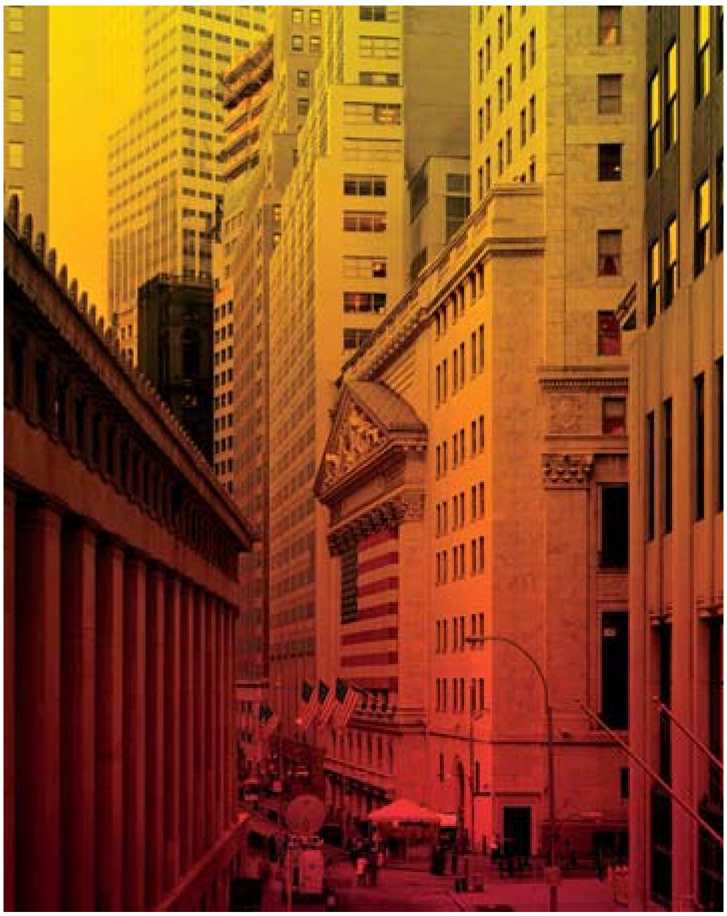
VANITY FAIR

EXCERPT

Wall Street's Near-Death Experience

With the implosion of Lehman Brothers, in September 2008, the realization dawned: Morgan Stanley and Goldman Sachs could be next. In an excerpt from his new book, the author reveals the incredible scramble that took place—desperate phone calls, seat-of-the-pants merger proposals, flaring tempers—as Washington got tough and Wall Street titans Lloyd Blankfein and John Mack fought for survival.

BY ANDREW ROSS SORKIN
NOVEMBER 2009



Sunrise over the stock exchange, in Lower Manhattan, the traditional home of the city's famed financial firms, many of which have moved uptown or disappeared entirely. *By Scott Peterman/Higher Pictures.*

Excerpted from Too Big to Fail, *by Andrew Ross Sorkin, to be published this month by Viking, a member of Penguin Group (USA) Inc.; © 2009 by the author. This account is based on hundreds of hours of interviews with dozens of the participants, many of whom agreed to be interviewed on the condition that they not be identified as sources.*

Day One
Wednesday, September 17, 2008: After Lehman and A.I.G.

When Tim Geithner, president of the Federal Reserve Bank of New York, began his run that morning along the southern tip of Manhattan and up the East River just after six, the sun had yet to come up. He was tired and stressed, having slept only several hours in one of the three tiny, grubby bedrooms in the New York Fed's headquarters.

As he stared at the Statue of Liberty and the first of the morning's commuter ferries from Staten Island gliding across the harbor, he tried desperately to clear his mind. For five days his brain had been trapped in a maze of numbers—huge, inconceivable, abstract numbers, ranging in the span of 24 hours from zero for Lehman to $85 billion for A.I.G. Eighty-five billion dollars was more than the annual budgets of Singapore and Taiwan combined; who could even begin to understand a figure of that size? Geithner hoped that the sum would be sufficient to rescue the insurance giant from bankruptcy—and that the financial crisis would finally be over.

ALSO ON VF.COM

Andrew Ross Sorkin on wrangling Wall Street's C.E.O.'s. *Plus:* How did the economy get into this mess? Visit our archive "Charting the Road to Ruin." *Illustration by Brad Holland.*

Those ferries, freighted with office workers, gave him pause. This is what it was all about, he thought, the people who rise at dawn to go to their jobs, all of whom rely to some extent on the financial industry to help power the economy. Never mind the staggering numbers. Never mind the ruthless complexity of structured finance and derivatives, or the million-dollar bonuses of those who had made bad bets. This is what saving the financial industry is really about: protecting ordinary people with ordinary jobs.

But as he passed the South Street Seaport and then went under the Brooklyn Bridge, he inadvertently began thinking about what fresh hell the day would bring.

Due to disastrous bets on Lehman paper, the giant Reserve Primary Fund had broken the buck a day earlier, causing an investor run on the money-market funds. Between that, Geithner thought, and billions of dollars of investors' money locked up inside the now bankrupt Lehman Brothers, that meant only one thing: the two remaining broker-dealers—Morgan Stanley and Goldman Sachs—could actually be next.

The panic was already palpable in John Mack's office at Morgan Stanley's Times Square headquarters. Sitting on his sofa with his lieutenants, Walid Chammah, 54, and James Gorman, 50, drinking coffee from paper cups, Mack was railing: the major news on Wednesday morning, he thought, should have been the strength of Morgan Stanley's earnings report, which he had released the afternoon before, a day early, to stem any fears of the firm's following in Lehman's footsteps. His stock had fallen 28 percent in a matter of hours on Tuesday, and he decided he needed to do something to turn it around. The quarterly earnings report had been a good one—Morgan had announced $1.43 billion in profits, down a mere 7 percent from the quarter a year earlier. But the headline on *The Wall Street Journal* was gnawing at him: GOLDMAN, MORGAN NOW STAND ALONE; FIGHT ON OR FOLD? And as the futures markets were already indicating, his attempt to show strength and vitality had largely failed to impress.

Apart from the general nervousness about investment banks, he was facing a more serious problem than anyone on the outside realized: at the beginning of the week, Morgan Stanley had had $178 billion in the tank—money available to fund operations and lend to its hedge-fund clients. But in the past 24 hours, more than $20 billion of it had been withdrawn by anxious hedge-fund clients, in some cases closing their prime-brokerage accounts entirely.

“The money’s walking out of the door,” Chammah told Mack.

“Nobody gives a shit about loyalty,” Mack complained. The question was: how much more could they afford to let go? “We can’t do this forever,” Chammah said.

While Mack was beginning to believe that the hedge funds were conspiring against the firm—“This is what they did to Dick [Fuld, of Lehman Brothers]!” he roared, referring to the Monday implosion of Lehman—there was fresh evidence that some of them actually did need the cash. Funds that had accounts at Lehman’s London office couldn’t get at them and came begging to Morgan Stanley and Goldman.

And Morgan needed to keep paying out the money. It was essential in the midst of a crisis that the firm not display even the slightest sign of panic, or the entire franchise would be lost. Under normal circumstances, Mack, 63, was unflappable, but he was starting to come unwound.

‘This is an economic 9/11!” There was chilling silence in Treasury Secretary Hank Paulson’s office as he spoke. Nearly two dozen Treasury staffers had assembled there Wednesday morning, sitting on windowsills, on the arms of sofas, or on the edge of Paulson’s desk, scribbling on legal pads. Paulson was seated in a chair in the corner, slouching, nervously tapping his stomach. He had a pained look on his face as he explained to his inner circle at Treasury that in just the past four hours the crisis had reached a new height, one he could compare only to the World Trade Center attacks, seven years earlier, almost to the week. While this time no lives may have been at stake, companies with century-long histories and hundreds of thousands of jobs lay in the balance.

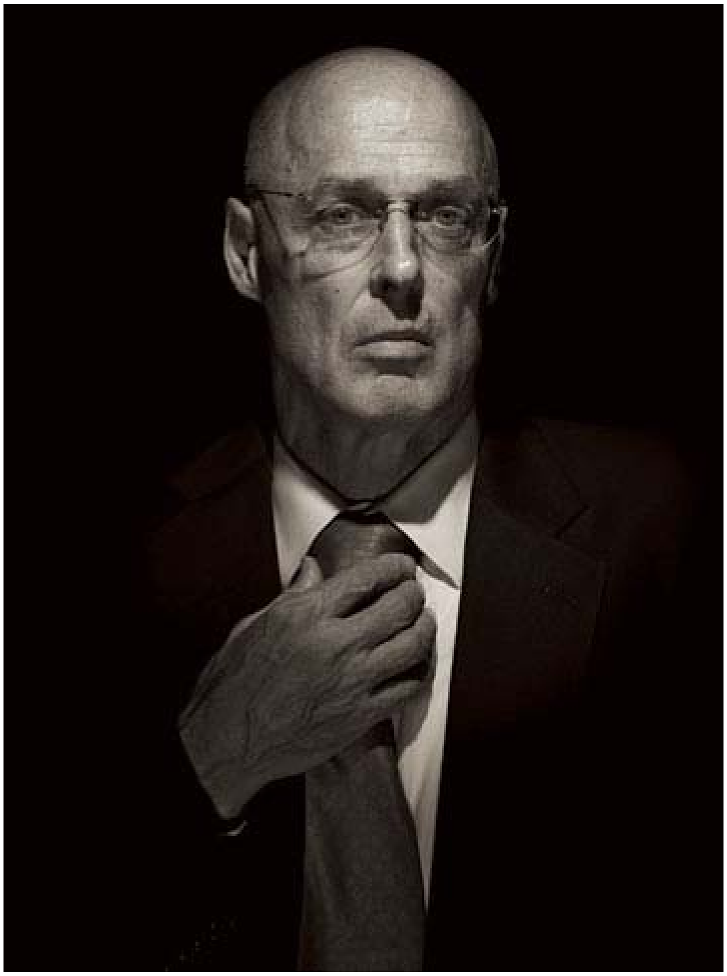
The entire economy, he said, was on the verge of collapsing. Paulson was no longer worried about just investment banks; he was worried about General Electric, the world’s largest company and an icon of American innovation. Jeffrey Immelt, G.E.’s C.E.O., had told him that the conglomerate’s commercial paper, used to fund its day-to-day operations, could stop rolling. Paulson had also heard murmurs that JPMorgan Chase had stopped lending to Citigroup; that Bank of America had stopped making loans to McDonald’s franchisees; that Treasury bills were trading for less than 1 percent interest, as if they were no better than cash, as if the full faith of the government had suddenly become meaningless.

Paulson knew this was *his* financial panic. The night before, chairman of the Federal Reserve Ben Bernanke had agreed it was time for a systemic solution; deciding the fate of each financial firm one at a time wasn’t working. It had been six months between the implosions of Bear Stearns and Lehman, but if Morgan Stanley went down, probably no more than six hours would pass before Goldman did, too. The big banks would follow, and God only knew what might happen after that.

And so Paulson stood in front of his staff in search of a holistic solution, a solution that would require intervention. He still hated the idea of bailouts, but now he knew he needed to succumb to the reality of the moment. “The only way to stop this thing may be to come up with a fiscal response,” he said.

‘It’s ridiculous that I can’t deal with Goldman at a time like this!” Paulson complained to his general counsel, Bob Hoyt. Paulson was supposed to take part in a three p.m. call with Bernanke, Geithner, and S.E.C. chairman Christopher Cox to discuss Goldman Sachs and Morgan Stanley, but unless he could get a waiver, he would be unable to participate.

With Morgan Stanley on the ropes, Paulson had been growing increasingly worried about Goldman, where he had worked for 30 years and where he was C.E.O. from 1999 to 2006. If Goldman were to topple, it would, he believed, represent a complete destruction of the system. He’d had enough of recusing himself. Part of him regretted signing the original ethics letter agreeing not to get involved in any matter related to Goldman.



Former Treasury secretary and Goldman C.E.O. Henry Paulson.
By Nigel Parry/CPi Syndication.

Geithner had raised this very issue back in March after the Bear Stearns deal. “You know, Hank, if another one of these banks goes,” he said, “I don’t know who would have the ability to take them over other than Goldman, and we have to do something about your waiver-recusal situation because I don’t know how we can do one of these without you.”

Given the extreme situation in the market, Hoyt told Paulson he thought it was only fair that he try to seek a waiver; Hoyt had in fact already drafted the material needed to request one. Paulson appreciated that the “optics” of a waiver to engage with his former employer were problematic, but he hoped it would remain a secret and he and Hoyt discussed keeping it confidential. Hoyt reached out to Fred F. Fielding, counsel to the White House and a longtime Washington hand, who knew his way around the system, and to Bernard J. Knight Jr., the D.A.E.O., or designated agency ethics official, at Treasury. Given the gravity of the situation, they quickly accepted Hoyt’s recommendation. Unknown to the public, Paulson was now officially free to help Goldman Sachs.

Kevin Warsh, a 38-year-old governor at the Federal Reserve, whose office was a few doors down from that of his boss, Ben Bernanke, was having his own worries over Morgan Stanley. He had worked as an M&A banker there six years earlier. He could tell that his former firm was quickly losing the confidence of the marketplace. To him, there was an obvious solution to its problems: Morgan Stanley needed to buy a large bank with deposits. His top choice? Wachovia, a commercial bank with a large deposit base that itself was struggling. Wachovia’s 2006 acquisition of Golden West, the California-based mortgage originator, was turning into a catastrophe, saddling the bank with a giant pile of bad debt that was beginning to reveal itself. After getting clearance to make contact with his old employer, based on an “overwhelming public interest,” Warsh contacted Wachovia C.E.O. Bob Steel and instructed him to call Mack in 20 minutes.

"Very interesting times," Steel said to Mack when they reached each other. "I imagine you've already heard from Kevin. He told me he thought we should connect."

Steel went on, intentionally keeping the discussion vague until he gauged Mack's intentions: "There might be an opportunity for us. We're thinking about a lot of things. I think this could be the right time to talk. But we'd need to move fast."

"I could see something," Mack replied, intrigued but noncommittal. "What's your timing?"

"We're moving in real time," Steel said.

For Steel, a Morgan Stanley deal happened to be both commercially and personally attractive. It could present an elegant solution to Morgan's succession problems down the road and could be Steel's big opportunity to finally run a top Wall Street firm.

After speaking with Steel, Mack called Robert Scully, his top deal-maker, and told him about the conversation. Scully had his doubts; he didn't know much about Wachovia's books, but what he did know alarmed him. He agreed, however, that at this point no options could be automatically ruled out. Scully in turn called Rob Kindler, a vice-chairman. In the relatively straitlaced banker culture of Morgan Stanley, Kindler was an outlier—loud, indiscreetly blunt, and predisposed to threadbare old suits. Despite his idiosyncrasies, when it came to deal-making, his advice was highly valued. Kindler didn't initially like the notion of a Wachovia merger, either, he told Scully, and took a reflexively cynical view. "Let's put this in context for a moment: Bob Steel comes from Goldman; Wachovia's investment bankers are Goldman; Hank Paulson is obviously from Goldman. The only reason we're having this meeting with Wachovia is because Goldman won't do the deal!"

Scully had been thinking much the same thing, but he and Kindler got Jonathan Pruzan, co-head of Morgan Stanley's financial-institutions practice, to start running the numbers on Wachovia. The obvious concern was its gargantuan subprime exposure, some $122 billion worth. As the Wachovia due diligence got under way, Mack got a callback from Citigroup C.E.O. Vikram Pandit, whom he'd telephoned earlier that morning after Citigroup's vice-chairman, Stephen Volk, had hinted they'd be open to a merger. Pandit delivered what amounted to a soft no on the merger talks. "The answer is no. The timing isn't right, but at some point we'd like to do something."

Mack clicked off, exasperated. Wachovia was nobody's idea of a dream date, but at the moment it was the only girl at the dance.

By midafternoon, Morgan Stanley's stock had fallen 42 percent. The rumors were flying: the latest gossip had the company as a trading partner with A.I.G., with more than $200 billion at risk. The gossip was inaccurate, but it didn't matter; hedge funds were now seeking nearly $50 billion in redemptions. John Mack was meeting with his brain trust. "It's outrageous what's going on here," Mack almost shouted, arguing that the raid on Morgan Stanley's stock was "immoral if not illegal." Intellectually he understood that short-sellers kept the market more efficient —after all, many were his clients—but at risk now was his own survival.

Colm Kelleher, Morgan Stanley's 51-year-old C.F.O., was more fatalistic—the short-sellers couldn't be stopped, he believed, or even necessarily blamed. They were market creatures, doing what they had to do to survive. "They are cold-blooded reptiles," he told Mack. "They eat what's in front of them."

Mack had just gotten off the phone with one of his closest friends, Arthur J. Samberg, the founder of Pequot Capital Management, then with $4 billion under management, who had called about withdrawing some money.

"Take your money," Mack told him, "and you can tell all your peers to take their credit balances out."

Mack believed negative speculation was purposely being spread by his rivals and repeated uncritically on CNBC. He was so furious with what he believed was “bullshit coverage” that he called to complain to Jeff Immelt. (G.E. owns CNBC as part of its NBC Universal unit.)

Tom Nides, Mack’s chief administrative officer, thought they needed to go on the offensive. He encouraged his boss to start working the phones in Washington and impress upon them the need to put in place a ban on short-selling. “We’ve got to shut down these assholes!” he told Mack.

Desperate for an ally, Mack contacted his most serious rival, Lloyd Blankfein, of Goldman. “Lloyd, you guys are in the same boat as I am.” He asked Blankfein to appear on CNBC with him, as a show of force.

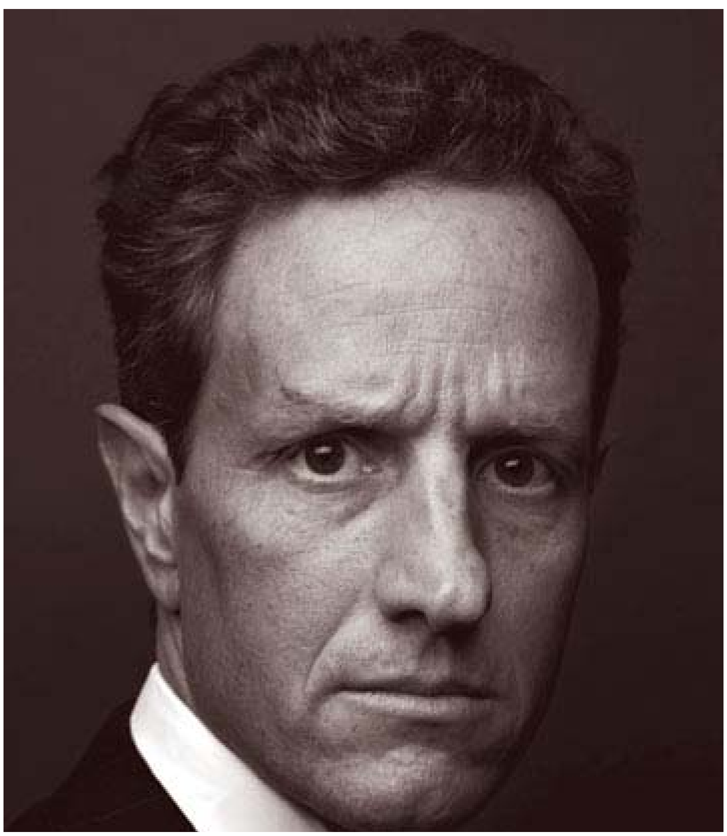
While the 53-year-old Goldman C.E.O. kept a television in his office, he was so disgusted with what he believed was CNBC’s Charlie Gasparino’s “rumor-mongering” that he had turned it off in protest. “That’s not my thing,” he told Mack. “I don’t do TV.”

As Goldman wasn’t in total crisis mode, Blankfein explained, he was disinclined to join Mack in a war on the shorts until he absolutely needed to.

Making little progress, Nides had another, perhaps shrewder, angle to play. He could call Andrew Cuomo, the New York State attorney general. Nides had a hunch that Cuomo might be willing to put a scare into the shorts. It was an easy populist message to get behind: Rich hedge-fund managers were betting against teetering banks amid a financial crisis.

“If you do this,” Nides told Cuomo, “we’ll come out and praise you.” Nides knew Mack would be reluctant—he’d be assailing his own clients—but this was a matter of survival.

‘What’s wrong?” Mack asked in alarm as Colm Kelleher walked into his office later in the day, his face ashen. “John, we’re going to be out of money on Friday,” Kelleher said with his staccato British inflection. He had been nervously watching the firm’s tank—its liquid assets—shrink, the way an airline pilot might stare at the fuel gauge while circling an airport, waiting for landing clearance.



Current Treasury secretary Timothy Geithner. *By Ben Baker/Redux.*

“That can’t be,” Mack said anxiously. “Do me a favor: go back to the financing desk—go through it again.”

Kelleher returned to Mack’s office 30 minutes later, less shaken, but only slightly. After finding some additional money trapped in the system between trades that hadn’t yet settled, he revised his prognosis: “Maybe we’ll make it through early next week.”

Day Two
Thursday, September 18, 2008: Fortress Goldman Under Attack

The panic at Goldman Sachs could no longer be denied. Perhaps the greatest sign of anxiety was the fact that Gary Cohn, Goldman’s co-president, who usually remained perched in his 30th-floor office, had relocated himself to the office of Harvey M. Schwartz, head of global-securities-division sales, who had a glass wall looking onto the trading floor. The door was left open; Cohn wanted to see and hear exactly what was going on.

Goldman’s shares opened down 7.4 percent. Investors were quickly beginning to believe the unthinkable: that Goldman, too, could falter. In two days, its share price had dropped from $133 to $108.

Every five minutes a salesman would tear into Schwartz’s office with news of another hedge fund announcing its plan to move its money out of Goldman, and would hand Cohn a piece of paper with the hedge fund’s phone number so he could try to talk some sense into them. With Morgan Stanley slowing down its payouts, some investors were now testing Goldman, asking for $100 million just to see if it could afford to pay. In every case, Cohn would wire the money immediately, concerned that if he didn’t the client would abandon the firm entirely.

Nevertheless, Stanley Druckenmiller, a George Soros acolyte worth more than $3.5 billion, had taken most of his money out earlier that week, concerned about the firm’s solvency. If word got around that a hedge-fund manager of Druckenmiller’s reputation had lost confidence in Goldman, that alone could cause a run. Cohn called him and tried to persuade him to return the money to the firm. “I have a long memory,” Cohn, who was taking this personally, told Druckenmiller, in whose honor he had even once hosted a charity cocktail party. “Look, the one thing I’m doing is I’m learning who my friends are and who my enemies are, and I’m making lists.”

Druckenmiller, however, was unmoved. “I don’t really give a shit—it’s my money!” he shot back. Unlike most hedge funds, Druckenmiller’s consisted primarily of his own money. “It’s my livelihood,” he said. “I’ve got to protect myself, and I don’t really give a shit what you have to say.”

“You can do whatever you want,” Cohn said in carefully measured tones. But, he added, “this will change our relationship for a long time.”

‘Listen, [JPMorgan Chase C.E.O.] Jamie [Dimon] just called me fishing around for something,” Colm Kelleher told John Mack midday Thursday as he marched into Mack’s office. “He said he was calling to see if he could be of help. It was strange.”

James Gorman, the firm’s co-president, had just reported receiving a similar call, Mack replied, and Geithner had phoned earlier to suggest that he talk to Dimon as a possible merger partner, too.

“It’s clear that, for him to be calling us, he wants to do a deal,” Kelleher said. “Jamie is always hanging around the hoop.... You know Jamie’s saying, ‘Let’s make friends with these guys before I eat them.’”

Mack was irritated by these suggestions; he didn’t particularly want to do a deal with Dimon, as he believed it would involve far too much overlap. But he decided to stop guessing what Dimon might be up to and ask him directly.

“Jamie, Geithner says I should call you,” Mack said abruptly when he reached Dimon on the phone a few minutes later. “Let’s get this out in the open: do you want to do a deal?”

“No, I don’t want to do a deal,” Dimon said flatly.

“Well, that’s interesting,” Mack retorted. “You’re calling my C.F.O. and you’re calling my president—why would you do that?”

“I was trying to be helpful,” Dimon repeated.

“If you want to be helpful, then talk to me. I don’t want you calling my guys,” Mack said, hanging up the phone.

Lloyd Blankfein, his top shirt button undone and tie slightly askew, looked at his computer screen and saw in dismay that his stock price had dropped 22 percent over the past several hours to $89.29.

In his e-mail in-box was a message from one of his traders saying that JPMorgan was trying to steal his hedge-fund clients by telling everyone that Goldman was going under. It was becoming a vicious circle.

Blankfein had been hearing these rumors for the past 24 hours, but he had finally had enough. He was furious. The rumormongering, he felt, had gotten out of control. And he couldn’t believe JPMorgan was trashing his firm to his own clients. He could feel himself becoming as anxious as Mack had sounded when they spoke the day before.

He called Dimon, too. “We’ve got to talk,” Blankfein began, then tried to calmly explain his problem. “I’m not saying you’re doing it, but there are a lot of footprints here.”

“Well, people may be doing something that I don’t know about,” Dimon replied. “But they know what I’ve said, which is that we’re not going after our competitors in the middle of all this.”

Blankfein, however, wasn’t buying this explanation. “But, Jamie, if they’re still doing it, you can’t be telling them not to!” Trying to get his point across, Blankfein, a movie buff, started doing his own rendition of *A Few Good Men:* “Did you order the Code Red? Did you say your guys would never do anything?” Dimon just listened patiently, eager not to get Blankfein even more wound up.

“Jamie, the point is, I don’t think you’re telling them to do this, but if you wanted to stop them in your organization, you could scare them into not doing it,” Blankfein said.

Even in its panicked state, Goldman was still Goldman, and Dimon didn’t want a war. Within half an hour he had his deputies Steve Black and Bill Winters send out a companywide e-mail: “We are operating as business as usual with Morgan Stanley and Goldman Sachs as counterparties. While they are both formidable competitors, during this period, we do not want anyone approaching their clients or employees in a predatory way.”

The 50th-floor office of Goldman’s fixed-income trading unit, in Lower Manhattan, was in near meltdown by lunchtime on Thursday. No trading was taking place, and the traders themselves were glued to their terminals, staring at the GS ticker as the market continued its swoon. Goldman’s stock dropped to $85.88, its lowest level in nearly six years.

Jon Winkelried, Goldman’s other co-president, had been walking the floors, trying to calm everyone’s nerves. “We could raise $5 billion in an hour if we wanted to,” he told a group of traders, as if to suggest that nothing was amiss. But just then, at one p.m., the market—and Goldman’s stock—suddenly turned around, with Goldman rising to $87 a share, and then $89. Traders raced through their screens trying to determine what had been responsible for the lift and discovered that the Financial Services Authority in the U.K. had announced a 30-day ban on short-selling 29 financial stocks, including Goldman Sachs’s.

The squawk boxes on Goldman’s trading floor soon crackled to attention. A young trader found a recording of “The

Star-Spangled Banner” on the Internet and broadcast it over the speakers to commemorate the moment. About three dozen traders stood up from their desks, placed their hands over their hearts, and sang aloud, accompanied by rounds of high-fives and cheers.

Goldman Sachs C.E.O. Lloyd Blankfein. *By Michelle V. Agins*/The New York Times/*Redux*.

At exactly 3:01 p.m. the market took off. Traders all over Wall Street turned up the volume on the trading-floor flat-screens when Charlie Gasparino reported what he was hearing from his sources on Wall Street: the federal government was preparing “some sort of R.T.C.-like plan” (referring to the Resolution Trust Corporation, formed in 1989 during the savings-and-loan crisis) that would “get some or all of the toxic waste off the balance sheets of the banks and brokerages.” Between the time Gasparino began his report and the segment ended, the market jumped 108 points.

But Blankfein was not mollified by the market’s late turnaround, with Goldman’s stock ending the day up at $108. Gary Cohn had been on the phone earlier in the day with Kevin Warsh at the Federal Reserve, brainstorming a way to get in front of the financial tsunami. Warsh had thrown out the idea that perhaps Goldman should be looking at a merger with Citigroup, a fit that could solve major problems for both parties. Goldman could get a huge deposit base, while Citigroup would acquire a management team that investors could support.

Cohn expressed his doubts about the suggestion. “It probably doesn’t work, because I could never buy their balance sheet,” he explained. “And the social issues would be enormous.” The expression “social issues” was yet more Wall Street code, for who would run the firm. Goldman’s management didn’t exactly have high regard for Pandit and his team.

“Don’t worry about the social issues,” Warsh told him. “We’ll take care of them.” That was a not-so-subtle hint that, if a deal was struck, Pandit might be out of a job.

But Blankfein wasn't particularly interested in either alternative. Goldman's lawyer Rodgin Cohen, from Sullivan & Cromwell, had been encouraging him to think about transforming the firm into a regulated bank-holding company, such as JPMorgan and Citigroup. That would give Goldman unlimited access to the Fed's discount window, enabling it to borrow funds at the same cheap rate as the government and to raise capital more easily, among other things.

Blankfein had always resisted the idea, however, because it came with a hefty price tag in the form of increased regulatory oversight. But these were extraordinary circumstances, to say the least, and the C.E.O. sensed that the world might be moving inexorably in that direction.

John Mack was still at his office in Times Square when Tom Nides told him the good news: his sources at the S.E.C. had confirmed that the agency was preparing to finally put in place a ban on shorting financial stocks, affecting some 799 different companies.

Rumors of the pending action were already moving on the wires. James Chanos, perhaps the best known of the short-sellers, who had pulled his money from Morgan Stanley because of Mack's support for the ban, was already on the warpath.

That day, Morgan Stanley's stock had fallen 46 percent, only to turn around in the last hours of trading, ending up 3.7 percent, or 80 cents. Between word of the government's intervention and the short-selling ban, Mack was hoping that he'd finally have some breathing room.

He knew, though, that beneath the surface the firm was hurting. Hedge funds continued to seek redemptions. What the firm needed most was an investor to step up and take a big stake in the company to shore it up. "I don't know how this happened," he confided in Nides.

Mack could think of only one investor that might be seriously interested in making a sizable investment in the firm: China Investment Corporation (C.I.C.), China's first sovereign-wealth fund. Wei Sun Christianson, C.E.O. of Morgan Stanley China, a 51-year-old dynamo with close relationships throughout the Chinese government, had initiated discussions with Gao Xiqing, president of C.I.C., within the past 24 hours. She happened to be in Aspen at a conference with him hosted by Teddy Forstmann, the leveraged-buyout king. C.I.C. already held a 9.9 percent stake in Morgan Stanley, and Gao had indicated to Christianson that he'd be interested in buying up to 49 percent of the firm. Gao had a major incentive to keep Morgan Stanley alive: he had invested $5 billion in the firm in December 2007, which was now worth half that. If Morgan Stanley filed for bankruptcy, he might lose his job.

Mack and Nides discussed the deal, and while neither man was particularly interested, given their choices, they knew it might prove to be the only solution. Gao was planning to fly to New York Friday night to meet with them.

Earlier in the day, Mack had spoken with Hank Paulson, who prided himself on his extensive Chinese contacts, trying to persuade him to call the Chinese government and encourage them to pursue the deal. It was a tad unusual to ask the government to serve as a broker, but Mack was desperate. "The Chinese need to feel as if they are being invited in," Mack explained. Paulson said he'd work on it and see if President Bush would be willing to call Chinese president Hu Jintao. "We need an independent Morgan Stanley," Paulson affirmed.

Nides, however, had a more cynical view of Paulson's desire to protect Morgan Stanley. "He'll keep us alive," Nides told Mack, "because if he doesn't, then Goldman will go."

Day Three
Friday, September 19, 2008: The Asians Are Coming

Hoarse and a little haggard, Paulson made his way to the podium in the pressroom of the Treasury Building to formally announce and clarify what he had christened earlier that morning as the Troubled Asset Relief Program, soon known as TARP, a vast series of guarantees and outright purchases of "the illiquid assets that are weighing down our financial institutions and threatening our economy." John Mack had been watching CNBC on Friday morning when he received a phone call from Lloyd Blankfein. "What do you think of becoming a bank-holding company?" Blankfein asked Mack.

Mack hadn't really studied the issue and asked, "Would that help us?"

Blankfein said that Goldman had been investigating the possibility and explained to him the benefits.

"Well, in the long run it would really help us," Mack said. "In the short run, however, I don't know if you can pull it off fast enough to help us."

"You have to hang on," Blankfein urged him, clearly still anxious about how punishing the markets had become, "because I'm 30 seconds behind you."

Meanwhile, Jon Pruzan, the Morgan Stanley banker who had been assigned to review Wachovia's $122 billion mortgage portfolio—to crack the tape—finally had some answers. A team of Morgan bankers in New York, London, and Hong Kong had worked overnight to sift through as many mortgages as they humanly could.

"Now I know why they didn't want to give us the tape!" Pruzan announced dourly at a meeting before they headed over to Sullivan & Cromwell to begin due diligence on Wachovia. "It shows they're expecting a 19 percent cumulative loss."

"You've got to be fucking kidding me," Robert Scully exclaimed. "We obviously can't do this deal."

To make it work, Morgan Stanley would have to raise some $20 to $24 billion of equity to capitalize the combined firms, a virtual impossibility under the current market conditions. Scully described Wachovia's mortgage book as "a $40 to $50 billion problem. It's huge. The junior Wachovia team is not disputing our analysis."

Kelleher, who had been keeping a careful watch over the firm's dwindling cash pile, had just taken a look at Wachovia's numbers for himself and observed, "That's a shit sandwich even I can't get my big mouth around."

It became increasingly clear to everybody that the only way this deal was going to take place was if the government provided a guarantee, which nobody thought would happen. Steel and Mack agreed they'd get back in touch, but before he hung up, Steel asked Mack for a favor. "It wouldn't be helpful if it leaked out that we're not talking," he said.

Morgan Stanley C.F.O. Colm Kelleher. *Courtesy of Morgan Stanley.*

The waiter at Blue Fin had just brought several massive plates of sushi—spicy lobster rolls, pieces of yellowtail tuna, and *tobiko*—when Colm Kelleher's cell phone rang. He had gone to get a late lunch with his Morgan Stanley colleagues, including James Gorman, Walid Chammah, and Tom Nides, and the group had been chatting about their plan to meet later that night with Gao Xiqing and his team. With Wachovia effectively out of the picture, the Chinese were now their sole prospect.

When Kelleher looked down at the caller ID, he saw it was a number in Japan and walked to the corner of the restaurant.

Jonathan Kindred, president of Morgan Stanley's securities business in Tokyo, greeted him and said excitedly, "This is interesting. I just got a call from Mitsubishi. They want to do the deal." Mitsubishi UFJ, Japan's biggest bank, was interested in buying a stake in Morgan Stanley.

The call had come completely unexpectedly and was totally unsolicited. Earlier in the week Morgan Stanley's management had actually ruled out calling Mitsubishi after its chairman, Ryosuke Tamakoshi, said publicly that following Lehman's bankruptcy his firm would not be making any investments in the United States.

Kindred said he thought Mitsubishi was prepared to move quickly. But Kelleher, rolling his eyes, was skeptical. He had worked with other Japanese banks before, and in his experience, they had always lived up to their reputation as being slow, risk-averse, and deeply bureaucratic.

James Gorman's eyes widened when Kelleher returned to the table with Kindred's news. This could be exactly what they needed, he thought.

Kelleher only scoffed. "This is a waste of time—they're never going to do anything."

"Colm, I really feel they're going to do something," Gorman insisted. He thought the fact that Mitsubishi had initiated the call to express interest was an encouraging sign. "This stuff doesn't happen by accident."

Kevin Warsh had taken the US Airways shuttle to New York late on Friday to help Geithner think through how to handle the upcoming weekend. Just as important, he would be Bernanke's eyes and ears on the ground. As his driver made his way from La Guardia Airport through traffic to the New York Fed, Warsh received a call from Rodgin Cohen, the Sullivan & Cromwell lawyer who by now was advising both Wachovia on its talks with Morgan Stanley, and Goldman Sachs on its bank-holding-company status. He told Warsh he had an idea—a potentially big one. It wasn't an officially sanctioned plan by his clients, just a friendly suggestion from an old-timer in the business.

He suggested to Warsh that the government attempt a shotgun wedding between Goldman and Wachovia. He knew it was a long shot—the "optics," he acknowledged, would be problematic, given that Paulson and Bob Steel were both former Goldman men—but it would solve everyone's problems: Goldman would get the deposit base it had been seeking, and Wachovia would have its death sentence stayed.

Warsh listened to the proposal and, almost to his own surprise, liked it.

Gao Xiqing, dressed in a sporty turtleneck and blazer, arrived at Morgan Stanley with his team just after nine p.m., having flown into New York with Morgan Stanley's Wei Sun Christianson on a private jet from Teddy Forstmann's Aspen conference. Gao's bad back was causing him so much pain that when James Gorman went to introduce himself he found Gao lying on the floor of a conference room on the 40th floor, in the middle of a telephone call. Mack, ever the accommodating host, had a couch brought from the executive dining room for his guest to lie on.

Over dinner, ordered in from Mack's favorite restaurant, San Pietro, they discussed a possible transaction. Alternating between standing up and lying down, Gao reiterated his interest in buying 49 percent of Morgan Stanley. As he had told Christianson on the flight over, he was now prepared to provide the firm with a credit line of as much as $50 billion and a nominal equity investment—no more than $5 billion, maybe less.

Mack was stunned. He knew the price that would be offered might be low, but to him this was absurdly so—the company was worth nearly $40 billion. This offer was effectively just a loan. While it might help Morgan Stanley stay in business, Gao was clearly taking advantage of its weakened condition. To Gao, the offer presented a way to reset the price he had paid for the 10 percent stake he had acquired in Morgan Stanley, in 2007, which was now worth far less. Unlike deals that other sovereign-wealth funds had struck then, giving them the right to reset the value of the deal if the firms sold equity at a lower price later, C.I.C. hadn't had the presence of mind to insist on that stipulation. For some inexplicable reason, Gao had convinced himself that the agreement did include such a provision until Morgan Stanley got him a copy to show him that it didn't.

However insulting Gao's proposal, Mack recognized that his situation was desperate. Despite the market rally, the firm had continued to bleed cash. Kelleher had given him the cash balances, and they were not good—about $40 billion left in the tank. A few bad days could wipe them out, and most days lately had been bad ones.

When Mack returned to his office and huddled with Christianson and his team, they were flabbergasted; Chammah initially thought he had misheard Christianson when she presented the offer.

"That's a ludicrous ask," Kelleher said. "They are being unreasonable."

Gorman, trying to calm everyone down, said they should all hope it might just be an opening bid: "They ask for the moon and then maybe they get more reasonable?"

Day Four
Saturday, September 20, 2008: Shall We Dance?

Tim Geithner hadn't slept well on Friday night, having again decided to stay in one of the grim rooms on the 12th floor of the Federal Reserve. By six a.m., he had returned upstairs to his office dressed in an oxford dress shirt and sweatpants.

In his mind, he was already making battle plans. He had made it safely to the weekend but was worried about what would happen on Monday.

"John's holding on to a slim reed," Paulson had told Geithner about John Mack's perilous position on a phone call the night before. Paulson was also still anxious about Goldman Sachs, his former employer. "We've got to find a lifeline for these guys," said Paulson, and they reviewed the possible options.

On note cards that morning, Geithner started writing out various merger permutations: Morgan Stanley and Citigroup. Morgan Stanley and JPMorgan Chase. Morgan Stanley and Mitsubishi. Morgan Stanley and C.I.C. Morgan Stanley and Outside Investor. Goldman Sachs and Citigroup. Goldman Sachs and Wachovia. Goldman Sachs and Outside Investor. Fortress Goldman. Fortress Morgan Stanley.

It was the ultimate Wall Street chessboard.

Lloyd Blankfein arrived at his office at just past seven on Saturday morning. On Friday, Gary Cohn had had another conversation with the Fed's Kevin Warsh, who encouraged him to keep looking at merger options, especially at Citigroup. Initially Cohn's notion was that Citi should buy Goldman; he had even established an asking price. But Warsh suggested that Cohn approach it the other way around: Goldman should be the buyer. To Cohn, that made no sense, given that Citi was so much bigger. But what Warsh knew—and hadn't yet shared with Cohn—was that Citigroup's balance sheet had so many holes that its value was likely a lot lower than its current stock price reflected.

Blankfein was reading an e-mail when John Rogers, Goldman's chief of staff, arrived. As they were reviewing their own battle plans, Geithner called. In his usual impatient tone, he insisted that Blankfein immediately call Vikram Pandit, Citigroup's C.E.O., and begin merger discussions. Blankfein, surprised at the directness of the request, agreed he would place the call.

"Well, I guess you know why I'm calling," Blankfein said when he reached Pandit a few minutes later.

"No, I don't," Pandit replied with genuine puzzlement.

Citigroup C.E.O. Vikram Pandit. *By Chip Somodevilla/Getty Images.*

There was an awkward pause on the phone. Blankfein had assumed that the Fed had pre-arranged the call. "Well, I'm calling you because at least some people in the world might be thinking that combining our firms would be a good idea," he said.

After another few moments of uncomfortable silence Pandit finally replied, "I want you to know I'm flattered by this call.”

Blankfein now began to wonder if Pandit was putting him on. “Well, Vikram,” he said briskly, “I’m not calling with any flattery towards you in mind.”

Pandit hurriedly ended the call: “I’ll have to talk to my board. I’ll call you back.”

Blankfein hung up and looked up at Rogers. “Well, that was embarrassing. He had no idea what I was talking about!” From Blankfein’s perspective, he had done what he was asked to do, only to be shown up.

Blankfein phoned Geithner back immediately. “I just called Vikram,” he said testily. “As I think about it, you never told me whether Vikram was expecting a call, but I inferred it. He behaved as if he wasn’t expecting the call, and he convinced me that he wasn’t expecting the call.”

Geithner had miscalculated—could Pandit not see the gift that was being handed to him? It defied all reason. But Geithner had no time to deal with anybody’s injured feelings. “O.K., I’ll talk to you later,” he said and then hung up. Blankfein sat there, wondering what the hell had just happened.

Bob Steel, of Wachovia, had considered canceling his appearance on the second day of Teddy Forstmann’s weekend conference, but flew into Aspen that morning, having left the East Coast at four a.m. to arrive on time. But as the moderator, Charlie Rose, got to the Q&A portion of the panel, “Crisis on Wall Street: What’s Next?,” Steel was nervously checking his watch because he knew he had to get to New York fast. Jumping into a red Jeep Wrangler that he had rented at the airport, he finally had a minute to check his BlackBerry and discovered that Kevin Warsh had sent him several e-mails urging him to contact him immediately.

“Listen, I have a call for you to make,” Warsh told Steel when he finally reached him. “We think you should connect with Lloyd!”

Steel, reading between the lines, was stunned: the government was trying to orchestrate a merger between Goldman Sachs and Wachovia! On its face, he knew that it could be a politically explosive deal, considering the two firms’ connections to Treasury. Paulson, he imagined, must be involved somehow. But, given Steel’s former role at Treasury, Paulson wasn’t allowed to contact him directly. Steel was immediately anxious about the idea. If Goldman had really wanted to buy Wachovia, he thought, it would have done so long ago. After all, up until this week, when he spoke to Mack, Goldman had been on Wachovia’s payroll as its adviser and, as such, knew every aspect of its internal numbers. So, if there was a bargain to be had, then Goldman hadn’t seen it. Still, Steel saw the merits in such a deal, and because it was being encouraged by the Federal Reserve, he imagined it might just happen.

“I spoke to Kevin, and he said to give you a call,” Steel began when he got through to Blankfein.

This call, unlike the Citigroup fiasco, had been pre-wired. “Yes, I know,” Blankfein said. “We’d be interested in putting a deal together.”

As his plane headed to New York, Steel mused how a deal with Goldman would be something of a homecoming, even if it had been the result of a direct order from the government. Perhaps he could even wrangle the chairmanship.

Jamie Dimon had been hoping to take his first day off in two weeks. That was until Geithner called him early Saturday morning and instructed him—the president of the New York Federal Reserve seldom suggested anything—to start thinking about whether he’d like to buy Morgan Stanley.

“You’ve got to be kidding me,” Dimon replied.

No, Geithner said, he was quite serious.

“I did Bear,” Dimon objected, referring to JPMorgan’s taking over Bear Stearns the previous March at Paulson’s behest. “I can’t do this.”

Geithner ignored the answer. “You’ll be getting a call from John Mack,” he said and hung up the phone.

Mack, who had had a similar peremptory call from Geithner, phoned Dimon five minutes later. Dimon reiterated that he didn’t want to buy Morgan Stanley, which he had already told Mack earlier in the week. But Dimon was under orders to try to help Mack, so the two rivals talked about whether JPMorgan could offer Morgan Stanley a credit line that might give it some breathing room. Dimon said he’d think about it and come back to him with a decision.

As soon as he got off the phone with Mack, Dimon called Geithner. “I talked to John,” he said. “We’re talking about getting him a credit line.”

“I don’t know if that’ll be enough,” Geithner said, frustrated at the news. He wasn’t the slightest bit interested in any temporary measures.

Dimon immediately shot off an e-mail to his operating committee summoning them to the office, and within an hour, dressed in golf shirts and khakis, they had assembled in a conference room on the 48th floor.

Dimon had a grimace on his face as he related the call he’d received from Geithner. On a whiteboard Dimon used a black marker to sketch out what he had been thinking. “We can either buy them, buy part of them, or give them some type of financing.”

But what, exactly, would they be buying? The overlap between the firms was enormous. And what were Morgan Stanley’s toxic assets really worth? These were all but unanswerable questions.

Geithner was by now seriously miffed. He had been trying to reach Pandit since eight in the morning and had just heard back from Blankfein, who had somehow actually managed to get through to Pandit again. The only problem was that Pandit had turned Goldman down, and Geithner hadn’t even had a chance to speak with him.

Finally, he got through.

“I haven’t been able to reach you for four hours,” Geithner barked into the phone. “That’s unacceptable on a day like today!”

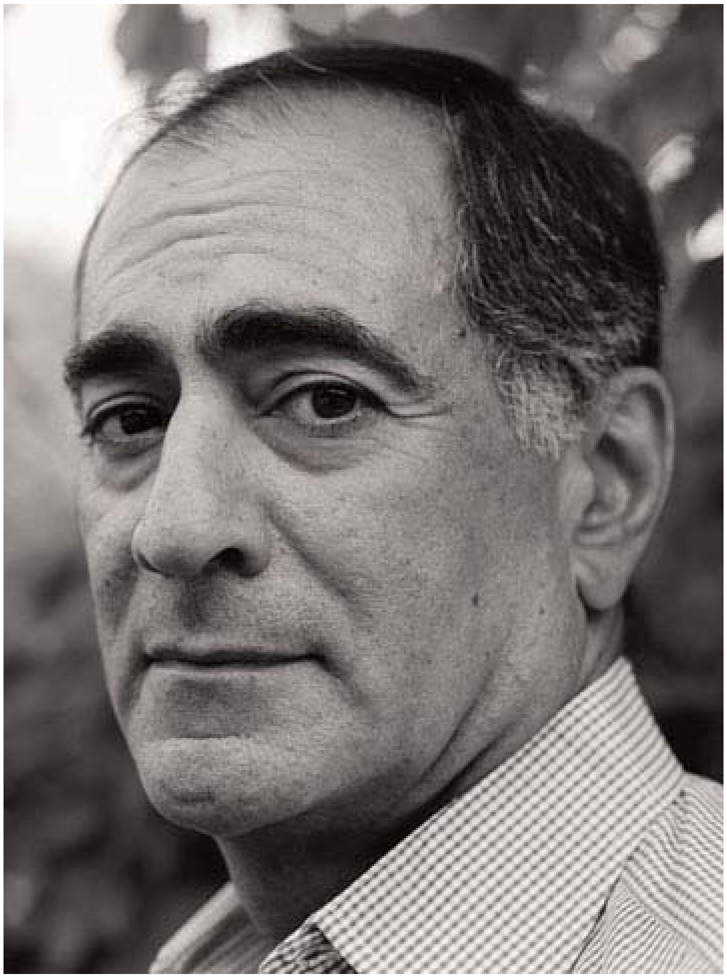
Apologizing, Pandit explained that he had been talking to his team about the Goldman proposal, which they had ultimately rejected. “We’re concerned about taking on Goldman,” Pandit said, trying to explain his rationale for turning them down. “I don’t need another trillion dollars on my balance sheet.”

Geithner could only laugh to himself—Pandit should have been so lucky as to own Goldman. “This is a bank,” Pandit said. “And a bank takes deposits and a bank has a prudency culture. I cannot envision a bank taking its deposits and investing them all in hedge funds. I know that’s not what Goldman is, but the perception is that they’d be taking deposits and putting them to work against a proprietary trade. That can’t be right philosophically!”

Having dispensed with pushing Goldman and Citigroup together, Geithner moved on to his next idea: merging Morgan Stanley and Citigroup. Pandit had been considering that option, too, and while he was more predisposed to merging with Morgan Stanley, he still was reluctant. “It’s still not our choice to do this deal, but we could think about it,” he told Geithner.

By two p.m., John Mack had grown concerned that the talks with C.I.C. were going nowhere. Gao hadn’t budged on what Mack was describing around the office as an “offensive” offer. He had no idea what Jamie Dimon would come up with, and he hadn’t heard anything from Mitsubishi.

Downstairs, Paul Taubman, the firm’s head of investment banking, was experiencing much the same panic as Mack. A disarmingly young-looking 48-year-old, Taubman had worked his entire career at Morgan Stanley, rising to become one of the most trusted merger advisers in the nation, and could now only wonder if it was all going to come to an end this weekend.



Morgan Stanley chairman John Mack. *By Michele Asselin/Corbis.*

Taubman and his colleague Ji-Yeun Lee were on the phone to Tokyo, where it was past midnight, with Kohei Yuki, Morgan Stanley’s vice-chairman and director in Japan, who was trying to coordinate talks with Mitsubishi.

“I think they’ve gone to bed for the night—we’ll pick it up in the morning,” Yuki said.

“That’s not going to work,” Taubman answered. “You need to call them at home and wake them up.”

There was a long pause; this was certainly a breach of Japanese protocol.

“O. … K.,” he said.

Twenty minutes later, Yuki was back on the phone: “I got him.” Mitsubishi was going to wake up its entire deal team and get working.

Goldman co-president Gary Cohn had agreed to engage in talks with Wachovia only on the presumption the Fed would help Goldman off-load some of Wachovia’s most toxic assets; Warsh, in a bold gesture, made a commitment that the Fed would strongly consider it. Paulson had spoken with Blankfein and told him to take the talks seriously. “If you go into this looking for all the problems and how much help you’re going to get, it’s never going to happen,” he said, adding, “You’re in trouble, and I can’t help you.”

In the meantime, Warsh instructed Cohn to make sure they could work out the personal dynamics. “Let’s not waste our time on economics if you guys are never going to solve the social issues,” he said. “If you aren’t willing to accommodate them, if Bob [Steel]’s not willing to do whatever, this isn’t going to happen.”

Steel was scheduled to land at Westchester County Airport, in White Plains, a suburb of New York City, in only a few hours, and Cohn walked into Blankfein’s office and made a suggestion.

“Lloyd, you should go pick Steel up at the airport,” Cohn said, believing it would be a gracious gesture to kick off the merger talks.

Blankfein looked seriously annoyed. He felt that he had not gotten along with Steel particularly well ever since Paulson had made them co-heads of Goldman’s equities division years earlier. “Do I have to?”

“Yes,” Cohn said firmly. “I would go with you, but it would be awkward. You should go pick him up.”

Blankfein was still resistant. “Can you go by yourself?”

“No,” said Cohn, who considered Steel a friend. “I already have a very good relationship with him.”

Blankfein relented. He’d head to the airport. Wearing slacks and a button-down shirt, he was waiting in the parking lot when Bob Steel arrived. As he walked out of the terminal, Steel, always perfectly coiffed, nonetheless looked as if he could use some sleep. He had already been awake for 15 hours, and his day was hardly done.

“What a birthday present!” Blankfein said to Steel brightly when he saw him. Blankfein, who turned 54 that day, was still hoping to get to a birthday dinner later that evening at Porter House New York, a steak restaurant, with his wife, Laura.

As the two men drove into the city they delicately began discussing the outlines of a deal and discussing their history together. Neither knew what to make of the merger idea or, for that matter, each other.

When they reached Goldman headquarters, Steel went directly to the 30th floor, where he once had an office. As he stepped into the conference room, he saw Chris Cole, who had been his firm’s adviser for the past five months. Now Cole would be on the other side, trying to buy Wachovia. Meanwhile, Steel’s lawyer, Rodgin Cohen, was also Goldman’s lawyer. It had all become so confusing and rife with conflicts, but they agreed that if they were going to do a deal they’d have to reach an agreement by Monday morning.

Goldman’s biggest issue was, as it had been with Morgan Stanley, trying to determine the scope of the hole. Wachovia owned $122 billion of pay-option ARMS—adjustable-rate mortgages—which Goldman Sachs felt weren’t going to be worth much. They each agreed to put teams on it to work up the numbers; Steel said he’d have his group fly up from North Carolina by morning.

Before decamping for the night, Blankfein invited Steel back to his office. He wanted to talk about titles, perhaps the most sensitive issue for men who often measure themselves as much by their business cards as by their wallets. Blankfein said he was thinking of making Steel one of three co-presidents, along with Gary Cohn and Jon Winkelried; Steel would continue to manage Wachovia as the consumer arm of Goldman Sachs.

Steel was taken aback and slightly offended. He was already the C.E.O. of a major bank; he’d been a vice-chairman of Goldman and a Treasury undersecretary in Washington. And now he was being asked to become one of three co-presidents?

"I'm not sure I want to be at the same level with Gary and Jon," he said diplomatically. "But we'll figure this out."

As the sun was setting, Hank Paulson was still in his office and had just gotten off the phone with Geithner. The news was not promising. Geithner told him that Morgan Stanley had no plan apart from what he called the "naked" bank-holding-company scenario. Geithner said he was uncertain whether any investor—JPMorgan, Citigroup, the Chinese, or the Japanese—would come through. And he was skeptical of the Goldman-Wachovia deal.

"We're running out of options," he told Paulson.

Paulson, who had been living on barely three hours of sleep a night for a week, was beginning to feel nauseated. Watching the financial industry crumble in front of his eyes—the world he had inhabited his entire career—was getting to him. For a moment, he felt light-headed.

From outside his office, his staff could hear him vomit.

Saturday night, John Mack returned to his Upper East Side apartment, nursing a persistent cold. His wife, Christy, who had driven into the city from their weekend house in the suburban town of Rye to console him, was waiting up.

He was quieter than usual, wondering yet again how he would manage to raise billions of dollars in capital in only 24 hours. "You know, there's a chance I could lose the firm," he said, despair in his voice.

He needed some air, he told Christy, and decided to go out for a walk. As he roamed up Madison Avenue, he realized that his entire adult life, his entire professional career, was on the line. But this was not just about his personal survival; it was about the 45,000 people around the globe who worked for him, and for whom he felt a keen sense of responsibility. Images of Lehman employees streaming out of their building the previous Sunday night carrying boxes of their possessions still haunted him. He needed to buck himself up. Somehow, he was going to save Morgan Stanley.

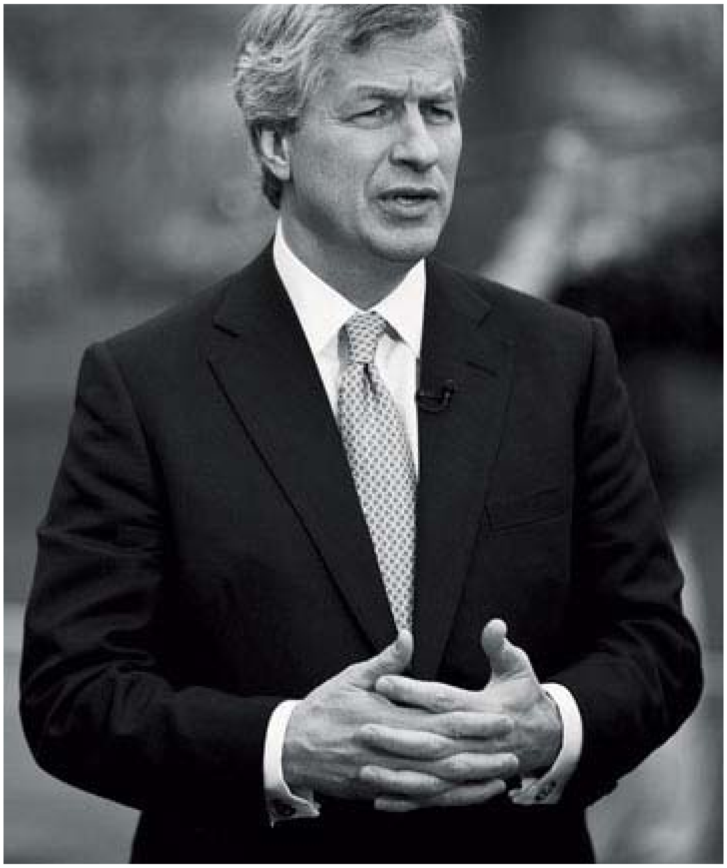
When he stepped into his living room a few minutes later, he admitted to Christy with a grateful smile, "I'd rather be doing this than reading a book in North Carolina."

Even before the black Suburban had come to a stop in his driveway, in a leafy enclave of Northwest Washington, D.C., on Saturday evening, Hank Paulson was stepping out of the car door, his Razr at his ear. His Secret Service agent preferred that Paulson wait inside until he got out of the vehicle, but Paulson had long since abandoned such protocol.

He raced inside to get on a call with Vice Premier Wang Qishan in China. For the past day, he had been trying to coordinate the call to press his case for China to pursue an investment in Morgan Stanley. Originally, he had wanted President Bush to call China's president personally and had spoken with Josh Bolten, the president's chief of staff, about it. But Bolten had concerns about whether it was appropriate for the president to be calling on behalf of a specific U.S. company.

Paulson had scheduled the call with Wang for 9:30 p.m. He knew Wang well from his trips to China as the C.E.O. of Goldman, and they had a comfortable rapport. He also knew it was highly unusual to be orchestrating a private market deal with another country, in this case the largest holder of U.S. debt. Before placing the call, Paulson had reached out to Stephen Hadley, the national-security adviser, to get some guidance. The instructions: Tread carefully.

JPMorgan Chase C.E.O. Jamie Dimon. *By Joshua Roberts/Bloomberg.*



When Paulson was finally connected to Wang, he moved quickly to the topic at hand, Morgan Stanley. "We'd welcome your investment," Paulson told Wang. He also suggested that one of China's biggest banks, such as the Industrial and Commercial Bank of China, should participate, making the investment a strategic one. Wang, however, expressed his anxiety about C.I.C.'s becoming involved with Morgan Stanley, given Lehman Brothers' bankruptcy.

"Morgan Stanley is strategically important," Paulson said, suggesting he would not let it fail.

Wang remained unimpressed, asking for a commitment that the U.S. government would guarantee any investment. Paulson, trying to avoid making an explicit promise but also trying to assuage him, said, "I can assure you that an investment in Morgan Stanley would be viewed positively."

Day Five

Sunday, September 21, 2008: The Last Stand

By midday, Goldman Sachs and Wachovia were making rapid progress toward completing a deal. Peter Weinberg, Bob Steel's main adviser and a former Goldman man, had constructed the outlines of an agreement. Just then, Joseph Neubauer, a Wachovia board member and the C.E.O. of Aramark, who was on hand at Goldman, got a call on his cell phone. It was Paulson. "This is not just about Goldman Sachs," Paulson said, pressing him to do the deal. "I'm concerned about Wachovia. Aren't you concerned?"

When Neubauer put down the phone, he looked at his fellow directors. "You're not going to believe this. That was Hank."

Warren Buffett was at his home in Omaha when he received a phone call from Byron Trott, a vice-chairman at Goldman Sachs. Buffett, who dislikes most Wall Street bankers, adored Trott, a mild-mannered midwesterner based in Chicago. For the past several weeks Trott had been trying in vain to persuade Buffett to make an investment in Goldman, but he had now come up with a new idea. He disclosed to Buffett that Goldman was in talks to buy Wachovia, with government assistance, and wanted to know whether Buffett might be interested in investing in a combined Goldman-Wachovia.

At first, Buffett wasn't sure he was hearing Trott correctly. Government assistance? In a Goldman deal?

"Byron, it's a waste of time," he said in his folksy way after considering the new configuration. "By tonight the government will realize they can't provide capital to a deal that's being done by the former firm of the Treasury secretary with the company of a former vice-chairman of Goldman Sachs and former deputy Treasury secretary. There is no way. They'll all wake up and realize, even if it was the best deal in the world, they can't do it."

John Mack had received some promising news that afternoon: Mitsubishi looked like it would actually pull through and make a sizable investment in Morgan Stanley. A conference call had been arranged for Mack to speak with Mitsubishi's chief executive, Nobuo Kuroyanagi, that evening.

Just as they were going over the details, however, Paulson called.

"John, you have to do something," Paulson said sternly.

"What do you mean I have to do something?" he asked, his voice rising with impatience, explaining that he had just learned that the Japanese were inclined to do the deal. "You've been so supportive—you said we can get through this."

"I know," Paulson said, "but you've got to find a partner."

"I have the Japanese! Mitsubishi is going to come in," he repeated, as if Paulson hadn't heard him the first time around.

"Come on. You and I know the Japanese. They're not going to do that. They'll never move that quickly," Paulson said, suggesting that Mack focus more on the deal with the Chinese or JPMorgan.

"No, I do know them. And I know I don't agree with you," Mack answered angrily. He explained that Mitsubishi had used Morgan Stanley as an adviser during its hostile bid for a part of Union Bank in California earlier in the year. "Japanese rarely do a hostile," Mack reminded him. "They hired us, they followed through and got it done, so they'll come through for us."

Paulson was still skeptical. "They won't do it," he said with a sigh.

"You and I disagree," Mack sputtered.

Calling Kevin Warsh out of a meeting at the Fed to come to the phone, Gary Cohn outlined the preliminary Goldman-Wachovia terms for him. They had agreed to a deal at market—Friday's closing price of $18.75—and considering that Wachovia's stock had jumped 29 percent that day on the back of the TARP news, Cohn thought it was a generous concession.

But then he wound up for his big pitch: to complete the deal, he said, Goldman would need the government to guarantee, or ring-fence, Wachovia's entire portfolio of pay-option ARM mortgages—all $122 billion worth.

Warsh stopped Cohn in midsentence. "We're just not prepared to do that," he said. "We can't look as if we're just writing a blank check." He suggested that if they structured it so that Goldman would take a first loss—in the same way that JPMorgan had agreed to accept the first $1 billion of losses at Bear Stearns before the Federal Reserve would step in and guarantee the next $29 billion—the government might well consider acting as a backstop.

At Treasury, Jim Wilkinson, Paulson's chief of staff, was by now practically sleepwalking down the halls. Paulson had just updated him on the Goldman-Wachovia talks and asked him for his counsel. Should the government provide assistance? Wilkinson, in his stupor, said he thought that it sounded like a reasonable idea.

But a half-hour later, after a cup of coffee and further reflection, Wilkinson changed his mind. He realized that such a deal would be a public-relations nightmare at the worst possible time, just as they were trying to pass TARP. Paulson would lose all credibility; he would be accused of lining the pockets of his friends at Goldman; the "Government Sachs" conspiracy theories would flourish.

Wilkinson ran back into Paulson's office. "Hank, if you do this, you'll get killed," Wilkinson said frantically. "It would be fucking crazy."

Ben Bernanke was being piped in over the speakerphone in Geithner's conference room, where Warsh was reviewing the new terms of the Goldman-Wachovia agreement. Cohn and Steel had come back to him with a slight revision to the previous proposal, allowing for Goldman Sachs to take the first $1 billion of losses, per Warsh's suggestion. Cohn and Steel said they were committed to completing the deal that afternoon if the government would agree to provide assistance. The boards of both companies had been put on standby.

The general view in the room seemed to be that it was a good transaction, but Geithner was quick to point out its drawbacks. "Does it make Goldman look weaker than they are?" he asked—a question Blankfein had raised earlier in the day. Geithner also wondered whether the Fed should be the one lending the money. Since Wachovia's regulator was the F.D.I.C., perhaps it ought to be the one to bear that burden.

Terry Checki from the New York Fed couldn't believe the gall of Goldman's request. "They're still driving these negotiations as though they have leverage," he said. But he opposed the merger for a different reason: he was concerned that neither side had enough time to make a thoughtful decision, referring to the situation as "the shotgun-wedding syndrome."

Then the New York Fed's Bill Dudley, a former Goldman man himself, who thought the deal was unattractive for the government, raised the same objection that Buffett had raised just hours earlier: it would prove a public-relations disaster for the government.

"What are we doing here?" Dudley asked. "Look at all of the connections you've got: Treasury and Steel and me. Goldman is everywhere. We have to be careful."

After Geithner and Bernanke called Paulson, all three agreed: they just couldn't support the deal.

When Warsh delivered the news to Steel and Cohn, both men were flabbergasted. They had spent the last 24 hours trying to formulate an agreement at the behest of the government and were now being told it could not be carried out.

How did the economy get into this mess? Visit our archive "Charting the Road to Ruin." *Illustration by Brad Holland.*

"I'm sorry. I understand—I'm just as frustrated as you are. We just don't have the money; we don't have the authorization," Warsh explained.

Steel, feeling particularly slighted, told Warsh that he felt as if he were running from one bride to another, trying to find the right marriage to save his firm. First Morgan Stanley, and now Goldman Sachs.

Cohn, realizing that the conversation was about to get testy, said, "I think I should step out."

"No, you should listen to this," Steel insisted, raising his voice for the first time. "You should sit here and listen to every goddamn word of this."

Anxiously talking into the speakerphone in the center of the table, Steel became even more irate. "What do you want me to do? Tell me what to do? You can't make this work, you don't like *this*, you don't like *that*. Do you want to do the Midtown deal?" he said, referring to Morgan Stanley. "Do you want me to call Citi? I've got to protect my shareholders. That's my job. Just tell me what the fuck you want me to do because I'm tired of running in circles."

Paulson had gotten word that the Goldman-Wachovia deal was off, which put even more pressure on him to find a solution for Morgan Stanley. To him, JPMorgan was the obvious answer. While Dimon may have been resisting Paulson's overtures—Paulson had broached the subject with him several times already over the past day—Paulson felt he now needed to apply some serious pressure.

"Jamie," Paulson said when he reached him, conferencing in Geithner and Bernanke, "I need you to really think about buying Morgan Stanley. It's a great company with great assets."

Dimon, who had been anticipating that the government might try to foist the deal on him, was adamant.

"You've got to stop. This is not doable," he said intently. "It's not possible. I would do anything for you and for this country, but not if it's going to jeopardize JPMorgan.

"Even if you gave it to me, I couldn't do it," Dimon continued, explaining that he thought the deal would cost the bank $50 billion and countless jobs.

"I don't want to do it, and John doesn't want to do it," Dimon told him.

"Well, I might need you to do it," Paulson persisted.

A few moments of silence passed until Dimon relented, but only slightly. "We'll consider it, but it's going to be tough," he said.

At about 3:30 p.m., John Mack's assistant announced that Secretary Paulson was on the line. "Hi, John. I'm on with Ben Bernanke and Tim Geithner. We want to talk to you," Paulson said.

"Well," Mack said, "since you're all on the line, can I put my general counsel on?"

Paulson agreed, and Mack hit the speakerphone button after the television was muted.

"Markets can't open Monday without a resolution of Morgan Stanley," Paulson told him in the sternest way he knew. "You need to find a solution—we want you to do a deal."

Mack just listened, dumbstruck.

Bernanke, who was usually remote and silent in such situations, cleared his throat and added, "You don't see what we see. We're trying to keep the system safe. We really need you to do a deal."

"We've spent a lot of time working on this and we think you need to call Jamie," Geithner insisted.

"Tim, I called Jamie," Mack replied, clearly exasperated. "He doesn't want the bank."

"No, he'll buy it," Geithner said.

"Yes. For a dollar!" Mack exclaimed. "That makes no sense."

"We want you to do this," Geithner persisted.

"Let me ask you a question: Do you think this is good public policy?" Mack asked, clearly furious. "There are 35,000 jobs that have been lost in this city between A.I.G., Lehman, Bear Stearns, and just layoffs. And you're telling me that the right thing to do is to take 45,000 to 50,000 people, put them in play, and have 20,000 jobs disappear? I don't see how that's good public policy."

For a moment, there was silence on the phone.

"It's about soundness," Geithner said impassively.

"Well, look, I have the utmost respect for the three of you and what you're doing," Mack said. "You are patriots, and no one in our country can thank you enough for that. But I won't do it. I just won't do it. I won't do it to the 45,000 people that work here."

The Morgan Stanley bankers were still waiting to find out if the Mitsubishi deal was a go. The Fed, they had learned, was going to grant them bank-holding-company status (and likely Goldman, too), but Geithner was still insisting the firm needed a big investment by Monday as a show of confidence in the company. Mitsubishi had sent over a proposal, a "letter of intent," to buy up to 20 percent of the firm for as much as $9 billion. But all they were getting was a letter; it wouldn't be an ironclad contract, as they couldn't get a full deal turned around quickly enough. But they were just hoping investors in the market would take the Japanese at their word and have more faith in them than Paulson or Geithner did.

Upstairs, Mack was on the phone with Mitsubishi's chief executive, Nobuo Kuroyanagi, and a translator trying to nail down the letter of intent. His assistant interrupted him, whispering, "Tim Geithner is on the phone—he has to talk to you."

Cupping the receiver, Mack said, "Tell him I can't speak now. I'll call him back."

Five minutes later, Paulson called. "I can't. I'm on with the Japanese. I'll call him when I'm off," he told his assistant.

Two minutes later, Geithner was back on the line. "He says he has to talk to you and it's important," Mack's assistant reported helplessly.

Mack was minutes away from reaching an agreement. He looked at Ji-Yeun Lee, who was standing in his office helping with the deal, and told her, "Cover your ears."

"Tell him to get fucked," Mack said of Geithner. "I'm trying to save my firm."

"Thank God. We're out!" Jamie Dimon exclaimed as he ran across JPMorgan's executive floor into his colleague Jimmy Lee's office, where the management team had camped out waiting for their next orders, watching the Ryder Cup and the New York Giants game, chowing down on steaks from the Palm.

"Mack just called," Dimon said, breathing a sigh of relief. "They got $9 billion from the Japanese!"

Purchase Too Big to Fail: The Inside Story of How Wall Street and Washington Fought to Save the Financial System—and Themselves *on Amazon.com*.

Andrew Ross Sorkin is a financial columnist for *The New York Times*.