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Lehman Bros. executives, auditors hit with lawsuit

**"We are going after these guys' houses,
their bonuses, their salaries
and everything these guys have."**

JOE COTCHETT, *lead counsel on lawsuit*

Failed firm accused
of fraud and deceit
in \$150 million loss

By Jim Doyle
CHRONICLE STAFF WRITER

A San Mateo County investment fund on Thursday accused executives of failed Wall Street investment bank Lehman Bros. Holdings Inc. and their accountants of fraud and deceit that led to the loss of more than \$150 million of the public's money.

According to a lawsuit filed in San Francisco Superior Court, Lehman Bros. hid the company's exposure to losses in the real estate and mortgage markets as it raised more than \$30 billion from investors, including the San Mateo County investment fund, while privately scrambling to prevent the company from collapsing.

Among other things, the suit asserts that Lehman executives made public statements in Securities and Exchange Commission filings about the company's financial strength while "concealing its dangerous exposure from its low-grade mortgage portfolio and its refusal to properly value its assets."

Among individuals being sued are Lehman chief executive Richard S. Fuld Jr., former chief financial officers Christopher M. O'Meara and Erin Callan, and former President Joseph M. Gregory.

Also named is Ernst & Young, Lehman's auditing company, which is accused of helping cover up the fraud before Lehman declared bankruptcy on Sept. 15. It was the largest corporate bankruptcy in U.S. history.

"This is Main Street taking on Wall Street," said Burlingame lawyer Joe Cotchett, the lead counsel retained by the county. "This is a brushfire that's going to burn East, and the Hudson River is not going to stop it.

"This is the first of its kind," he added. "We are going after these guys' houses, their bonuses, their salaries and everything these guys have. Plus, we're going after Ernst & Young."

According to the 57-page complaint, Fuld owns a 10,000-square-foot mansion in Greenwich, Conn., a \$21 million apartment on Park Avenue in New York, a \$13 million beachfront home in Florida, a ski vacation house in Sun Valley, Idaho, and a multimillion-dollar art collection.

"We believe the executives have taken out more than \$1 billion in the past two years in bonuses alone," Cotchett said.

Ernst & Young, a national accounting firm, received an estimated fee of \$31 million in 2007 to audit Lehman's books and sign off on its subprime mortgage portfolio, the complaint asserts.

"A rosier view of Lehman Bros. was being projected than the actual facts merited," said San Mateo County Counsel Michael Murphy.

The investment fund, managed by the San Mateo County treasurer, handles investments for the county, various school districts, local municipalities, special districts and other public agencies.

County officials said the losses included \$37 million to San Mateo County kindergarten through grade 12 public schools; \$25 million to the San Mateo County Community College District; \$22 million to the San Mateo County Transportation Authority; and millions of dollars to Belmont, Brisbane, Burlingame, Daly City, Hillsborough, Menlo Park, Millbrae, Pacifica, Portola Valley, Redwood City, San Bruno, San Carlos, San Mateo, Foster City, Woodside, among others.

The suit claims the FBI is investigating Lehman and its executives for securities fraud and criminal conduct.

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'Main Street strikes back'

San Mateo County files lawsuit against 'Wall Street robber barons'; first such action in the nation

By Michelle Durand
DAILY JOURNAL STAFF

Lehman Bros. executives purposely deceived investors by publicly claiming the now-bankrupt company's financial strength while privately scrambling to save it from collapse and awarding lucrative bonuses, according to a lawsuit filed yesterday by the San Mateo County Investment Pool against the firm and the accountants it claims helped perpetuate the fraud.

The suit filed in San Francisco Superior Court is "the first case where Main Street strikes back at the executives of Wall Street" and is thought to be the first aimed directly at the firm and its players.

The complaint demands a jury trial for fraud, negligent misrepresentation, breach of fiduciary duty and violations of California law and the federal Securities Act.

"This case represents the worst example of the fraud committed by modern day robber barons of Wall Street who targeted public entities to finance their risky practices and then paid themselves hundreds of millions of dollars in compensation while their companies deteriorated," the complaint states.

The Sept. 15 Lehman collapse rippled through the economy, particularly 19 California counties with investments in it. San Mateo County lost more than \$150 million from its investment pool which includes school districts, cities and special agencies. In the aftermath, local officials and residents demanded answers from County Treasurer Lee Buffington about the county's continuing investment in Lehman. The suit alleges Lehman's deliberate fraud led investors, like the county, to believe the company was solid

although executives knew better.

"The defendants focused their efforts on trying to save their company and their jobs with little or no regard to how their egregious actions harmed those who in good faith invested in Lehman brothers," County Counsel Mike Murphy said. "In our view, their actions were blatantly illegal."

Like others involved, the county is seeking to recoup some money through bankruptcy proceedings. Congresswoman Anna Eshoo, D-Palo Alto, recently sent a letter to Treasury Secretary Henry Paulson asking for the federal government to help the county through the recently approved federal bailout plan.

Suing the executives specifically is a different tactic, arguing high-ranking individuals are to blame rather than economic conditions.

"There is evidence they perpetrated a fraud against investors. This isn't some sort of paper loss that is simply written off a ledger book. This hurts our school children, our roads, our necessary services," said Supervisor Mark Church, chairman of the board's Finance and Operations Committee.

The suit filed by the law firm of Cotchett, Pitre and McCarthy names Lehman Chief Executive Richard S. Fuld, Jr., former chief financial officers Christopher M. O'Meara and Erin Callan, former president Joseph M. Gregory and accounting firm Ernst & Young.

Ernst & Young helped the firm conceal its financial reality as it publicly hit its exposure to mortgage-related losses — a tactic, according to the suit, that helped it report record profits for fiscal year 2007 and raise more than \$30 billion from investors like the San Mateo County Investment Pool.

Specifically, the suit claims that as investors lost billions of dollars, Fuld "reportedly took out almost \$500 million, purchasing a lavish multi-million dollar home ... a \$21 million apartment ... a \$13 million beachfront vacation home ... a million-dollar ski house ... and a multi-million dollar art collection."

Others it alleged took out lucrative bonuses as "Lehman had the audacity to ask the U.S. taxpayers for assistance in September 2008, just before filing for bankruptcy."

The bankruptcy's impact pool participants include:

- \$37 million for public schools kindergarten through grade 12;
- \$25 million to the San Mateo County Community College District;
- \$22 million to the San Mateo County Transportation Authority;
- Millions more among Peninsula cities and public entities.



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very warm.
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LEHMAN BROTHERS

Peninsula wants \$155M back

San Mateo County files lawsuit vs. Lehman to recoup investments

By Mike Rosenberg
Examiner Staff Writer

Executives from the bankrupt investment bank Lehman Brothers Inc. defrauded San Mateo County schools, transportation groups and government out of \$155 million by concealing massive losses while lavishing its executives with lucrative bonuses, according to a lawsuit filed Thursday. The county's investment pool lost \$155 million in Lehman investments after the company went bankrupt Sept. 15, with K-12 schools, community colleges and transportation projects losing most of the money.

"Our main effort is to try to recoup as much of the \$155 million loss as we can," county counsel Michael Murphy said. "If we can do that, we consider it quite a victory."

In the suit, which was filed in San Francisco Superior Court, the county is demanding a jury trial and asking to recoup the money directly from Lehman's top executives.

The suit is the first of its kind against Lehman filed since their bankruptcy, to the

county's knowledge.

The suit claims Lehman and its executives committed fraud and deceit, misled the public about its finances, and violated state and federal law. Lehman reported record profits in 2007 and gave lucrative bonuses to its executives, all while hiding its exposure to mortgage-related losses, the suit said.

Lehman continued to expand its real estate and mortgage portfolio in 2006 and 2007, despite the fact that other large investment banks booked enormous losses, the suit said. Lehman then attempted to conceal its losses with the help of its auditor, Ernst & Young, which is also named in the suit. The suit names Lehman Chief Executive Richard Fuld and 10 other directors.

County Superintendent of Schools Jean Holbrook said the lawsuit was a good sign, but officials are also seeking money through bankruptcy proceedings. They also asked U.S. Treasury Secretary Henry Paulson for a Washington meeting to discuss receiving a portion of

the \$700 billion federal bailout package.

Hastings College of the Law professor Fred Lambert said it is not unusual for bankrupt financial institutions to be sued, although to prove claims against individuals would require proving that they knowingly committed fraud. And, he said, the lawsuit may face barriers as other cases proceed through bankruptcy court. County officials could recoup only 20 to 60 percent of their loss through those proceedings.

Officials from the British bank Barclays, which acquired Lehman's North American business and assets in September, did not return calls seeking comment. Ernst & Young officials said they could not comment Thursday.

The Board of Supervisors on Oct. 28 selected Burlingame-based attorney Joseph Cotchett to file the suit. Cotchett called Lehman's executives' actions a "fraud committed upon the public."

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County sues Lehman execs

Lawsuit claims firm hid information from investors in loss of more than \$150M

BY SHAUN BISHOP
DAILY NEWS STAFF WRITER

Executives for Lehman Brothers Holdings Inc. concealed information from investors about the firm's losses in the real estate market and took home lucrative bonuses even in the face of signs that trouble loomed, according to a lawsuit filed Thursday by the San Mateo County Investment Pool.

The pool, representing public agencies that invested in Lehman and lost more than \$150 million when the firm went bankrupt, sued the executives and their firm's auditor, Ernst & Young, in San Francisco Superior Court for fraud, negligent misrepresentation and violations of California law and the federal Securities Act.

The San Mateo County Board of Supervisors decided two weeks ago to authorize the investment pool to sue Lehman's executives on behalf of its members, which include cities, school districts and transit agencies.

The suit is one of the first in the country to target several Lehman top officials and the more than \$1 billion in bonuses they received in the years leading up to the collapse, said Joseph Cotchett, the lead attorney retained by the county.

The pool is seeking reimbursement from the executives for the financial losses it suffered as a result of Lehman's bankruptcy, plus interest and punitive damages. "The theory here is the top management fraudulently represented that the company was financially strong at a time when they were about to declare bankruptcy," said Supervisor Mark Church. "What makes this case so outrageous is all the while, they were siphoning off millions of dollars for their personal benefit, leaving good-faith investors holding the bag. It hurts our schoolchildren, our transit projects, and other essential services that we provide."

Lehman's corporate office in New York could not be reached for comment.

Ernst & Young is also named in the suit because it "chose to look the other way and give its stamp of approval on Lehman's financial condition and risk exposure, rather than risk losing lucrative accounting and auditing fees" estimated at \$31 million in 2007, according to the lawsuit.

Spokesman Charlie Perkins said in an e-mail that Ernst & Young officials have not yet seen the suit and declined to comment.

The top officials named in the suit are Lehman CEO Richard Fuld, Jr.; former chief financial officers Christopher O'Meara, Erin Callan, Ian Lowitt and David Goldfarb; former Chief Operating Of-

ficer Joseph Gregory; and five members of the company's board of directors.

The Lehman case "represents the worst example of the fraud committed by modern-day robber barons of Wall Street, who targeted public entities to finance their risky practices and then paid themselves hundreds of millions of dollars in compensation while their companies deteriorated," according to the lawsuit.

The lawsuit claims the company expanded its real estate portfolio in 2006 and 2007, despite declining values, rising mortgage defaults and "enormous losses" reported by other companies such as Citigroup, Bear Stearns and UBS.

Instead, the executives misrepresented the firm's financial health to induce the county and other investors to buy its securities, the suit states.

Lehman also claimed it had superior risk management practices that "hedged" against the company's real estate losses, but did not give information about those practices, according to the suit.

The executives had a "built-in incentive to inflate Lehman's financial condition and the value of its assets," according to the complaint, because their bonuses were tied to financial benchmarks.

When Lehman filed for bankruptcy protection on Sept. 15 — the largest such filing in U.S. history — it left San Mateo County agencies in its "ruinous wake," with more than \$150 million in losses, the suit states.

Preliminary numbers show high school and elementary school districts lost \$37 million, the San Mateo County Community College District lost \$25 million, the Transportation Authority lost \$22 million and 15 cities sustained large losses.

The county has also filed a claim in New York bankruptcy court for its share of Lehman's estate and is lobbying congressional representatives to get a portion of the \$700 billion bailout package.

Attorneys filed the suit in state court in San Francisco because the county purchased Lehman securities from representatives working out of the San Francisco office and because the pool's custodial account with the securities is held in California.

The county is represented by Burlingame-based law firm Cotchett, Pitre & McCarthy and Millbrae-based law firm Corey, Luzaich, Pliska, deGhetaldi & Nastari.

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