

# THE WILSON LAW FIRM

## MEMORANDUM

**To:** Lehman Shareholder Clients  
**From:** L. Matt Wilson  
**Date:** October 31, 2008  
**Re:** The LBHI Bankruptcy Case Disaster

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This is a status report on Lehman Brothers Holdings, Inc. ("LBHI") bankruptcy proceedings, including our October 16, 2008 court appearance on our Motion for Appointment of an Official Equity Committee.

The Bankruptcy Court issued an Order (Docket Number 1095) which denied the motion, without prejudice, and verbally explained that its decision was based on its finding that there was no likelihood or possibility of an equity recovery. This was a remarkable factual conclusion which, in our opinion, reflects very poorly on the current state of this bankruptcy case, the professionals representing the debtor, and our entire bankruptcy system.

As of August 31, 2008, LBHI's audited financial statements indicated over \$28 billion in shareholder equity. LBHI was an investment bank, providing various professional services and owning interests in many thousands of individual holding companies. There is no indication of any accounting irregularities or fraud; no history of operating losses; and no history of negative cash flow. LBHI had a history of astute investing, mostly structured in separate subsidiary corporations or limited liability companies.

An orderly liquidation should involve each subsidiary's assets being netted against its liabilities, generally paying creditors as and when due, with losses contained within that subsidiary and operating profits and capital gains flowing up to the LBHI parent. This solution would have been consistent with the fundamental purpose prompting the formation of single asset entities in the first instance, by isolating liabilities and losses and thereby safeguarding LBHI shareholder interests.

LBHI filed its Chapter 11 petition on September 15, 2008, reportedly with little or no advance preparation or planning. Within 48 hours, LBHI's trading and brokerage operations, employing approximately 12,000 employees, were under contract of sale to Barclays, which sale was approved on September 19, and closed on September 22. By the end of the week of September 22, the vast majority of LBHI's remaining 18,000 worldwide employees had been

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laid off, including virtually all senior employees with any institutional knowledge as to the status of LBHI's several thousand investments. The CEO has subsequently been removed and most of senior management has been lost. As of the October 16 hearing, remaining LBHI employees numbered only a few hundred. As LBHI's primary on-going business was financial services, it has now lost substantially all of its ability to provide services.

The Chief Restructuring Officer and his firm are entirely new to LBHI, being unfamiliar with its history, market place, and most importantly, with the specifics of its many thousand individual investments. As the CRO reported to the Court, he and his team are 'just beginning to get their arms around it', meaning that small portion of LBHI which is left after the hurried sale to Barclays and the wholesale layoffs.

From the pleadings, it appears that neither LBHI nor Barclays fully understands exactly what has been sold and what has been retained, as both continue to submit followup orders and schedules under seal clarifying various aspects of the arrangement between them. Other parties are seeking discovery regarding various cash transactions and the location and ownership of specific securities.

Additionally, as a result of, or in conjunction with the Barclays transaction, there may have been a substantial reorganization of the remaining subsidiaries, without any consideration as to whether such action would have constituted an administrative consolidation or what effect it might have had on inter-company liabilities and third party claims. The most recent organizational chart, a copy of which is available on our website ([www.willaw.com/Lehman/Lehmandocs/LehmanSubsidiaryChartOctober14.pdf](http://www.willaw.com/Lehman/Lehmandocs/LehmanSubsidiaryChartOctober14.pdf)), confirms that LBHI had several thousand direct subsidiaries and approximately ten thousand indirect subsidiaries.

At this juncture, this Chapter 11 "Reorganization" is actually proceeding as a hurried liquidation. In our opinion, the "smartest guys in the room" are all in near panic, disposing of assets without knowledge of their value, and without determining whether there is actually any necessity of sale. All of this suggests that a quick resolution to the difficult issues presented by this case has taken precedence over the preservation and maximization of value.

Two events that occurred on October 16 serve to amply illustrate our concerns. The first was the sale of Eagle Energy

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Partners I, L.P. ("Eagle"). Eagle was formed in 2003 to acquire, manage and deliver natural gas and electric power across the United States and Canada. Based in Houston, Eagle has offices in Atlanta, Pittsburgh, Chicago, Ft. Worth, and Calgary that offer energy-asset management and power-marketing services, conveying approximately 1.5 billion cubic feet of natural gas and approximately 35,000 megawatt-hours of electricity per day, coupled with natural gas storage capacity of approximately 30 billion cubic feet.

LBHI, through certain of its subsidiaries, acquired all of Eagle's limited and general partnership interests in May of 2007. The acquisition price was not disclosed! No details regarding Eagle's current performance, income or loss, cash flow, or balance sheet were disclosed, other than the fact Eagle owed LBHI approximately \$664 million under an inter-company loan.

The debtor proposed, and the Court approved, a sale of Eagle pursuant to a purchase agreement dated September 26, 2008, just eleven days after the bankruptcy filing. Under the agreement, the purchasers will pay LBHI approximately \$230 million of the \$664 million loan; LBHI will forgive the balance and assign the note to the purchasers; and LBHI will receive no other consideration. In other words, LBHI has sold both the note and its 100% ownership interests in this subsidiary, for payment of approximately a third of the note, all without any of the substantive disclosures necessary for a fair or appropriate business evaluation of the transaction.

The Court approved this transaction, purely (or primarily) on the strength of representations from Debtors' counsel, that there were "exigent circumstances surrounding these Chapter 11 cases" and that the Debtors "conducted 'an extensive search for a strategic buyer'" in eleven days. Those conclusions are obvious foolishness and the transaction, on the basis of the information disclosed, represents a possible wholesale giveaway, despite all the other "bells and whistles" that were added to the sale documents in an attempt to create an appearance of normality.

The second event was even more troubling. In May of 2008, LBHI made a "seed capital investment" of approximately \$1 billion, acquiring an "indirect 45% nonvoting equity interest" in an offshore, Cayman Islands exempted company, which held an interest in R3 Capital Management, LLC. Although it was not disclosed, one can logically presume that the 55% voting equity interest contributed at least a similar, if not greater, amount of cash or

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other value. LBHI had an additional obligation to provide certain "servicing" on behalf of the fund, which it would not be able to provide post-bankruptcy because of the sale of the trading operation to Barclays and the lay-off of virtually all remaining employees. The specifics of this "servicing" were not disclosed, nor was the cost of obtaining alternative servicing in the open market.

Under the terms of this transaction, as set forth in a purchase agreement dated October 8, 2008, and approved by the Court on October 16, 2008, the 55% investor became the buyer, with an obligation to pay \$125 million in cash at closing, deliver a unsecured promissory note for \$125 million, and leave LBHI with a \$250 million interest in the fund, "based on the overall net asset value of the master fund as of September 30, 2008." But that value was not disclosed, so it is unclear what value the fund had at the time of the sale and what percentage LBHI will retain! All that is clear is that LBHI invested \$1 billion in cash in May of 2008, and then sold its interest for, at most, \$500 million in October of 2008, financing 75% of that sales price on an unsecured basis, with no disclosure as to (1) the amount which the 55% partner invested in May of 2008, or (2) the present value of the fund.

Under these circumstances of these sales, including the Barclay's sale and the many others that now appear of record in the pleadings, the Bankruptcy Court is correct in concluding that there is little likelihood of an equity distribution. Senior counsel for the Debtor even broadly hinted at the likelihood of administrative consolidation, because of the difficulty accounting for inter-company transfers, which would eliminate 150 years of carefully crafted corporate structures designed to isolate losses while preserving profits and gains to shareholders.

\$28+ billion of hard equity, derived from paid in capital and retained earnings, will be lost to poorly considered sales, administrative consolidations, and the chaos of bankruptcy, without proper accounting, valuations, or fundamental business considerations, justified by allegations of "exigent circumstances" and the exercise of "business judgment" by outsider professionals.

While we may long debate whether LBHI was "too big" to fail, it is clear that it was "too big" for a successful Reorganization in Bankruptcy.

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