their underlying assets.

Rachel Carlton, *Recent Development: Mortgage Forgiveness Debt Relief Act of 2007,* HARV. J. ON LEGIS. 601, 603-04 (2008) (noting that upward adjustments in subprime ARM interest rates occurring with simultaneous declines in home prices will likely result in increased foreclosures).

4. Rick Rothacker & Kerry Hall, *Wachovia faced a 'silent' bank run: Fearing a loss of funding over the weekend, the FDIC forced the sale,* THE NEWS & OBSERVER, Oct. 2, 2008 at A1, *available at* http://www.newsobserver.com/business/story/1240315.html (last visited Jan. 17, 2009) (hereinafter "*Wachovia faced a silent bank run*").

5. Ben White & Eric Dash, *Wachovia, Looking for Help, Turns to Citigroup,* N.Y. TIMES, Sept. 27, 2008, at C1 (hereinafter "*Wachovia looking for Help*").

6. Eric Dash & Ben White, *Wells Fargo Swoops In,* N.Y. TIMES, Oct. 4, 2008, at C1 (hereinafter "*Wells Fargo Swoops In*").

Business Court reviewed the terms of the Wells Fargo-Wachovia merger in the context of a putative class action brought by a Wachovia shareholder seeking to stop the transaction.[7] The named plaintiff, Irving Ehrenhaus, alleged that the members of Wachovia's board of directors breached their fiduciary duties by entering into a Merger Agreement with Wells Fargo pursuant to which Wells Fargo received 39.9% of the stock voting rights in Wachovia prior to the shareholder vote on the merger. Further, Wachovia's directors could withdraw their support for – but could not prevent a shareholder vote on – the Wells Fargo merger.[8] In an opinion issued on December 5, 2008, Business Court Judge Albert Diaz declined to grant the preliminary injunction that Ehrenhaus requested to prevent the merger.[9] For Judge Diaz, the case turned on the application of the business judgment rule, and he was persuaded that Wachovia's directors had not breached their fiduciary duties in accepting the Merger Agreement with Wells Fargo, given the unfavorable market conditions and time pressures confronting them.[10]

This article chronicles the events that led to Wachovia's sudden decline and its acquisition by Wells Fargo. Part I discusses how market events impacted the Business Court's ruling that Wachovia's directors made the best decision they could under imposing circumstances. Part II places Wachovia's decline in context by recounting the events leading up to the bank's failure, including the mounting financial difficulties of Wachovia following its acquisition of Golden West Financial Corporation (Golden West) in 2006 and the silent run on deposits Wachovia encountered during the financial markets crisis. Part III address the FDIC's role in forcing Wachovia into a merger situation by refusing Wachovia's request for assistance in remaining independent and by attempting to force a bank combination between Citigroup and Wachovia. Part IV turns to the circumstances under which Wachovia's directors accepted Wells

7. Ehrenhaus v. Baker, 2008 WL 5124899, 2008 N.C. Bus. C. 20, ¶ 54 (N.C. Super. Ct. 2008) (unpublished decision).

8. *Id.*

9. *Id.*

10. *Id.*

Fargo's acquisition bid and the merger terms to which they agreed. Part V of the article addresses how the unique circumstances of Wachovia's collapse affected the Business Court's assessment of the Wells Fargo merger and its decision that the challenged aspects of the merger should not be undone. Finally, some questions are raised and some observations made about the demise of Wachovia as an institution.

II. THE PRELUDE TO WACHOVIA'S COLLAPSE

A. *Wachovia's Mounting Problems Following the Acquisition of Golden West*

By mid-2008, Wachovia, like many financial institutions was suffering losses as a result of the credit crisis.[11] Many attributed Wachovia's woes to its acquisition of Golden West in late 2006, at the peak of the housing boom.[12] As one observer noted, "Golden West's heavy reliance on option adjustable-rate mortgages loaded Wachovia's balance sheet with them almost precisely at the time the cyclical credit-quality tide was turning against the product."[13] By some accounts, Golden West executives exerted their will after the merger and convinced Wachovia to continue offering borrowers "pick-a-payment" loans,[14] which in some cases led to negative amortization.[15] Wachovia ultimately

11. Eric Dash, *Surprise Loss at Wachovia Stirs Profit-Season Unease*, N.Y. TIMES, Apr. 15, 2008, *available at* http://www.nytimes.com/2008/04/15/business/15bank.html; Eric Dash, *Bank Investors Expect Less as Losses Mount*, N.Y. TIMES, July 23, 2008, at C1.

12. *Wachovia Looking for Help*, *supra* note 5.

13. Paul Davis, *Was It Really All Golden West?*, 173 AM. BANKER 1 (Oct. 1, 2008). Davis asserts that a number of other causes, in addition to the Golden West transaction, played a substantial role in Wachovia's downfall. *Id.* Some others placed more emphasis on the increase in adjustable rate mortgages Wachovia acquired as part of the Golden West transaction. *See, e.g., Wachovia Looking for Help*, *supra* note 5 ("'Wachovia has a real problem,' said Len Blum of the investment bank Westwood Capital. 'Option ARMs are probably the worst mortgage products out there and Wachovia has a lot more of them than it has in tangible equity.'").

14. Dean Foust, *Wachovia: Golden West Wasn't Golden*, BUS. WEEK (June 4, 2008), *available at* http://www.businessweek.com/magazine/content/08_24/b40880263 92 160.htm?chan=magazine+channel_top+stories.

15. Les Christie, *Pick-a-payment loans turn poisonous: Defaults on option ARM mortgages are expected to double in the next two years, driving foreclosure rates even higher*, CNNMONEY.COM, http://money.cnn.com/2008/09/02/real_estate/pick_a_pois

tightened standards for its pick-a-payment loans[16] and did away with the below-interest minimum payment option;[17] nonetheless, the approximately $120 billion portfolio of pick-a-payment mortgages took its toll on Wachovia's bottom line.[18] The decision to acquire Golden West was a key factor that resulted in the eventual firing of Wachovia's former CEO, Ken Thompson.[19]

Other problems may have contributed to Wachovia's financial insecurity as well. One author has argued that

> Wachovia . . . faced a host of other problems. Some of the biggest: $4.7 billion in charges from structured products and leveraged loans, $4.1 billion in provision expense for loans outside the option ARM book, and $6.1 billion in goodwill impairment charges associated with commercial-related businesses. More hits have come from legal reserves, tax issues, securities losses, and merger-related charges.
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> The long list of setbacks left the company in a deep

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on/index.htm (Sept. 3, 2008) (last visited Jan. 17, 2008). With "pick-a-payment" loans,

> Borrowers who take out option ARM loans have four payment options. They can make the minimum payment, which doesn't cover all of the interest; an interest-only payment; a payment that pays off the loans in 30 years; or one that would pay it off in 15 years.
>
> The problem is most borrowers pay just the minimum. According to First American Loan Performance, which tracks the mortgage market, more than 65% of option ARM borrowers make only minimum payments every month. They can continue to do that for up to five years, or until their loan balance reaches 110% to 125% of the original principal.

Id.

16. Foust, *supra* note 14.
17. Associated Press, *Wachovia quits offering risky mortgage loan: Pick-A-Payment option allowed borrowers to pay less than interest monthly,* MSNBC.com (June 30, 2008), http://www.msnbc.msn.com/id/25460875 (last visited Jan. 17, 2009).
18. *Id.*; Foust, *supra* note 14.
19. *Id.*

> hole and ill-equipped for adversity. Analysts noted its tangible capital ratio was on the decline and stood at 4.8% before it announced the Golden West deal in May 2006.
>
> In the past year the $812 billion-asset Wachovia has racked up more than $25 billion in charges and losses. Roughly a fourth of the total came from loan-loss provisions tied to its so-called pick-a-payment portfolio.[20]

In addition, although no wrongdoing was determined, Wachovia agreed to pay a $144 million settlement in April 2008 to end an investigation by the Office of the Comptroller of the Currency into allegations that Wachovia had engaged in unsafe practices that allowed telemarketers to use borrowers' account information improperly.[21]

B. *The Financial Services Market Meltdown Led to a Run on the Bank Before the Federal Bailout Program Became an Option*

Even with these problems, however, few if any were predicting the downfall of the Charlotte-based banking behemoth.[22] Indeed, in mid-September of 2008, Wachovia was

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20. Davis, *supra* note 13.

21. Charles Duhigg, *Big Fine Set for Wachovia to End Case*, N.Y. TIMES, Apr. 26, 2008, at C1.

22. *See, e.g.*, Andrew Ross Sorkin & Eric Dash, *Morgan Stanley Is Said to Press for Merger With Wachovia*, N.Y. TIMES, Sept. 19, 2008, at C7 (explaining Wachovia's strengths and weaknesses in the financial marketplace). Sorkin and Dash did note the following, however:

> Wachovia has been ravaged by the trouble in the housing market. Its 2006 acquisition of Golden West Financial, a large California mortgage lender that specialized in so-called pay-option mortgages, proved disastrous. The bank also faces mounting losses on loans to builders and commercial real estate developers. And its investment bank was a big player in complex mortgage-related investments and buyout financing to middle-market companies, two areas hit hard by the crisis.

engaged in serious merger discussions with Wall Street investment firm Morgan Stanley, a possible move designed to help both companies navigate the uncertain financial situation.[23] A week later, even after the Morgan Stanley merger fell through, Wachovia still appeared to have the option of either striking a deal with another financial institution or "going it alone."[24] Like other financial institutions, Wachovia had outlined a plan to increase profitability by cutting jobs, cutting dividends, reducing the number of its adjustable rate mortgage holdings, and decreasing its total assets.[25] Like other financial institutions, Wachovia was also taking a wait-and-see approach to determine what assistance the much anticipated federal credit market "bailout" would offer.[26]

For Wachovia, the wait proved too long. On Thursday, September 25, 2008, federal regulators seized the assets of Washington Mutual and brokered an emergency sale of some of WaMu's assets to JP Morgan Chase.[27] In the wake of the Washington Mutual collapse, Wachovia's stock – which had been selling at more than $50 per share one year earlier – fell twenty-seven percent the following day, closing at approximately $10.[28] Also on September 25th, uncertainty in the financial markets led

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Id.

23. One option under consideration during the merger discussions was to split Wachovia into a "good bank" and a "bad bank," with the bad bank holding Wachovia's toxic, sub-prime assets and to then have Morgan Stanley merge only with the "good bank." *Id.* The merger discussions also appeared to contemplate a foreign investor. *Id.*

24. Rick Rothacker, *Which way should Wachovia go? Now that a merger with Morgan Stanley is apparently off*. . . , THE CHARLOTTE OBSERVER, Sept. 24, 2008, at D1, *available at* http://www.charlotteobserver.com/business/story/212870.html.

25. *Id.* Wachovia's CEO, Robert Steel outlined the following specific measures to preserve $5 billion in capital by the end of 2009, including "[1] eliminating about 7,000 jobs, or 6 percent of the [Wachovia] workforce[, 2] cutting the quarterly dividend to 5 cents per share[, 3] decreasing the size of the bank's Pick-A-Pay loan portfolio[, and 4] reducing total assets, which could include the sale of 'noncore' businesses." *Id.*

26. *Id.*

27. Eric Dash and Andrew Ross Sorkin, *Government Seizes WaMu and Sells Some Assets*, N.Y. TIMES, Sept. 26, 2008, at A1, *available at* http://www.nytimes.com/2008/09/26/business/26wamu.html?partner=rssnyt.

28. *Wachovia Looking for Help, supra* note 7; Mitch Weiss, *Wachovia's fall jolts Charlotte: The queen city loses a jewel from its financial crown and looks toward an humbling transition*, THE NEWS & OBSERVER, Sept. 30, 2008, at B5, *available at* http://www.newsobserver.com/business/story/1237574.html (last visited Jan. 17, 2009).

to a "silent" run on Wachovia's deposits, with businesses and institutions with large accounts lowering their balances to below the $100,000 amount insured by the FDIC.[29] The following Monday, the stock plunged another eighty-two percent, closing at a meager $1.84.[30]

By late September, as Wachovia went from "hurt" to "weakened" and from "weakened" to "in trouble,"[31] it sought potential mergers with at least Wells Fargo, Citigroup, and Banco Santander S.A. of Spain.[32] The hopes Wachovia had for the passage of a $700 billion bailout package for struggling financial institutions were dashed when the House of Representatives rejected the original version of the legislation on Monday, September 29, 2008.[33] Although it was only five days later that Congress passed a $700 billion economic bailout package designed

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29. *Wachovia faced a 'silent' bank run*, *supra* note 6. A run on a banks deposits poses risks to the entire banking system:

> The classic example of systemic risk in this context is a "bank run," in which the inability of a bank to satisfy withdrawal-demands causes its failure, in turn causing other banks or their creditors to fail. The original failure can occur when depositors panic, converging on the bank to quickly withdraw their monies. Because banks keep only a small fraction of their deposits on hand as cash reserves, a bank may have insufficient cash to pay all withdrawal-demands, causing it to default and ultimately fail. The chain of subsequent failures can occur because banks are closely intertwined financially. They lend to and borrow from each other, hold deposit balances with each other, and make payments through the interbank clearing system (whereby banks with equity and deposit accounts exceeding their liabilities can offer these excess funds to other banks who wish to increase loans to their customers). Because of this interconnectedness, one bank's default on an obligation to another may adversely affect that other bank's ability to meet its obligations to yet other banks, and "so on down the chain of banks and beyond.

Stephen L. Schwatz, *Systemic Risk*, 97 GEO. L.J. 193, 199-200 (2008). Thus, the run on deposits likely explains the urgency of the FDIC in forcing a merger of Wachovia as discussed *infra* Part III of this note.

30. Weiss, *supra* note 28.

31. *Id.* (quoting Wachovia wholesale banking executive Carlos Evans).

32. Robin Sidel, David Enrich, & Dan Fitzpatrick, *Troubled Wachovia Seeks Out a Merger*, WALL ST. J., Sept. 27, 2008, at A1.

33. Carl Hulse & David M. Herszenhorn, *Defiant House Rejects Huge Bailout; Next Step Is Uncertain*, N.Y. TIMES, Sept. 30, 2008, at A1.

to assist the ailing financial markets,[34] such aid came too late for Wachovia. Unable to negotiate a merger or to receive the benefit of a federal bailout, Wachovia cratered, leaving Citigroup and Wells Fargo to fight over the remains of the former banking titan.[35]

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34. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008); *see also* David M. Herszenhorn, *Bailout Plan Wins Approval; Democrats Vow Tighter Rules*, N.Y. TIMES, Oct. 4, 2008, at A1. The New York Times describes the history of the bailout as follows:

> On Sept. 19, 2008, Treasury Secretary Henry M. Paulson Jr. proposed a sweeping bailout of financial institutions battered by bad mortgages and a loss of investor confidence. In Mr. Paulson's original proposal -- called the Troubled Asset Relief Program -- he asked Congress for $700 billion to use to buy up mortgage-backed securities whose value had dropped sharply or had become impossible to sell.
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> ....
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> The plan in its original form was quickly rejected by both Democrats and Republicans in Congress and was criticized by many economists across the political spectrum. Congress insisted on adding provisions for oversight, limits on executive pay for participating companies and an ownership stake for the government in return for its investments.
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> Even so, the plan proved to be strikingly unpopular with an outraged public, and on Sept. 29 it failed in the House of Representatives, primarily from a lack of Republican support. But as the markets continued to plunge, a slightly altered version won the support first of the Senate, on Oct. 1, and of the House, on Oct. 3. President Bush quickly signed the bill.
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> Shortly afterward, Mr. Paulson reversed course, and decided to use the $350 billion in the first round of funds allocated by Congress not to buy toxic assets, but to inject cash directly into banks by purchasing shares, an approach that many Congressional Democrats had pushed for earlier. In an initial round of financing, nine of the largest banks were given $25 billion apiece.

Credit Crisis - Bailout Plan, N.Y. TIMES, http://topics.nytimes.com/topics/reference/timestopics/subjects/c/credit_crisis/bailout_plan/index.html (last visited Jan. 17, 2009).

35. Eric Dash, *Weekend Legal Frenzy Between Citigroup and Wells Fargo for Wachovia*, N.Y. TIMES, Oct. 6, 2008, at B1 (hereinafter "*Weekend Legal Frenzy*").

III. THE FDIC'S REFUSAL TO SUPPORT WACHOVIA AS A STAND-ALONE FINANCIAL INSTITUTION AND ITS EFFORTS TO FORCE A MERGER BETWEEN WACHOVIA AND CITIGROUP

With Wells Fargo indicating that it felt too rushed to enter into a proposed merger and with Wachovia apparently feeling less enthusiastic about a merger with Citigroup, Wachovia submitted a plan to the FDIC shortly after midnight on Monday, September 29, 2008, in which Wachovia asked for assistance in remaining a stand-alone entity.[36] Wachovia proposed that the FDIC provide a loss-sharing agreement for "a designated loan portfolio" (presumably the adjustable rate "pick-a-payment" loan portfolio), take an equity stake in the lender, and allow Wachovia to raise $10 billion in new capital.[37]

In less than four hours and at 4:00 a.m., the FDIC rejected Wachovia's proposal and essentially mandated the government-assisted sale of Wachovia's banking subsidiaries to Citigroup for $2.16 billion, with government protection being provided to Citigroup for certain problem loans on Wachovia's books.[38] The FDIC gave Wachovia until 6:30 a.m. to accept the arrangement or risk having its banking subsidiaries placed into receivership.[39] The FDIC ordered immediate negotiations between Wachovia and Citigroup, and within hours issued the following statement:

> Citigroup . . . will acquire the bulk of Wachovia's assets and liabilities, including five depository institutions and assume senior and subordinated debt of Wachovia . . . . Wachovia Corporation will continue to own Wachovia Securities, AG Edwards and Evergreen. The FDIC has entered into a loss sharing arrangement on a pre-identified pool of

36. Rick Rothacker, *Wachovia had sought FDIC help, was told no, Agency determined Citigroup should buy ailing bank, securities filing shows*, THE CHARLOTTE OBSERVER, Nov. 1, 2008 at A1.

37. Dan Fitzpatrick, *On Crisis Stage, FDIC Plays the Tough: Wells Filing on Wachovia Deal Shows Agency Acting Quickly, Decisively,* WALL ST. J., Nov. 3, 2008, at C3.

38. *Id.*

39. *Id.*

> loans. Under the agreement, Citigroup Inc. will absorb up to $42 billion of losses on a $312 billion pool of loans. The FDIC will absorb losses beyond that. Citigroup has granted the FDIC $12 billion in preferred stock and warrants to compensate the FDIC for bearing this risk.[40]

The deal was never reduced to a formal merger agreement.[41] Rather, the parties' arrangement consisted of a two-page term sheet.[42] The parties arrived at an informal "exclusivity agreement," which Citigroup contended prevented Wachovia from having competing discussions with other potential buyers.[43]

Apparently, Wachovia had luke-warm feelings about the Citigroup arrangement from the outset for several reasons. First, Citigroup was not purchasing all of the Wachovia empire, and Wachovia's management had concerns about the viability and liquidity of the Wachovia entities left out of the deal.[44] Second, under the government-mandated arrangement, Citigroup was slated to acquire Wachovia for $1 per share, a price that was not attractive to Wachovia's shareholders.[45] Indeed, some Wachovia investors were planning suits to challenge the deal with Citigroup

40. Press Release, FDIC, Citigroup Inc. to Acquire Banking Operations of Wachovia FDIC, Federal Reserve and Treasury Agree to Provide Open Bank Assistance to Protect Depositors (Sept. 29, 2008). The release was careful to note, in addition, that "Wachovia did not fail; rather, it is to be acquired by Citigroup . . . on an open bank basis with assistance from the FDIC." *Id.* The FDIC loss sharing proposal embodied in the Citigroup merger deal was the FDIC's first use of the systemic risk provision, which mandates least cost resolution except in the case of systemic risk. FDIC Improvement Act of 1991, 12 U.S.C. § 1823 (2006).

41. David Enrich & Dan Fitzpatrick, *Wachovia Chooses Wells Fargo, Spurns Citi: Deal Avoids Need for Taxpayer Cash; Pandit Vows a Fight*, WALL ST. J., Oct. 4, 2008, at A1.

42. *Id.*

43. Jonathan D. Glater, *Citi, Jilted in Wachovia Deal, Ponders Lawsuit*, N.Y. TIMES, Oct. 4, 2008, at C1.

44. Matthias Rieker, *Wells Fargo discloses details about Wachovia deal struggle*, WALL ST. J., Oct. 31, 2008, *available at* http://www.marketwatch.com/news/story/wells-fargo-discloses-details-about/story.aspx?guid=%7B00F5CDD2-5DB4-4CAD-8CAB-19981FADAEA8%7D.

45. *Id.*; *Wells Fargo Swoops In*, *supra* note 6.

had it been successfully consummated.[46] The deal with Citigroup, however, did not go through.[47]

IV. THE WELLS FARGO BID TO PURCHASE WACHOVIA

Less than two days after the FDIC press release marrying Wachovia to Citigroup at 9:00 p.m. on Thursday, October 2, 2008, Wells Fargo contacted Wachovia with an offer to purchase the Charlotte-based bank for about $15 billion.[48] The Wells Fargo deal offered approximately $7 per share to shareholders.[49] Further, Wells Fargo's offer did not include participation by the FDIC, and it provided for the purchase of Wachovia in one piece.[50]

Within two-and-a-half-hours of receiving the call from Wells Fargo, a telephone meeting of Wachovia's board of directors was in progress.[51] By 2:15 a.m. on Friday, October 3rd, just hours after receiving the call from Wells Fargo, Wachovia had agreed to the Wells Fargo merger and had informed Citigroup of its decision.[52]

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46. Glater, *supra*, note 43.

47. *Id.*

48. *Wells Fargo Swoops In*, *supra* note 6.

49. Rick Rothacker, *A phone call put Wachovia back in play*, THE CHARLOTTE OBSERVER, Oct. 4, 2008, *available at* http://www.charlotteobserver.com/408/story/232569.html.

50. Enrich & Fitzpatrick, *supra* note 41.

51. *Wells Fargo Swoops In*, *supra* note 6.

52. *Id.* Citigroup responded to the Wachovia-Wells Fargo merger by filing a lawsuit in New York state court seeking to enjoin the merger based on the exclusivity agreement between Citigroup and Wachovia and seeking $60 billion in damages for alleged unjust enrichment, breach of contract (against Wachovia) , and tortious interference with contract (against Wells Fargo). *See* Complaint at 11-16, Citigroup, Inc. v. Wachovia Corporation, et al, Index No. 602872-2008 (N.Y. Sup. Ct. 2008). At 4:30 p.m. on Saturday, October 4, 2008, the parties argued the case in the home of Justice Charles E. Ramos in Cornwall, Connecticut, after which Justice Ramos entered an injunction restraining the Wachovia-Wells Fargo merger. *Weekend Legal Frenzy, supra* note 35. Later the next day, Judge James M. McGuire of the New York Court of Appeals overturned Justice Ramos's injunction. *Id.* Citigroup ultimately abandoned its efforts to block the Wachovia-Wells Fargo merger, but is pursuing its $60 billion damages claims. Michael J. de la Merced, *Wells Fargo Wins the War for Wachovia*, N.Y. TIMES, Oct. 10, 2008, at B1.

The FDIC initially took a confusing position with respect to the Wells Fargo transaction. Although the initial word from the FDIC was that the regulator would not block the transaction, *id.*, it issued the following statement later on October 3: "The FDIC stands behind its previously announced agreement with Citigroup. The FDIC will be reviewing all proposals and working with the primary regulators of all three institutions to pursue a resolution that serves the public interest. Press Release, As part of the merger, Wachovia entered into a share exchange agreement with Wells Fargo.[53] This stock transfer awarded 39.9% of the voting power at Wachovia to Wells Fargo.[54] The merger terms further required Wachovia to amend its articles of incorporation to prevent Wachovia from redeeming the shares representing the 39.9% Wells Fargo voting bloc, even if the Wells Fargo merger was not approved by Wachovia's shareholders.[55] Under the terms of the merger, Wachovia's board of directors was not permitted to withdraw Wachovia from the Wells Fargo merger; rather, the Merger Agreement included a "fiduciary out" provision, which stated that if the board "determine[d] in good faith that, because of a conflict of interest or other special circumstances . . . it would violate its fiduciary duties under applicable law to continue to recommend the plan of merger . . . then it [could] submit the plan of merger to it shareholders without recommendation" and "[could] communicate the basis for its lack of a recommendation."[56]

FDIC, FDIC Chairman Sheila Bair Comments on Agreement to Merge by Wells Fargo and Wachovia, PR-90-2008 (Oct. 3, 2008), *available at* http://www.fdic.gov/news/news/press/2008/pr08090.html.

53. Wachovia agreed "to issue and sell 10 shares of Series M, Class A Preferred Stock, no par value, of [Wachovia], in exchange for . . . 1,000 shares of common stock, par value $1 2/3 per share, of [Wells Fargo]." Share Exchange Agreement by and between Wachovia & Corp. and Wells Fargo & Co., (Oct. 3, 2008), *available at* http://www.sec.gov/Archives/edgar/data/36995/000089882208000985/sharexchange.htm (last visited Jan. 17, 2009) (hereinafter "Share Exchange Agreement"); Agreement and Plan of Merger by and between Wells Fargo & Co. and Wachovia Corp. § 6.3 (Oct. 3, 2008), *available at* http://www.sec.gov/Archives/edgar/data/36995/000089882208000985/wellsmergeragreement.htm (last visited Jan. 17, 2009) (hereinafter "Merger Agreement").

54. Ehrenhaus v. Baker, 2008 WL 5124899, 2008 N.C. Bus. C. 20, ¶ 54 (N.C. Super. Ct. 2008) (unpublished decision).

55. *Id.* at ¶ 75.

56. Merger Agreement, *supra* note 53 at § 6.3.

V. THE NORTH CAROLINA BUSINESS COURT'S DECISION THAT WACHOVIA'S DIRECTORS ACTED REASONABLY IN ACCEPTING THE WELLS FARGO MERGER

A. The Shareholder Challenge to the Terms of the Merger

On October 8, 2008, five days after the Wells Fargo deal became public, Irving Ehrenhaus, a Wachovia shareholder, filed a class action complaint in Mecklenburg County Superior Court against Wachovia, the members of the Wachovia board of directors, and Wells Fargo.[57] The plaintiff thereafter transferred his action to the North Carolina Business Court.[58] Ehrenhaus sought to challenge the merger on several grounds. Chief among Ehrenhaus's concerns was the Share Exchange Agreement pursuant to which Wells Fargo was awarded 39.9% of Wachovia's voting power, in the form of preferred stock that votes as a single class with Wachovia's common stock.[59] Ehrenhaus alleged that Wachovia's board members entered into the Share Exchange Agreement in violation of their fiduciary duties for the following reasons:

> The Board . . . impermissibly circumvented the voting process and rendered the vote on the Merger essentially redundant, thereby coercing Wachovia's shareholders to accept the Merger. The unaffiliated Wachovia shareholders [were] effectively disenfranchised, in that 40% of the vote [would] almost certainly go in favor of the Merger (since Wachovia has issued . . . before the Merger vote preferred shares that provide Wells Fargo with 39.9% of the vote, combined with the fact that the directors and officers of Wachovia hold 2.48% of the Company's common stock) and there appears to

57. Complaint at 1, Ehrenhaus v. Baker, 2008 WL 4678644, (N.C. Super. Ct. 2008) (08 CVS 22632) (hereinafter "Complaint").

58. Notice of Designation of Action As Mandatory Complex Business Case Under N.C. Gen. Stat. 7A-45.4, Ehrenhaus v. Baker, 2008 WL 5124899, 2008 N.C. Bus. C. 20 (N.C. Super. Ct. 2008).

59. Complaint, *supra* note 57, at 2.

> be no protection for those unaffiliated shareholders, such as a requirement that a majority of the unaffiliated shareholders vote in favor of the Merger. The Board may believe that the Merger is the best possible transaction for Wachovia's unaffiliated shareholders, but, under the current structure, any shareholder vote would be robbed of its effectiveness by the impermissible ceding of effective voting control that has predetermined the outcome of the Merger vote without regard to its merits.[60]

Ehrenhaus also contended that the share exchange provision was unfair to shareholders because it "for all practical purposes, precluded any competing bid from being accepted by [Wachovia] without the consent of Wells Fargo, including any possible topping bid by Citigroup."[61] Ehrenhaus further argued that the $7 per share valuation of Wachovia's common stock resulting from the Wells Fargo-Wachovia merger was unfair and inadequate because, among other things, (1) it reflected a discount in the value of the stock when compared to the $10 price for the stock just prior to the late-September financial market crisis, and (2) the subsequent passage of the $700 billion federal bailout would permit a government purchase of Wachovia's poorly performing assets.[62] The Ehrenhaus complaint sought damages and injunctive relief for the alleged breaches of fiduciary duty by the Wachovia directors and alleged aiding and abetting in breaches of fiduciary duty by Wells Fargo.[63]

Ehrenhaus also filed a Motion for a Preliminary Injunction.[64] In addition to the contentions raised in his Complaint, Ehrenhaus's preliminary injunction filings took issue with the 39.9% voting bloc awarded to Wells Fargo because of the eighteen-month tail provision, which permitted Wells Fargo to

60. *Id.* at 9-10.
61. *Id.* at 10.
62. *Id.* at 10-11.
63. *Id.* at 11-14.
64. Mot. for Preliminary Inj. at 1, Ehrenhaus v. Baker, 2008 WL 5124899, 2008 N.C. Bus. C. 20 (N.C. Super. Ct. 2008).

retain its voting power for a year and a half, without regard to whether the Wells Fargo merger was completed.[65] According to Ehrenhaus, the eighteen-month tail impermissibly "extend[ed] the life of the shares far beyond the time of a shareholder vote,"[66] and

> for [eighteen] months, no bidder could even hope to obtain a favorable [fifty percent] vote no matter how favorable the transaction compared to the present Merger. Thus, the Wachovia shareholders are being asked to vote on the only transaction opportunity they will have for at least [eighteen] months, thereby making it very difficult for them to reject it when weighed against the disadvantages of uncertainty.[67]

Ehrenhaus's preliminary injunction filing also challenged the legality of the "fiduciary out" provision of the Merger Agreement in that it did not permit Wachovia's board of directors to withdraw the Wells Fargo merger "if a superior proposal to acquire or merge with the Company [were] offered or if circumstances change[d] (for example, the Government's bailout plan passes Congress) rendering the Merger price unfair or inadequate."[68] In Ehrenhaus's view, Wachovia's board could not discharge its fiduciary responsibilities properly unless it retained the right to pull out of the Wells Fargo Merger.[69]

B. *The Business Court Upholds the Business Judgment of Wachovia's Directors*

In a thirty-three page opinion issued on December 5, 2008, Judge Albert Diaz of the North Carolina Business Court rejected the plaintiff's request to enjoin the creation of a 39.9% voting bloc

65. Reply in Support of Mot. for Preliminary Inj. at 3, Ehrenhaus v. Baker, 2008 WL 5124899, 2008 N.C. Bus. C. 20 (N.C. Super. Ct. 2008).
66. *Id.* at 3.
67. *Id.* at 7.
68. Brief in Support of Mot. for Preliminary Inj. at 11, Ehrenhaus v. Baker, 2008 WL 5124899, 2008 N.C. Bus. C. 20 (N.C. Super. Ct. 2008).
69. *Id.*

for Wells Fargo and enforcement of the "fiduciary out" provision of the Merger Agreement. Judge Diaz did, however, enjoin the eighteen-month tail for the voting rights awarded to Wells Fargo in the Merger Agreement.[70] The business court opined that the outcome of the preliminary injunction hearing hinged on "whether the Wachovia directors approved the Merger Agreement in 'good faith,' '[w]ith the care an ordinarily prudent person in a like position would exercise under like circumstances,' and 'in a manner which [they] reasonably believe[d] to be in the best interests of the corporation[]' [in accordance with] N.C. Gen. Stat. 55-8-30[.]"[71]

1. Judge Diaz's Assessment of the Conditions under Which Wachovia Accepted the Merger

Judge Diaz determined that the circumstances under which the Wachovia directors approved the Wells Fargo Merger were imposing:

> • The Board (all of whom save one are outside directors) faced a financial crisis of historic proportions when it met on 2 October 2008 to consider the Merger Agreement;
> • In the second quarter of 2008, Wachovia had reported a loss of $9.1 billion;
> • The Board had previously fired the Company's CEO and President;
> • Over the mere span of weeks, the Board had seen the demise of other venerable financial institutions via bankruptcy or liquidation;
> • The U.S. House of Representatives had rejected the U.S. Treasury's original bailout bill aimed at providing relief to the capital markets and, although the U.S. Senate had passed a revised bill, it was unclear whether the House would follow suit;

70. Ehrenhaus v. Baker, 2008 WL 5124899, 2008 N.C. Bus. C. 20, at ¶ 6-8 (N.C. Super. Ct. 2008) (unpublished decision).
71. *Id.* at ¶ 113.

- The Company's stock price had plummeted nearly 90% in ten (10) days;
- Wachovia was facing an extreme liquidity crisis that had gotten the attention of federal regulators, who had effectively demanded that the Company merge with another financial institution to avoid a forced liquidation;
- Although the Board had little time to digest the Merger Agreement, it was not acting in an information vacuum as to the precarious financial stability of the Company, having met nine (9) times between 16 September 2008 and 2 October 2008;
- Over the course of those meetings, the Board had been informed that the Company had explored other merger options, attempted to raise capital and sell assets, and made an unsuccessful overture to federal regulators for assistance in allowing the Company to remain independent;
- The Board understood and appreciated the substantive terms of the Merger Agreement, including the deal protection devices embedded therein, and it had the benefit of counsel from legal and financial advisors;
- In deciding whether to accept the less palatable terms of the Merger Agreement, the Board weighed the certain value of the transaction against the risks of further negotiations with its two suitors and the very real probability that failure to consummate a merger (whether with Wells Fargo or Citigroup) would exacerbate Wachovia's liquidity crisis and result in a seizure of the Company's banking assets by federal regulators and the elimination of all shareholder equity;
- Following the Board's approval of the Merger Agreement, Wachovia posted a loss of more than $20 billion for the third quarter of 2008;
- No other entity has made a bid to purchase the Company; and

> • There is no evidence that the U.S. government will assist Wachovia in remaining a stand-alone entity should the Merger Agreement not be consummated.[72]

Based on the above scenario, Judge Diaz held that the Wachovia situation "[did] not fit neatly into conventional business judgment rule jurisprudence, which assumes the presence of a free and competitive market to assess the value and merits of a transaction."[73] Indeed, in Judge Diaz's estimation, the case had to be decided against the "unique" backdrop of the federal regulators' "pervasive . . . oversight over bank holding companies."[74] The Court had "little doubt that the threat of government intervention (in the form of a forced liquidation of the Company's banking assets) weighed heavily on the Board as it considered the Merger Agreement."[75]

Relying on his assessment of the business climate in which Wachovia had approved the merger, Judge Diaz rebuffed what he characterized as Ehrenhaus's invitation to engage in second guessing:

> But other than insisting that he would have stood firm in the eye of what can only be described as a cataclysmic financial storm, Plaintiff offers nothing to suggest that the Board's response to the Hobson's choice before it was unreasonable . . .
>
> The stark reality is that the Board (1) recognized that Wachovia was on the brink of failure because of an unprecedented financial tsunami, (2) understood the very real and immediate threat of a forced liquidation of the Company by government regulators in the absence of a completed merger transaction with someone, and (3) possessed little (if

72. *Id.* at ¶ 119.
73. *Id.* at ¶ 124.
74. *Id.* at ¶ 122.
75. *Id.* at ¶ 123.

> any) leverage in its negotiations with Wells Fargo because of the absence of any superior merger proposals.
>
> Against that backdrop, the Board had two options: (1) accept a merger proposal that, although partially circumscribing the shareholders' ability to vote on its merits, nevertheless still gave the shareholders a voice in the transaction and also provided substantial value; or (2) reject the Merger Agreement and face the very real prospect that Wachovia shareholders would receive nothing.
>
> Pared to its essence, Plaintiff's argument is that he would have voted to reject the Merger Agreement and take[n] his chances with the government had he been sitting on the Board on 2 October 2008. But it is precisely this sort of post hoc second-guessing that the business judgment rule prohibits, even where the transaction involves a merger or sale of control.[76]

Judge Diaz then proceeded to apply this general holding to the specific issues raised by Ehrenhaus.

2. The Denial of the Motion to Enjoin the Share Exchange Agreement

With respect to the 39.9% voting bloc share exchange, the Judge held that the measure was not coercive because there were sufficient shares remaining to defeat Wells Fargo's bloc vote:

> [W]hile it is certainly true that slightly over 40% of the total votes to be cast on the Merger Agreement have been spoken for, and that Plaintiff and those in his camp face a substantial hurdle in defeating this transaction, a majority of Wachovia shareholders

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76. *Id.* at ¶¶ 125, 131-33.

> (owning nearly [sixty percent] of all Wachovia shares) "may still freely vote for or against the merger, based on their own perceived best interests, and ultimately defeat the merger, if they desire."[77]

Judge Diaz dismissed the notion that Wells Fargo's 39.9% voting interest would prevent Wachovia from accepting a better acquisition offer:

> [E]xcept for the markedly inferior Citigroup merger proposal, there simply is no other acquisition offer for the Wachovia shareholders to consider.
>
> In support of his argument that the Merger Agreement precludes other options, Plaintiff again faults the Board for not waiting to act until after the U.S. House of Representatives' vote on the revised bailout bill, arguing that Wachovia would have been an ideal candidate for government assistance.
>
> But as the Court has already noted, the House had previously rejected such a bill and no one could predict how it would treat the Senate's revised proposal.
>
> In any event, what evidence exists in this record indicates that the U.S. government was prepared to abandon Wachovia on 2 October 2008, and there is nothing to suggest that it now has the desire or appetite to subsidize Wachovia should the Merger Agreement fail.
>
> Nor is there a reasonable prospect that a superior offer will materialize even absent the Share Exchange. . . .

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77. *Id.* at ¶ 142 (quoting In re IXC Commc'ns. S'holders Litig., 1999 Del. Ch. LEXIS 210, at 23).

> Thus, the sobering reality is that there are few (if any) entities in a position to make a credible bid for Wachovia that would be superior to the Merger Agreement.
>
> As a result, when the Board met to consider the Merger Agreement, it was entirely reasonable for it to conclude that there would be no other suitors and that if it failed to consummate a merger by the end of the day on 3 October 2008, the Company faced a government-directed liquidation of its banking assets and, with it, the obliteration of most, if not all, of the shareholder equity.[78]

Accordingly, Judge Diaz denied Ehrenhaus's request to enjoin the share exchange in favor of Wachovia's voting rights.[79]

3. The Denial of the Motion to Enjoin the "Fiduciary Out" Clause

On the issue of the "fiduciary out" clause, Judge Diaz felt that the fiduciary obligations of Wachovia's board members had been adequately preserved.[80] Judge Diaz recognized that the Merger Agreement prohibited Wachovia from soliciting third-party bidders for acquisition of the company and required the Merger Agreement be put to a shareholder vote even if the Board determined that it should no longer recommend it.[81] The Judge noted, however, that Wachovia's directors remained free to respond to unsolicited superior proposals made by third-party bidders prior to the vote on the Merger Agreement. Judge Diaz also relied on the notion that the board remained free to withdraw its recommendation of the Merger Agreement – even if it could not withdraw the Merger Agreement from consideration itself – and to fully and publicly explain the reasons for the withdrawal of

78. *Id.* at ¶¶ 145-48 (numbering and citations omitted).
79. *Id.* at ¶ 153.
80. *Id.* at ¶ 157.
81. *Id.* at ¶ 155.

support (thereby essentially advising shareholders to vote down the Merger Agreement).[82]

Turning again to his assessment of the tough circumstances under which the Wells Fargo merger was forged, Judge Diaz again declined to second-guess the Merger Agreement:

> [T]he relevant clause . . . does not impermissibly abrogate the Board's fiduciary obligations to the Wachovia shareholders. At worst, it requires the Board to submit the Merger Agreement to a vote even if they later determine they no longer recommend it. And, as the Court has already noted, the lack of any third-party bidders is a function of the realities of the market, not the deal protection devices of which Plaintiff complains.[83]

Judge Diaz therefore denied Ehrenhaus's request for a preliminary injunction based on the "fiduciary out" clause.

4. The Eighteen-Month Tail For the Voting Bloc Was Voided

Finally, Judge Diaz struck down the provision of the Merger Agreement that extended Wells Fargo's 39.9% voting bloc by as much as eighteen months if the Merger Agreement was not approved.[84] Although Judge Diaz again noted that "the Board acted in good faith, on an informed basis, and in the best interests of the Company in approving the Merger Agreement," he concluded that, if the Wells Fargo merger was rejected by Wachovia's shareholders, "the Board's duty to seek out other merger partners should not be impeded by a suitor with substantial voting power whose overtures have already been rejected."[85] Judge Diaz ruled that the provision thus "serve[d] no beneficial purpose in such an instance and, in fact, [would] prevent[] the Board from fulfilling its fiduciary duties" and that striking it would

82. *Id.* at ¶ 156.
83. *Id.* at ¶ 157.
84. *Id.* at ¶ 165.
85. *Id.* at 160-61.

do little, if any, harm to the Wells Fargo merger and accordingly granted injunctive relief on this isolated provision of the Merger Agreement.[86] Nonetheless, Ehrenhaus's victory on this isolated issue was not sufficient to stop the merger.[87]

C. *The Events Following the Business Court's Ruling*

Following Judge Diaz's ruling, the parties reached a proposed settlement of the *Ehringhaus* case.[88] Under the terms of the settlement, Wachovia and Wells Fargo agreed not to appeal from the portion of Judge Diaz's Order enjoining the eighteen-month tail provision, and Wells Fargo waived the enforceability of the tail provision.[89] Wachovia and Wells Fargo also agreed to make specified additional disclosures related to the proposed merger.[90] On December 23, 2008, Wachovia's shareholders approved the Wells Fargo merger[91] with seventy-six percent of the votes entitled to be cast supporting the undertaking.[92] The deal was ultimately consummated on December 31, 2008, and a venerable North Carolina banking icon slipped into history.[93]

86. *Id.* at 162-63.

87. Mack Sperling, *N.C. Business Court Denies Motion for Preliminary Injunction In Wachovia-Wells Fargo Merger Case*, N.C. BUS. LITIG. REPORT (posted Dec. 5, 2008), http://www.ncbusinesslitigationreport.com/2008/12/articles/class-actions/nc-business-court-denies-motion-for-preliminary-injunction-in-wachoviawells-fargo-merger-case/.

88. Press Release, Wachovia, Wachovia Announces Settlement of North Carolina Lawsuit Challenging the Wells Fargo Merger (Dec. 17, 2008), *available at* http://www.wachovia.com/inside/page/0,,134_307^1824,00.html.

89. *Id.*

90. *Id.*

91. Press Release, Wachovia, Wachovia Announces Shareholder Approval of Wells Fargo Merger (Dec. 23, 2008), *available at* http://www.wachovia.com/inside/page/0,,134_307^1825,00.html.

92. *Id.*

93. Press Release, WALL ST. J., Wells Fargo and Wachovia Merger Completed Creating North America's Most Extensive Financial Services Company, Coast-to-Coast in Community Banking (Jan. 1, 2009), *available at* http://www.marketwatch.com/news/story/wells-fargo-wachovia-merger-completed/story.aspx?guid=%7B998DE4C0-0A6E-4047-819C-B53EF67246B7%7D.

VI. POST MORTEM

Given the recency of events, it is probably too soon to make reasoned conclusions about the loss of Wachovia as a stand-alone bank. Time will tell whether and how the federal bailout funds will affect the U.S. banking marketplace. Federal bank regulatory policy will no doubt be impacted in significant ways as a result of the 2008 bank crisis, but it's too early to know what process changes will occur. Nonetheless, there are a number of questions raised and some observations worth making. A half dozen queries quickly come to mind:

1. Is there any way Wachovia might have survived and why was it not a bank "too big to fail?"
2. In the future, will the FDIC and bank regulators become less cryptic about when they will intervene as a lender of last resort?
3. Was the September 15, 2008, failure of Lehman Brothers, without regulator intervention, the missed opportunity to have helped Wachovia?
4. How realistic is it to demand that independent directors of a bank in crisis make rushed decisions on super-complex market issues when the "experts" cannot agree on either the cause of the crisis or the remedy?
5. Is a prominent position solidified for the Business Court in major legal disputes affecting corporate interests in North Carolina following its rulings on the Wachovia-First Union merger in 2001, over the objections of spurned suitor SunTrust Bank, and now the 2008 battle between Citigroup and Wells Fargo?
6. If SunTrust Bank had been allowed to buy Wachovia back in 2001, instead of First Union, how would the fate of the home-grown North Carolina bank been different?

Several points are worth noting. First, timing is everything. Wachovia was forced to deal with lightening fast market changes that were catastrophic challenges. The Wells Fargo-Wachovia Merger Agreement deal was hashed out in less than forty-eight hours. The Troubled Assets Relief Program (TARP) bailout funds were authorized just two days after Wachovia and Wells

Fargo signed their Merger Agreement. In a modern financial system of extreme interdependency, when trust between institutions leaves the playing field, bank failures are imminent. The attempted restoration of that trust is an on-going effort. As this Article goes to print, Congress struggles with whether to increase the $700 billion authorized for the TARP fund. Debate rages as to whether the funds released to banks so far are having the desired restorative/liquidity effects. Time will tell. One has to wonder if a couple of weeks of bridge capital may have saved Wachovia from its demise.

Second, the FDIC potentially made a big mistake by allowing Lehman Brothers to fail on September 15, 2008.[94] This failure to intervene caused market stresses which were arguably avoidable. As industry commentators have noted,[95] "[a]mong other things, Lehman's failure prompted runs on money market funds and deposits at weaker banks and thrifts, while lending between banks and by banks froze up, driving the spread between the three-month London Interbank Offered Rate (LIBOR) and Treasuries – the so-called TED spread."[96] When the TED spread rises, it is a sign that lenders believe the risk of default on interbank loans is increasing. While the long-term average of the TED spread is around thirty basis points, the TED spread rose above 300 basis points on September 17, 2008, breaking the record for the Black Monday crash of 1987. If the TED spread had been moderated, then things might have resulted differently.

Third, the protective umbrella of the business judgment rule was strengthened by the decision to respect the negotiated Merger Agreement with Wells Fargo. The Business Court's holding made it clear that Wachovia board members did not act unreasonably under extraordinary market conditions and liquidity stress events. The options were few and uncertain. The board members were affirmed in their decision by the Business Court

94. WALL STREET WEATHER, *How the Government Forced BofA to Marry Merrill Lynch*, SEEKING ALPHA, Jan. 18, 2009, http://seekingalpha.com/article/115277-how-the-government-forced-bofa-to-marry-merrill-lynch.

95. Robert Stowe England, *Back From the Brink*, MORTGAGE BANKING, Jan. 2009, at 42.

96. TED is a composite acronym derived from T-bill and ED – the ticker symbol for the Eurodollar futures contract.

opinion. The legality is still a bit vague for the specifically attacked elements of the Wells Fargo Merger Agreement – the 39.9% share transfer agreement and the eighteen month tail provision – concerning whether they would pass the business judgment rule in a different factual context. Nonetheless, if the crisis is large, then the business judgment rule provides substantial latitude.

Fourth, the Business Court affirmed its lead role in addressing corporate law disputes in North Carolina. The complex issues with respect to the Wachovia-Wells Fargo Merger Agreement were resolved through litigation which lasted only fifty-eight days – from the complaint filing on October 8, 2008 through the briefing, oral arguments, opinion writing, and reported decision on December 5, 2008. The flexibility of the Business Court to dedicate resources to resolving the questions of law on an expedited basis allowed for the merger to run the regulatory gauntlet toward consummation with extraordinary speed – less than three months in total. The wisdom of establishing a specialized court for handling corporate law and complex business disputes was underscored by recent events.

Finally, it is no doubt rank speculation to posit what would have happened had SunTrust won the lottery for legacy Wachovia and not First Union back in 2001. Yet, this is no doubt a topic about which many have very strong opinions. SunTrust appears to be weathering the crisis storms of 2008, and with Wachovia and Washington Mutual now gone, SunTrust climbs two spots up the list of the top 100 U.S. banks by deposits. The long-term value of former Wachovia shareholders in the newly-combined Wells Fargo franchise will manifest itself (or not) after the tsunami subsides and rebuilding occurs. From the present perspective, still being inside the storm, the market remains wary of all types of acquisitions. Just look at the nation's largest bank. As of February 3, 2009, Bank of America's stock had lost over eighty-five percent of its value from its fifty-two week high in 2008. Just over four months after the merger with Merrill Lynch was announced, Merrill Lynch's CEO John Thain was fired and the New York Attorney General Andrew Cuomo subpoenaed records regarding Merrill Lynch's bonuses paid just before the closing of that merger.[97] Numerous shareholder lawsuits have been filed against Bank of America and its board.[98] The outcome is undetermined and uncertain.

Wachovia, however, is forever gone. The big bank with the unusual name – given by Moravians who settled in Winston-Salem in the 1750s and borrowed from their native Wachau Valley in Austria – is absent after the bank crisis of 2008.[99]

97. *Thain gets subpoena from NY AG*, BUFFALO BUSINESS FIRST, Jan. 28, 2009, http://www.bizjournals.com/buffalo/stories/2009/01/26/ daily28.html.

98. *See, e.g.*, *Bank Of America Investors File Class Action Lawsuits On Behalf Of Certain BAC Investors Against BoA Over Merrill Lynch Acquisition*, PR-INSIDE.COM, Jan. 23, 2009, http://www.pr-inside.com/bank-of-america-nyse-bac-r1021809.htm.

99. Wachovia is an anglicized version of the original name the Moravian settlers gave to the lands they purchased in the Piedmont (Winston-Salem) area of North Carolina in 1753 – "deie Wach au" with "Wach" being the name of a stream and "an" meaning meadowlands in German – as an omage to the abundant area in Austria from which support came. *See* Wachovia.com, Company Facts, http://www.wachovia.com/inside/page/0,,132_148,00.html.