Fuld Understated Pay More Than $200 Million, Lehman's Budde Says

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Before Lloyd Blankfein of Goldman Sachs Group Inc. took his place, Richard S. Fuld Jr.'s angry face was the universal symbol of Wall Street greed.

On Oct. 6, 2008, three weeks after Lehman Brothers Holdings Inc. filed the largest bankruptcy in U.S. history, Lehman's former chief executive officer found himself before Representative Henry A. Waxman, the California Democrat who chaired the House Committee on Oversight and Government Reform. Waxman has stared down plenty of CEOs over the years, yet this had to be one of the most intense confrontations of his career.

"Mr. Fuld will do fine," Waxman said. "He can walk away from Lehman a wealthy man who earned over $500 million. But taxpayers are left with a $700 billion bill to rescue Wall Street and an economy in crisis."

Fuld said he was a victim, not an architect, of the collapse, blaming a "crisis of confidence" in the markets for dooming his firm. Reckless management had nothing to do with it. "Lehman Brothers," he said, "was a casualty."

Fuld and Waxman went on to disagree about just how much money Fuld had taken out of Lehman before it went under, Bloomberg Businessweek reported in its May 3 edition. Fuld, now 64, said his total compensation from 2000 through 2007 was less than $310 million, not the $485 million that appeared on Waxman's chart. He said 85 percent of his pay was in Lehman stock that had become worthless. "I never sold my shares," Fuld said at one point. At another, he said he had not sold the "vast majority" of them.

"That just seems to me an incredible amount of money," Waxman responded.

Under Oath

Among those closely observing Fuld was a 49-year-old former Lehman lawyer named Oliver Budde who was watching the hearing at home on C-Span. Budde (pronounced Boo-da) was certain Waxman's figures weren't too high. They were too low, and he could prove it. Fuld, he believed, had understated the amount he was paid during those years by more than $200 million, and now he had done it under oath, for the entire world to see.

For nine years, Budde had served as an associate general counsel at Lehman. Preparing the public filings on executive compensation had been one of his major responsibilities, and he had been infuriated by what he saw as the firm's intentional under-representation of how much top executives like Fuld were paid. Budde says he argued with his bosses for years over the matter, so much so that he eventually quit the firm. After he left, he couldn't let the matter rest.

Contacting Regulators

He contacted the Securities and Exchange Commission and the Lehman board of directors and says neither showed interest in meeting him. He was so shocked by Fuld's testimony in front of Congress that he started thinking about writing a book going public with his story, which is told here for the first time.

"I wasn't surprised, because these guys don't surprise me anymore," Budde says. "But it just struck me -- they're doing it again. I wasn't going to sit back and watch."

By his own admission, Budde lacks the aggressive career drive usually found on Wall Street. He speaks proudly of having been a "free spirit" in his younger days when he was a ski bum and took a year off during college to sail the Caribbean as a steward on a yacht. He grew up in Cheshire, Connecticut, and went to Columbia University, where he received a BA in economics in 1983.

After college, he drifted into a job as a cabdriver in New York, which ended when an irate driver sprayed him with a can of Mace after a fender bender on the FDR Drive. The experience made an office job suddenly seem tempting, and he found work as a paralegal at Skadden Arps, eventually going to law school on the firm's dime.

Move to Lehman

He served as an associate for six years, working long hours, handling mostly corporate and securities-related matters. In 1997, when it became clear that he would not make partner, he decided to leave, landing as a vice-president in Lehman's corporate general counsel's office.

Budde says things were good at Lehman. His weekends were his own again. He owned a house near Stowe, a ski town in Vermont, and managed to escape there frequently. "It was a perfect arrangement," he says. "I left Friday afternoons for Vermont and came back Monday mornings. It was a job I was proud of. There was no 'ick' factor, at least at first."

At the time, Lehman made its money largely on bonds, and Fuld was a source of inspiration at the firm, a tough trader who was putting the company back in the game after a series of corporate missteps.

Signs of Trouble

The first inklings of trouble for Budde came a couple of years into his tenure, when he says he objected to a tax deal that an outside accounting firm had proposed to lower medical insurance costs. This was an unusual move for a junior Wall Street lawyer. "My gut feeling was that this was just reshuffling some papers to get an expense off the balance sheet," he explains. "It was not the right thing, and I told them." Budde's bosses disagreed with him and OK'd the deal.

The incident opened his eyes to more serious issues, particularly what he began to see as a lack of transparency in how the firm disclosed restricted stock units, or RSUs, that it granted to senior executives.

There were three types of RSUs: annual awards that usually vested in five years, longer-term awards that took until retirement to vest, and a final type that vested only if there were a change in control (i.e., if Lehman were acquired). In that 2000-2007 time frame, Budde -- relying on SEC filings -- calculated that Fuld received $105 million in annual five-year RSU awards.

Long-Term Awards

What Lehman failed to disclose properly, Budde says, were certain longer-term awards. Lehman took advantage of an interpretation of the SEC disclosure rules to underreport the value of these awards in the company's annual proxy statement and thereby mislead shareholders about just how much top executives were making.

He complained to his superiors in the general counsel office, he says, and was told that the policy had been checked with outside attorneys at Simpson, Thacher & Bartlett. (Andrew Keller, the partner on the Lehman account, did not return calls seeking comment.) Those lawyers had deemed it acceptable to exclude unvested RSUs from the annual compensation tables in the SEC filings.

Budde thought this logic was flawed and believed the compensation committee made the problem worse when it pushed back the vesting of certain long-term RSUs. The firm's intention, says a former Lehman executive, was to promote long- term loyalty, but Budde suspected that it was a way to further postpone the disclosure of RSUs as compensation.

Retroactive Rewrite

Lehman tweaked its policy in another way Budde found dubious. In its 2003 proxy statement, the firm reported that the board's compensation committee had decided to rewrite, retroactively, the terms under which the awards had been made in previous years.

"Each tranche of the Extended RSUs will now vest following termination of employment with the Firm," the company disclosed. This meant the executives would get them when they left the firm, unless they were fired for cause. Lehman also disclosed that Fuld's extended RSUs were worth $90.4 million at the time. Budde believed that Lehman should have included that figure in the annual compensation table. Instead, the figure was put at the end of a long paragraph filled with financial jargon, where it was likely to be overlooked.

Budde says Lehman could also claim that it was disclosing these stock grants in its Section 16 statements, also known as "insider reports," which record top executives' transactions involving company stock.

Reporting Disparities

Budde created meticulous spreadsheets adding up Fuld's RSUs, options exercised, and any other shares bought or sold over the years. A disparity amounting to tens of millions of dollars shows up clearly if you compare the Section 16 information with the proxy statements, Budde says. "I just assumed that somebody was checking this stuff," he says. "They weren't."

According to W. Alan Kailer, a Dallas attorney with Hunton & Williams who has written articles and books on compensation disclosure, it would have been more transparent to disclose these types of awards in the compensation table the year they were granted to the executives, rather than waiting for them to vest. "This is an interpretation issue," he says, "but the best practice would be to report at the time that the award was originally made."

New Rules

In February 2006, just after he received his bonus for the previous year, Budde resigned from Lehman. To Budde's delight, later that year the SEC announced that it would require clear reporting of unvested RSUs and other stock-based awards in the proxy statement.

The first year Lehman had to alter its proxy reporting was 2008. Budde was ready to see how the firm would handle the change. At his home in Vermont, he pored over the documents when they were released in March. "I looked several times, and my jaw just dropped," he said. "What happened to the RSUs? It took me, someone who has written these documents, two or three times to spot the problems."

Budde calculated that while Lehman reported Fuld's RSUs as worth $146 million, the real figure, based on the Section 16 reports, was $409.5 million. Lehman had counted just 2 of 15 RSU awards. "You just didn't need to do this to this degree," he says. "It was disgraceful."

Considering his options, Budde decided to go to the SEC as a whistleblower. He sent a detailed two-page e-mail on April 14, 2008, to the SEC's Enforcement Division, under the subject line "Possible Material Noncompliance with New Executive Compensation Disclosure Rules."

Stock Awards

Lehman was already in crisis mode at the time, but the meltdown of the firm was still several months away. After detailing what he believed was Fuld's failure to disclose more than $250 million in restricted stock awards, Budde wrote: "The last thing the country needs right now is another investment bank in crisis. I have wrestled with this over the past five weeks, since I first read the proxy. This is not a shot at retribution, and I am in no way a disgruntled former employee (disappointed, even disgusted, yes). I walked away freely from Lehman, and my ethical concerns in a number of areas were no secret to my superiors there."

He got a standardized form thanking him for his letter in return. He never heard anything else. (The SEC does not comment on private communication with its enforcement division.)

Ignored by Board

Budde also wrote to Lehman's board members but was ignored by them as well. A former Lehman official, who spoke anonymously because internal board business is confidential, confirmed that the board had received Budde's warnings. Budde said that Fuld had understated his compensation by more than $200 million during the October 2008 congressional hearing. While Fuld said he earned less than $310 million from 2000 through 2007, he actually had received $529.4 million, according to Budde's calculations.

In direct contradiction to Fuld's claim to Waxman that he had not sold the majority of his shares, Budde estimates that Fuld earned $469 million from stock sales between 2000 and 2008. These calculations are supported by the working paper from a Harvard University study that was made public late last year and is scheduled to be published this summer in the Yale Journal on Regulation.

In "The Wages of Failure: Executive Compensation at Bear Stearns and Lehman, 2000-2008," Harvard Law professor Lucian Bebchuk; Alma Cohen, a visiting professor from Tel Aviv University; and Holger Spamann, a Harvard Law lecturer, calculate that Fuld earned $522.7 million from 2000 to 2007, only slightly less than Budde's tally.

Unvested RSUs

The study found that Fuld earned $461.2 million of that total from the sale of 12.4 million shares of Lehman stock, more than the 10.8 million shares, including unvested RSUs, he owned at the time of Lehman's bankruptcy.

The authors of the Harvard paper said they were motivated by an incorrect popular assumption that top executives of investment banks, particularly Bear Stearns Cos. and Lehman Brothers, had suffered big personal losses in their share holdings and that this proved the compensation systems at the firms were not to blame for the crisis. Instead, they concluded, executives including Fuld had sold many of their shares before the crisis hit and ended up losing much less than they let on.

Through his attorney Patricia Hynes, Fuld declined to comment.

"We're not giving any interviews," says Hynes. Fuld did not respond to detailed questions faxed to his office. Calls to John Akers, former chairman of IBM, and John Macomber, former chairman of Celanese Corp., who both served on the compensation committee of Lehman's board, were not returned.

'Successfully Navigating'

Fuld continued getting money out of Lehman Brothers right up until the end. In March 2008, with the credit crisis gathering force and talk circulating of Lehman's precarious state, Fuld and his lieutenants argued in the proxy statement that they deserved large incentive awards for "successfully navigating the difficult credit and mortgage environments and maintaining the

firm's strong risk controls." The board agreed, awarding Fuld $40 million for his work in 2007, of which $35 million was in restricted stock.

When the bank collapsed in September 2008, the restricted stock was rendered worthless. However, the board did allow Fuld to cash in a Lehman investment partnership despite rules that normally allowed redemptions only if the executive left Lehman or died, according to a report on the bankruptcy by Anton R. Valukas, the bankruptcy examiner. Two months before Lehman filed for bankruptcy, the board agreed to pay Fuld $4 million for his limited partnership interest.

Lawyer Bill

In advance of his testimony, Simpson Thacher & Bartlett racked up 889.3 hours of work prepping Fuld and producing documents for Congress. The bill, paid by the bankruptcy estate, came to $491,197.

One question that remains is why Budde stayed on at Lehman for as long as he did, given what he says he observed there. "It's kind of like the frog in the boiling water," he says. "It took a while to figure out how bad it was. My moral compass was always there, but I felt I was learning important stuff. I always told my boss how I felt, and I made my objections."

Budde doesn't have a job. He's living off savings in Vermont and says he's enjoying a simpler life. He is considering putting his financial background to a more productive use, by helping a pension fund do socially responsible investing, for example. "I don't want to come across as a Boy Scout," he says, "but this is the job you're licensed by society to do as a lawyer, to stand up."