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The Road to Lehman's Failure Was Littered With Lost Chances

By **LOUISE STORY** and BEN WHITE

Richard S. Fuld Jr. was under siege in mid-July. His renowned investment bank, **Lehman Brothers**, was barraged with questions about whether the expanding **credit crisis** would engulf the bank and wipe out investors.

Signs of worry abounded. The company's shares had plummeted, its debt had been downgraded, and investors were increasingly worried about a Lehman default. It was a downward spiral that mirrored the demise of **Bear Stearns** four months earlier.

Then Mr. Fuld, the chief executive, had an idea to silence the rumors that seemed to crop up every day. He would repaint the face of company as a commercial bank and ask to be regulated by the **Federal Reserve**, thinking that might give Lehman a more stable way to finance its operations.

But in an hourlong conference call with government officials, Mr. Fuld's hope was dashed when the president of the **Federal Reserve Bank of New York**, **Timothy F. Geithner**, refused to change rules to enable quick benefit from the change Mr. Fuld had sought.

In the months leading up to Lehman's downfall, the proposal was just one of many floated by Mr. Fuld as he embarked on a frenetic and increasingly desperate attempt to keep his 158-year-old investment bank alive, according to interviews with five former senior Lehman executives and one outsider who was intimately involved in its business dealings, who spoke on the condition that they not be named.

Looking for ways to save Lehman, Mr. Fuld called blue-chip companies and discussed mergers with a competitor. He sent emissaries to Asia and the Middle East looking for money. And he tried to find a commercial bank to buy the entire company. But none worked.

Now, Mr. Fuld is likely to face some tough questions about the final months and days of Lehman. He will discuss these lost opportunities in a Congressional hearing on Monday, in his first public appearance since the company collapsed last month and was sold off in pieces to buyers including **Barclays** and Nomura.

Mr. Fuld still works for the bankrupt entity, which has come under fierce criticism by customers who lost money, former employees whose severance checks have stopped showing up and investors who think he failed to stop the disaster. Among other things, he may be pressed in Washington to explain why Lehman was publicly presenting a rosy outlook about its future while it privately was scrambling for a solution to its deepening problems stemming from its exposure to toxic subprime mortgages. Mr. Fuld declined to comment on Sunday.

Lehman is already facing preliminary inquires from federal prosecutors in the Eastern and Southern districts of New York who are looking at statements the company made about its own financial condition as well as whether it overstated the value of its commercial real estate holdings, a person familiar with the matter said.

Though Lehman was the smallest investment bank when it failed — and regulators decided it was not too big to fail — its demise set off tremors throughout the financial system that reverberate to this day. The uncertainty surrounding its billions of dollars of transactions with banks and hedge funds exacerbated a crisis of confidence. That contributed to the freezing of credit markets that has forced governments around the globe to take steps to try to calm panicked markets, including guaranteeing bank deposits.

"This is a humongous mess, and I think that is one of the reasons that the storm came back so soon, and the mad dogs came chasing Goldman and **Morgan Stanley**," said Roy Smith, a professor of finance at **New York University**. "It wasn't obvious to me that Lehman should fail, but the control of whether it failed was in the hands of the government." Mr. Fuld was an institution inside the Lehman institution. He had worked at the bank nearly 40 years, after starting as a clerk straight out of college. He rose to the top seat while Lehman was owned by **American Express**, and he triumphantly took the company public in 1994.

Lehman executives complain bitterly that any chance of keeping the firm alive began to dissipate rapidly just after **Labor Day** when **JPMorgan Chase**, which handled Lehman's trades, came calling for more money. Lehman had put down securities it believed were worth $6 billion during the summer to assuage the bank's concerns that its trades were risky. But JPMorgan thought those securities had deteriorated in value, and asked for $5 billion in cash or liquid assets on Sept. 4.

Over the course of the next week, JPMorgan requested more money from Lehman. However, executives at the two companies disagree over how much money was requested and whether the requests were reasonable. The dispute has become part of a legal claim filed by creditors of Lehman.

By the weekend of Sept. 14-15, most Lehman workers knew the firm's days as an independent bank were over. Mr. Fuld continued fevered deal talks with **Bank of America** and Barclays, but both banks dropped out by the end of the weekend. Meanwhile, Wall Street executives at the Federal Reserve Bank of New York quickly shifted conversations from preventing a bankruptcy of Lehman to dealing with its consequences.

At the urging of federal officials, a group of remaining banks set up a $70 billion private-sector fund designed to assist any contributor to the fund that ran into trouble. And the Federal Reserve eased its restrictions on what investment banks could pledge as collateral to borrow from the Fed. The programs were not open to Lehman because the government reportedly deemed it too troubled, and Lehman immediately filed for bankruptcy.

Lehman executives were furious, because the government had denied their request in July to ease restrictions on collateral. That step might have paved the way for Lehman to more easily become a bank holding company. And, worsening the sting, **Goldman Sachs** and Morgan Stanley turned themselves into deposit-taking commercial banks with the blessing of the Federal Reserve just one week after Lehman collapsed.

"What they did to save Morgan Stanley and Goldman Sachs, they could have done that for us, and in fact, we showed them the path," one former Lehman executive said Saturday.

A spokesman for the Federal Reserve declined to comment Sunday.

Mr. Fuld's attempts to attract investors actually had begun well before its problems appeared. He had been trying since at least early 2006, seeking out foreign investors in places where Lehman wanted to grow. He wanted each of them to purchase a 5 to 10 percent stake in the company on the open market.

Lehman executives had lengthy discussions with the Citic Group, a large Chinese bank; the Ping An Insurance Company of China; and Kuwait's sovereign wealth arm, but no one signed up. Ping An declined to comment this past weekend, and Citic and the Kuwait officials could not be reached.

Around the same time, Mr. Fuld talked with Martin J. Sullivan, the then chief executive of **American International Group** about selling all of Lehman to the insurance giant. A.I.G., which itself would eventually would find itself in deep financial trouble, declined to comment on Sunday.

The latest round of talks by Lehman to seek partners started in early 2007, in the early stages of the subprime mortgage debacle. Those discussions went nowhere. In early March of this year, Mr. Fuld stepped up the efforts to seek partners, dispatching emissaries to China, where Lehman was considering purchasing two banks, including Shanghai Aijian.

But things took a turn for the worse then Bear Stearns collapsed in mid-March, leaving Lehman as the smallest and most vulnerable independent investment bank. Mr. Fuld immediately raised $3 billion in capital, mostly from large public companies. Days later, he held an intensive planning session. At that time, he reviewed their options, including building or acquiring a deposit base, merging with a large bank, or acquiring a smaller bank.

In May, Lehman began discussing a merger or sale to Barclays Capital, the British bank that ended up purchasing the bulk of Lehman last month after Lehman's bankruptcy filing. Lehman was also in talks with Korea Development Bank, the state bank of South Korea, for a strategic investment.

Those talks hit the newsstands in June, and investors, worried that Lehman needed capital, battered its share price.

A hedge fund manager named David Einhorn also took to the news media with criticism of Lehman, accusing company executives of playing down their problems.

"Now it is clear that Lehman's problems were their own doing," Mr. Einhorn, president of Greenlight Capital, said Sunday night.

Days before second-quarter earnings, Mr. Fuld called on the billionaire investor **Warren E.**

Buffett, who would eventually purchase a stake in Goldman Sachs, but Mr. Buffett was demanding terms that Lehman considered too onerous.

Mr. Fuld had better luck with others, raising a total of $6 billion from a group including C. V. Starr & Company, the investment fund led by **Maurice R. Greenberg**, the former head of A.I.G., and the state pension fund of New Jersey.

The stock kept falling, bringing its four-week loss to 47 percent by mid-June. At that time, Mr. Fuld came up with about a dozen possible solutions for his company, which included a conversion into a bank holding company, the sale of commercial or residential mortgage assets, and spinning off parts of the investment management division.

Meanwhile, Mr. Fuld kept looking for an investor that would quiet the skeptics, focusing on those who might be interested in purchasing stakes of 15 to 25 percent of Lehman. He called **General Electric**, but talks went nowhere. About the time that he was seeking government approval to form a bank holding company, he also tried to woo Bank of America beginning in July. And he met with John Mack, the chief executive of Morgan Stanley, in the following weeks to discuss a merger. Mr. Mack decided he was not interested.

Mr. Fuld also approached **HSBC** — a British bank that had been on his list since the April meeting. Also at the end of August, Mr. Fuld courted two **sovereign wealth funds** in the Middle East.

But Lehman received no formal bids before its bankruptcy filing. It is unclear what kept potential partners at bay.

In the wake of Lehman's downfall, many of its former employees are left with their lives in pieces. Mr. Fuld, for his part, has lost $800 million in company stock as it fell from its peak just over a year ago. He and his wife have put some of their art collection, worth millions of dollars, up for sale. but he still owns several homes and his net worth is estimated to be around $100 million now.

Ordinary employees are not as well off. Among them are some 1,000 workers who were laid off in the days before Lehman filed for bankruptcy. Last week, they received letters from Lehman Holdings, the bankrupt entity, saying their promised severance payments and health benefits would cease immediately.

Michael Petrucelli, who worked on commission as a salesman for Lehman's investment management division, said it was bad enough to lose his savings in Lehman stock and his job, but the letter last week was the last straw. The decision about their benefits rests with the bankruptcy judge.

"Life's not fair. You pick yourself up and move on," said Mr. Petrucelli, 45, in an interview at his home in Riverside, Conn. "But this is wrong, and this I can't stand for. They need to just do the right thing."

Vikas Bajaj, Michael J. de la Merced and Andrew Ross Sorkin contributed reporting.