This client alert details the history of the recent Bear Stearns collapse resulting in the proposed sale of the company to JP Morgan. It summarizes certain key deal protections in the merger agreement and the standards which courts will use in reviewing both a breach of fiduciary duty claim and the deal protections contained in the merger agreement. Finally, this client alert analyzes the changes made to the key deal protections in the March 24th amendment to the merger agreement. In particular, these provisions will be analyzed to show how they were changed to better survive scrutiny under Delaware law.

Background

The Crisis

The genesis of Bear Stearns’ crisis occurred with the tightening of the credit markets, in part as a result of the exposure of investment banks to subprime mortgages. Bear Stearns was one of the biggest underwriters of complex investments linked to these mortgages. Bear Stearns’ problems began in late June 2007 as news about its risky funds began to enter the market and its stock price began to fall. By July of 2007, two of its hedge funds, heavily invested in subprime mortgages, had folded. In December 2007, Bear Stearns announced the first loss in the company’s eight-decade history. They also reported a write-down of $1.9 billion of holdings in mortgages and mortgage-based securities, up from the $1.2 billion that had been anticipated the month before.

Fast forward to March of 2008. Rumors were circulating in the financial markets regarding the financial condition of Bear Stearns, and customers began withdrawing their funds. As a result, by the latter part of the week of March 10, 2008, Bear Stearns was faced with a liquidity crisis. By March 13th and March 14th, counterparties to Bear Stearns were refusing to lend them additional money on customary terms and simultaneously demanded repayment of Bear Stearns’ outstanding debt obligations.

By the close of business on Friday, March 14, 2008, Bear Stearns was on the verge of collapse. Because it was linked to so many other financial institutions, the collapse of Bear Stearns threatened not just the investment bank itself, but the already precarious financial markets as well. According to Treasury Secretary Henry M. Paulson, it is the job of regulators to address times of turmoil in the capital markets such as the situation that Bear Stearns faced. In this instance the Federal Reserve desired to prevent a “fire sale” of Bear Stearns’ assets which could have further depressed markets. For that reason, the Federal Reserve stepped in to
mitigate the damage.

**The Proposed Merger**

On March 14, 2008, the Federal Reserve and JP Morgan, with the support of the Department of the Treasury, announced that they would provide emergency funding to Bear Stearns for up to twenty-eight days. In addition, the Federal Reserve Bank of New York provided a form of nonrecourse financing to JP Morgan through its Discount Window. Even with this assistance, by the close of trading on March 14th, the per share price of Bear Stearns had plummeted from the prior day’s closing price of $57 to $30. This was the largest one-day decrease in Bear Stearns’ per-share price in two decades. In order to avoid a complete collapse at Bear Stearns, a solution had to be found prior to the opening of the financial markets in Asia on Monday, March 17th. The Federal Reserve was particularly anxious to resolve the matter before then because they feared that the financial panic resulting from a Bear Stearns bankruptcy filing might create a domino effect and a “run” on other investment banks. This, in turn would destabilize the broader financial markets.

As a result, over the March 15, 2008 weekend, Bear Stearns discussed potential solutions with various parties. While it discussed a potential sale with other suitors, such as private equity firm J.C. Flowers & Company, the only meaningful bidder (specifically, the only bidder with the backing of the Federal Reserve and other federal regulatory agencies) was JP Morgan. Simultaneously with the negotiation of a sale, Bear Stearns prepared to file for bankruptcy protection in the event a company-saving deal could not be reached.

The collapse of Bear Stearns was averted by the announcement of the merger with JP Morgan on March 16, 2008. The merger proposed what amounted to a $2 per share purchase price and was backstopped by the Federal Reserve’s support for up to $30 billion of Bear Stearns’ less liquid assets.

**Reaction to the Proposed Merger**

Stockholders of Bear Stearns reacted negatively to the announcement of the merger. In particular, the $2 per share price was deemed to be woefully inadequate. This price represented a discount of approximately 93% from the $30 closing price of Bear Stearns on March 14th. Earlier in that week, shares had been trading as high as $60 per share and in early to mid-2007 was trading at over $150 per share.

By March 20, 2008, five separate class action lawsuits were filed in New York alleging, among other things, that the proposed purchase price was inadequate and that the merger was approved by the directors of Bear Stearns in breach of their fiduciary duties. These actions were subsequently consolidated (the “New York Action”).

On March 20th and 24th, the Wayne County Employees’ Retirement System of Michigan and the Police and Fire Retirement System of the City of Detroit (the “Pension Funds”) filed class action lawsuits in Delaware on behalf of all Bear Stearns stockholders. The Pension Funds’ lawsuits were consolidated by the Chancery Court of Delaware on April 9, 2008.

The plaintiffs in the New York Action initially sought a preliminary injunction to block the Stock Swap (as discussed below) contemplated by the merger. The request was later changed to a preliminary injunction seeking to block JP Morgan from voting the shares it acquired pursuant to the Stock Swap. The Pension Funds sought the same preliminary injunction to block JP Morgan from voting its shares in Bear Stearns. Shortly after the Pension Funds commenced their actions, the parties to the New York Action sought to stay the Pension Funds’ Delaware suit, claiming that the matter was already in the process of being heard in the New York courts. The Delaware Chancery Court hearing this motion agreed. Rather than risk conflicting rulings, and given the confusion and inefficiency of parallel actions in New York and Delaware, on April 9, 2008, the Delaware Chancery Court agreed to stay the consolidated
class action brought by the Pension Funds in favor of the New York Action, at least until the preliminary injunction motion is resolved in New York.4

Bear Stearns’ prime brokerage customers continued to flee to other brokerage firms. The departure of these customers stemmed from widespread concern over whether the stockholders of Bear Stearns would vote down the merger.

The Amended Merger Proposal
In response to the general unrest over the proposed merger, on March 24, 2008, JP Morgan and Bear Stearns entered into an amendment to the merger agreement to increase the purchase price to $10 per share, increasing the approximate total value to $1.2 billion. In connection with the revised deal, Bear Stearns sold JP Morgan a 39.5% interest in Bear Stearns’ common stock in exchange for JP Morgan stock (the “Stock Swap”). The Stock Swap was closed on April 8, 2008. Bear Stearns’ board of directors has also pledged to vote their shares of stock in favor of the deal. Along with the new deal, the Federal Reserve also revised its guarantee of Bear Stearns’ debt downward to $29 billion, with JP Morgan taking the first billion dollars of losses, if any, of the $30 billion of Bear Stearns’ less liquid assets that the Federal Reserve had guaranteed with the initial merger proposal.

The terms of the revised agreement will be closely examined in the coming months. The next section of this client alert discusses the deal protections in the original and amended merger agreements in greater detail.

Merger Agreement
The Original Merger Agreement
In addition to the $2 per share price, the original merger agreement contained the following deal protection measures:

- a “force the vote” provision requiring the board of Bear Stearns to submit the merger for stockholder approval;
- a covenant to restructure the transaction if stockholder approval is not obtained;
- an option to purchase 19.9% of Bear Stearns’ common stock; and
- an option to purchase Bear Stearns’ headquarters building.

Force the Vote
The original merger agreement contained a provision requiring the board of directors of Bear Stearns to submit the transaction to its stockholders for approval even if the board of Bear Stearns withdrew, modified or qualified its recommendation to approve the transaction with JP Morgan (the “Force the Vote Provision”). The provision also contained a covenant requiring the directors of Bear Stearns to use their reasonable best efforts to obtain stockholder approval for the merger. The covenant is unusual in that it was not explicitly subject to a “fiduciary out” which would allow the board to change its recommendation in light of a superior proposal.

The merger agreement did, however, contain a “fiduciary out” in another provision. This provision, however, explicitly stated that a condition precedent that must be met for the board to change its recommendation was that Bear Stearns could not be in breach of the Force the Vote Provision.

Renegotiation Covenant
Before the March 24th amendment of the merger agreement, the agreement also provided that if Bear Stearns’ stockholders failed to approve the transaction, Bear Stearns and JP Morgan were required to use their reasonable best efforts to renegotiate the transaction and to submit the revised transaction to Bear Stearns’ stockholders for approval (the “Renegotiation Covenant”).
**Stock Option**

In connection with the original merger agreement, JP Morgan and Bear Stearns entered into an option agreement which would have given JP Morgan an option to purchase 19.9% of Bear Stearns’ stock for $2 per share (the “Stock Option”). The Stock Option was exercisable if the stockholders of Bear Stearns did not approve the merger with JP Morgan or if another acquisition offer was made and a third party purchased 20% or more of the outstanding shares of Bear Stearns.

**Asset Option**

In connection with the transaction, JP Morgan also received an option to purchase Bear Stearns’ headquarters building (the “Asset Option”) for $1.1 billion minus the dollar value of encumbrances on the building, and any reasonable transaction costs incurred by JP Morgan in completing the purchase of the building. The Asset Option was only exercisable if certain conditions were triggered, including if:

1. JP Morgan terminated the agreement because the Bear Stearns board changed its recommendation or Bear Stearns breached any of its representations, warranties or covenants and continued to breach them through the closing date;
2. either JP Morgan or Bear Stearns terminated the agreement because the transaction had not been consummated by the first anniversary of the date of the merger agreement; or
3. Bear Stearns acted in bad faith in restructuring the transaction pursuant to the Renegotiation Covenant if the initial stockholder vote did not approve the merger.

**The Amended Merger Agreement**

The merger agreement was amended on March 24, 2008 to increase the purchase price to $10 per share, to fix a provision requiring JP Morgan to guarantee Bear Stearns’ trades even if stockholders voted down the JP Morgan deal, and to make changes to the Force the Vote Provision, the Stock Option, the Asset Option and the Renegotiation Covenant.

**Force the Vote**

The parties revised the Force the Vote Provision so that the covenant to obtain stockholder approval is now explicitly subject to the “fiduciary out” of the Bear Stearns board. The parties also revised the “fiduciary out” of the Bear Stearns board by restricting when it can be used. Under the original version of the merger agreement, the board of Bear Stearns had a “fiduciary out” if a superior proposal was made by any third party. The March 24th amendment, however, provides that a proposal can only be considered a superior proposal if it is made by a “Qualifying Party.” In order to be a “Qualifying Party,” a third party must provide certain guaranties, financing and support arrangements and it must meet certain capital, liquidity and other financial requirements.

**Stock Swap**

The March 24th amendment also significantly modifies and strengthens the lock-up arrangement. The parties terminated the Stock Option and replaced it with the Stock Swap, which gave JP Morgan a 39.5% stake in Bear Stearns.

**Asset Option**

The parties also expanded the situations in which the Asset Option can be exercised. The Asset Option can now also be exercised if stockholders vote down the transaction or if either JP Morgan or Bear Stearns terminates the agreement in the event the necessary stockholder approval is not obtained.

**Renegotiation Covenant**

The parties also deleted the Renegotiation Covenant.

Although JP Morgan and Bear Stearns completed the Stock Swap on April 8, 2008, the question still remains as to whether Bear Stearns’ directors fulfilled their fiduciary duties in agreeing to the original and amended merger agreements with JP Morgan and whether they agreed to unfair deal protection measures to
improperly thwart other suitors. The remainder of this client alert analyzes the legal standards which the courts will use in reviewing these claims and then analyze a breach of fiduciary duty claim and impermissible deal protection claims in more detail.

**Applicable Legal Standards**

In his April 9, 2008 Memorandum Opinion, Vice Chancellor Parsons granted a motion to stay the lawsuits brought by the Pension Funds in favor of the New York Action. Vice Chancellor Parsons cited various reasons in reaching this conclusion. Among these considerations was the desire to avoid creating inefficient, duplicative proceedings and to avoid confusion and potentially conflicting results with the New York Action, especially since the claims were procedurally further along in the New York Action.

But perhaps more importantly, a key component of Vice Chancellor Parsons’ decision was that it was undisputed that Delaware law principles would apply to the New York Action. Vice Chancellor Parsons held that the claims asserted in the New York Action only “require the application of well-settled principles of Delaware law to evaluate the deal protections in the merger and the alleged breaches of fiduciary duty.” This client alert assumes that the New York courts will thus apply Delaware law principles in deciding the New York Action. Therefore, this client alert focuses on how the Delaware courts would approach the claims alleged in the New York Action.

In scrutinizing the actions of directors in the context of acquisitions, Delaware courts employ one of three standards: (1) the business judgment rule; (2) the *Unocal* enhanced scrutiny test; or (3) the *Revlon* change of control test. When the business judgment rule is applied, the Delaware courts will give broad deference to the decisions made by directors.

The Delaware courts will typically apply a higher level of scrutiny to acquisition transactions. The level of scrutiny applied depends on whether a change in control is inevitable. Where a change of control is not inevitable, such as where a company is not considering an acquisition transaction but has received an unsolicited offer, the Delaware courts will use the *Unocal* enhanced scrutiny analysis. This involves a two-pronged analysis requiring that, first, there must be reasonable grounds to believe that a third-party offer would be a danger to corporate policy and, second, the actions taken by the board must be reasonable in response to the perceived threat.

In situations where a change of control in a company is inevitable, the Delaware courts will use the more exacting *Revlon* test. Under a *Revlon* analysis, the board of directors’ primary duty is to maximize shareholder value and any deal protection devices utilized must have the purpose of securing the best value reasonably available to stockholders.

In the case of Bear Stearns, a change of control was inevitable because the only alternative to a change of control was insolvency. Therefore, the courts will apply the *Revlon* test. Moreover, in applying the *Revlon* test, the courts will review a breach of fiduciary duty claim and any deal protection measures under a highly contextual, fact-intensive analysis. In particular, the courts will review each deal protection both individually and collectively with all other measures.

**Breach of Fiduciary Duty Claim**

The New York Action alleges that the directors of Bear Stearns agreed to unfair deal protection measures to thwart other suitors, including the sale of its headquarters even if the buyout failed, and breached their fiduciary duties by accepting an unreasonably low valuation for the company, both at the $2 and the $10 per share prices. These purchase prices represent a substantial discount from the $30 closing price of Bear Stearns’ shares on the last trading day before the deal was announced.

In applying Delaware legal principles to these facts, however, the New York courts will need to consider the four following facts:
First, Bear Stearns did not have access to the cash needed to continue to operate the company’s day-to-day activities. The Federal Reserve indicated that it would only lend money to Bear Stearns through JP Morgan. Due to its inability to obtain cash, Bear Stearns was preparing its bankruptcy filing simultaneously with negotiating with JP Morgan. If Bear Stearns did not have a deal by the time the financial markets in Asia opened on March 17th, Bear Stearns would likely have filed for bankruptcy protection.

Second, no other viable bidders emerged during the weekend negotiations. While J.C. Flowers & Company and a few other suitors conducted due diligence, none apparently delivered a viable proposal.

Third, the JP Morgan transaction has features that were not and were unlikely to be duplicated or matched by any other potential purchaser. The Federal Reserve is providing financing for JP Morgan’s transaction, including support for up to $29 billion of Bear Stearns’ less liquid assets. Also, the JP Morgan transaction is not subject to further approvals from federal regulators. This kind of support would be extremely difficult to replicate and Bear Stearns cannot exercise its “fiduciary out” unless it receives a proposal from a “Qualifying Party” who has offered similar guarantees.

Finally, the $2 per share purchase price was the only viable offer made for Bear Stearns and, therefore, represented the best purchase price from a shareholder value perspective. Also, although a better per share purchase price was subsequently offered at $10 per share, it was offered by the same bidder.

Commentators have wondered to what extent the courts will consider and pay deference to the federal government’s desire to rescue Bear Stearns and stabilize the financial markets generally and whether the federal government’s involvement in the transaction lessens a director’s fiduciary duties under state law. In this instance, however, that question need not be answered. By the time Bear Stearns had called bidders to the table, there were only two options, bankruptcy or a sale. In this case, JP Morgan’s deal, the only deal that could be completed before Sunday evening, would benefit stockholders and creditors. Stockholders would receive a guaranteed price on their shares rather than possibly nothing through bankruptcy. Although the merger produces significant benefits to creditors and the financial markets generally, under a Revlon analysis these benefits would likely be incidental to the New York courts’ analysis. The New York courts are more likely to focus on whether the directors fulfilled their fiduciary duties to their stockholders by taking an acquisition proposal, the only available alternative to bankruptcy at the time and most likely the strongest offer possible now, rather than put Bear Stearns into bankruptcy.

If the New York courts apply Revlon and other applicable Delaware legal principles consistent with prior rulings by the Delaware courts, they should determine that the directors of Bear Stearns satisfied their fiduciary duties.

Summary of Changes to Certain Deal Protections

Most of the commentary relating to the March 24th amendment to the merger agreement has focused on the increased per-share purchase price and JP Morgan’s desire to fix a provision requiring JP Morgan to guarantee Bear Stearns’ trades even if stockholders voted down the JP Morgan deal. What have not been examined in any great detail are the amendments that modify the deal protection measures contained in the original merger agreement.

Some of these modifications suggest that the parties were concerned that certain deal protections like the Renegotiation Covenant and the “fiduciary out” might not survive scrutiny by the Delaware courts. In addition, the parties also significantly strengthened the Asset Option and the lock-up arrangement, which might have caused the Delaware courts to review the deal protection measures as a whole more critically.
Therefore, it appears that the parties revised or deleted the deal protection measures in the March 24th amendment to give them a better chance of surviving scrutiny by the Delaware courts. Below is an analysis of how some of the major deal protections were changed.

**Force the Vote Provision**

By not explicitly making the original merger agreement’s Force the Vote Provision subject to the “fiduciary out” and by preventing the Bear Stearns board from invoking the “fiduciary out” if the board was in breach of its covenant to use its reasonable best efforts to obtain stockholder approval, the parties created an ambiguity as to whether the covenant to obtain stockholder approval is superseded by the “fiduciary out” provision.

Bear Stearns and JP Morgan remedied this ambiguity in the March 24th amendment. The provision is now explicitly subject to the “fiduciary out.” The parties, however, weakened the “fiduciary out” by restricting when it can be used. Under the original merger agreement, the board of Bear Stearns had a “fiduciary out” if a superior proposal was made by any third party. The March 24th amendment, however, provides that a proposal can only be considered a superior proposal if it is made by a “Qualifying Party.” In order to be a “Qualifying Party,” the third party must provide replacement guarantees for the JP Morgan and Federal Reserve guarantees, must provide financing and support arrangements with the Federal Reserve to enable Bear Stearns to conduct its business in the ordinary course, and the third party must meet certain capital, liquidity and other financial requirements. Thus, the board of Bear Stearns must clear an additional hurdle before it can invoke the “fiduciary out.”

**Renegotiation Covenant**

The original merger agreement contained the Renegotiation Covenant which had the effect of precluding any topping bid because neither party was permitted to unilaterally terminate the agreement for at least one year except as otherwise provided in the merger agreement. The Delaware courts would likely take a hard stance against such a provision since it effectively precludes superior proposals, especially in combination with the other deal protections. Perhaps with this in mind, the parties deleted this provision in its entirety in the March 24th amendment.

**Lock-Up Arrangement**

The Stock Option entered into in connection with the original merger agreement made it more difficult for a competing purchaser to complete a transaction. A competitor would have to obtain the requisite majority approval to approve its transaction from only 80% of the outstanding shares. Also, since the Stock Option could be exercised and exchanged for the purchase price consideration in a competing transaction, the Stock Option would have compensated JP Morgan for its failed transaction.

The March 24th amendment significantly strengthens the lock-up arrangement by replacing the Stock Option with the Stock Swap, which gave JP Morgan a 39.5% stake in Bear Stearns. The Stock Swap has the additional effect of deterring a competing bidder because a majority vote will now be exceedingly difficult for it to obtain. The Stock Swap also gives JP Morgan a significant head start in obtaining the majority vote it needs to approve its merger.

The Stock Swap appears to have been carefully crafted to avoid running afoul of the Delaware Supreme Court’s ruling in *Omnicare*. In *Omnicare*, stockholders holding a majority of shares had agreed contractually with the buyer to vote to approve the agreement, and the merger agreement required a stockholder vote even if the company board later withdrew support for the transaction. The Delaware Supreme Court held that such a combination of mechanisms impermissibly limited the board’s ability to respond to subsequent events, such as a superior offer, and thus was unenforceable.

Subsequent to *Omnicare*, however, the Delaware courts have not invalidated a lock-up
arrangement where less than a majority of the stockholder vote is locked up and the underlying Force the Vote Provision contains a "fiduciary out." The amended merger agreement seeks to avoid running afoul of Omnicare by taking these two steps. Therefore, the parties have made it less likely that the Delaware courts will strike down this particular deal protection.

**Asset Option**

The building underlying the Asset Option has been estimated to be worth approximately $1.4 billion, which would net JP Morgan a value of approximately $300 million if the option were exercised. Originally, the Asset Option was only exercisable if certain conditions were triggered, including if: (1) JP Morgan terminated the agreement because the Bear Stearns board changed its recommendation or Bear Stearns breached any of its representations, warranties or covenants and continued to breach them through the closing date; (2) either JP Morgan or Bear Stearns terminated the agreement because the transaction had not been consummated by the first anniversary of the date of the merger agreement; or (3) Bear Stearns acted in bad faith in restructuring the transaction if the initial stockholder vote did not approve the merger.

The parties strengthened the Asset Option by providing that it can also be exercised if stockholders vote down the transaction in its first meeting held for the purpose of voting on the transaction or if either JP Morgan or Bear Stearns terminates the agreement because the necessary stockholder approval is not obtained.

One argument that could be made against the Asset Option is that it is an impermissibly high breakup fee. The Asset Option may be exercised for $1.1 billion minus the amount of indebtedness, encumbrances and liabilities to which the headquarters is subject and any reasonable transaction costs paid by JP Morgan. The estimated value of the headquarters is in excess of $1.4 billion. Given that the amended transaction value of the merger is approximately $1.2 billion and that JP Morgan may exercise the Asset Option even if there is a superior third party proposal allowing Bear Stearns’ directors to change their recommendation, the Asset Option is potentially a significant deterrent to third-party offers. The Delaware Supreme Court, however, has held that termination fees will be upheld if they are an integral part of the transaction. In other words, a termination fee is likely to be upheld if the deal would not have occurred without the inclusion of such fee. In this case, JP Morgan most likely would not have agreed to the merger without some form of termination fee. Since Bear Stearns did not have cash to pay a standard termination fee, the Asset Option may have been the only way to satisfy JP Morgan. Moreover, the Asset Option is not a typical termination fee in that Bear Stearns will receive approximately $1.1 billion if JP Morgan exercises the Asset Option. The negative aspects to Bear Stearns of the Asset Option are that it would not receive the full estimated value of the building and it could not include the building in a competing purchase package.

**Review of Deal Protections**

As mentioned above, in analyzing the deal protections in the amended merger agreement, the New York courts will apply Delaware law principles in analyzing each deal protection measure. They will look at each deal protection individually and in aggregate with all other deal protection measures contained in the amended merger agreement.

If the New York courts were only reviewing the original merger agreement, they would have to take notice of not only the number of deal protections but also how restrictively each of the deal protections was originally drafted. The March 24th amendment ameliorated some of these issues with carefully tailored provisions like the lock-up and by clarifying provisions such as making the Force the Vote Provision explicitly subject to the “fiduciary out.” However, certain other deal protections were made more restrictive than the original. The Asset Option serves as a breakup fee, and the Stock Swap
has given JP Morgan such a large stake in the transaction that it will be exceedingly difficult for a competing transaction to get majority stockholder approval. One can argue that these protections have made it all but impossible for a competing purchaser to succeed.

While that argument may be true, the New York courts will have to take into account whether there were or are any real potential competing bids available. During that difficult weekend leading up to the March 16th announcement of the JP Morgan deal, Bear Stearns invited a number of potential acquirers to conduct their due diligence and propose a transaction. As mentioned above, no other realistic acquirer emerged. Moreover, no purchaser could match the strength of the Federal Reserve-backed guaranty of Bear Stearns’ riskiest assets or the approvals of other federal agencies, and it is unlikely any purchaser could do so now.

If the New York courts apply well-established Delaware law principles relating to deal protection measures, they will likely determine that none of the deal protections contained in the amended merger agreement individually, or in the aggregate with any of the other deal protections, is impermissible.

If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings Los Angeles lawyers:

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3 In re The Bear Stearns Co., Inc. Shareholder Litigation, No. 3643-VCP, mem. op. (Del. Ch. Apr. 9, 2008) (order granting motion to stay Delaware action in favor of New York Action and to consolidate the suits brought by the Pension Funds).

4 Id.

5 Id. at 14.


8 The near insolvency of Bear Stearns is a complicating factor to this analysis. The Delaware courts have held that the directors of near-insolvent companies also owe fiduciary duties to the corporate enterprise, which includes creditors. (Geyer v. Ingersol Publications Co. , 621 A.2d 784 (Del. 1992).) The Delaware courts have not given clear guidance on how to balance duties to stockholders and to creditors. Moreover, this area of the law appears to be changing. In 2007, the Delaware Supreme Court appeared to cut back on the idea that directors owe fiduciary duties to creditors in the zone of insolvency. (North Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007).) The Gheewalla case held that creditors cannot assert a direct claim for breach of fiduciary duties of a solvent company in the "zone of insolvency." This decision, however, also held that when a solvent corporation is navigating in the zone of insolvency, the directors continue to owe fiduciary duties to the corporation and its stockholders only and not to the creditors of the corporation. It is not completely clear as to how the Delaware courts will apply this case in situations such as the one presented by Bear Stearns, although the Delaware courts are likely to find that the board's Revlon duties are paramount.

9 Section 312.03 of the New York Stock Exchange Listed Company Manual requires that an issuer obtain stockholder approval prior to issuing shares of its common stock having 20% or more of the voting power of such issuer’s outstanding shares of common stock. Bear Stearns was able to avoid obtaining stockholder approval for this issuance by claiming an exception under Section 312.05 of the NYSE’s rules to avert such stockholder approval requirement. This exception provides that prior stockholder approval is not required if a delay in securing stockholder approval for the issuance would “seriously jeopardize the financial viability of the company.”


