Burning Down His House

Is Lehman CEO Dick Fuld the true villain in the collapse of Wall Street, or is he being sacrificed for the sins of his peers?

- By Steve Fishman
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Getty Images)

On June 11, Richard S. Fuld Jr., CEO of Lehman Brothers, sat down to lunch with a half-dozen of Lehman's senior investment bankers. Since the fall of Bear Stearns in March, Fuld had been struggling to keep "the mother ship," as Fuld liked to call his firm, from taking on water, but with little success. The stock was sinking quickly. In just a few months, Lehman had given back ten years of gains. Two days before the meeting, Lehman announced a second-quarter loss of $2.8 billion, its first negative quarter in fourteen years, causing the stock to plummet again, 21 percent in a couple of days. Fuld's own people, their net worth evaporating, were losing confidence. Hugh Skip McGee, the global head of investment banking and for years a loyal Lehman employee, had requested the meeting. They gathered in Fuld's private dining room on the 32nd floor of Lehman's Seventh Avenue headquarters, a somber mahogany-paneled room, with a list of several demands, chief among them a change in leadership."The board of directors is going to be under pressure," said one banker. And then added, "It has to deliver a head to the street."

At about five-eight, Fuld isn't physically imposing. But he has intensely dark eyes and a deep, wide forehead that slopes so sharply it reminds some of a can opener. Those features, and a palpable inner intensity, give him an almost animalistic presence. "Through these little physical cues, he made it seem like [a situation] will lead to physical violence if you didn't relent," says one former executive.

"I've given you fourteen years of earnings. I have one bad quarter. This is how you respond?" Fuld shot back. The veins on his neck popped.

But the bankers pressed their case. Actually, they wanted two heads. They would spare Fuld the indignity of a coup, but they wanted him to fire Joe Gregory, Lehman's president, and Erin Callan, Gregory's protégée, whom he'd made CFO and who had been the public, sunny face of Lehman as it spiraled down. Firing Gregory would be personally devastating to Fuld, as the bankers knew. Over three decades at Lehman, the two had rarely sat more than a hundred feet from each other. Professionally, they were complements: Mr. Inside and Mr. Outside.

"If it's not Joe, then it would be you," said another banker. "And that would be a disaster."

Fuld has a famously voracious appetite—senior executives sometimes ordered him a mid-morning plate of ribs. The joke was that he never gained weight; his intensity burned off the calories. That day, he hardly touched his food. At the end of the meal, he pushed out of his chair. Fuld had agreed to most of the bankers' demands, but he had been careful not to make an explicit commitment to fire his oldest ally. He wanted to know whether there was any way he could let Gregory and Callan survive without the bankers blowing him up in public.

"What are you going to say when you leave this meeting?" Fuld asked.

"It's not enough," one of the bankers replied.

"I got it."

The ax fell the next day.

Three months later, on September 15, Lehman filed for bankruptcy, the largest in history and a devastating blow to an already fragile financial system. Fuld became a symbol of failure, the face of arrogant, blindered, massively overleveraged Wall Street. Fuld is blamed for betting the farm on the way up, then stubbornly refusing to recognize the company's dire straits on the way down. A few weeks after the bankruptcy, Congress summoned him to Washington for a deeply humiliating inquisition. "You're the villain today," one congressman told him. For Congress, he was little better than a looter, pocketing millions as his company collapsed—$480 million over half a dozen years, another congressman charged. If that wasn't enough pain, three sets of prosecutors launched investigations of Fuld and Lehman, probing whether shareholders had been duped.

But Fuld is also, in some sense, a victim. He'd held on to 10 million shares of Lehman stock until the end and lost almost $1 billion—"He drank the Kool-Aid," said one executive. And consensus grows that the Lehman fall was one of Treasury Secretary Henry Paulson's and Fed chairman Ben Bernanke's biggest mistakes, amplifying the crisis exponentially. These days, Fuld goes to his office in the Time & Life Building—he's still nominally the CEO of Lehman—and talks on the phone to a few former colleagues, those he'd been close to for years, replaying the final months of the firm. They often work one another to the edge of rage trying to decipher "the mystery," as Fuld still thinks of Lehman's collapse. Why didn't the government save Lehman the way it saved so many others, Bear Stearns and AIG and, just last week, Citigroup? Fuld and his allies can't help but blame Paulson, whom he'd trusted and, until the end, viewed as an ally and even a friend. Yet Paulson, for reasons Fuld doesn't yet understand, participated in making him the scapegoat. "He feels betrayed," said one friend. At night, Fuld has trouble sleeping. Most of the time, he lives in Greenwich, Connecticut, in one of his five houses. He can wander through the twenty rooms, eight bedrooms, the poolhouse, tennis court, squash court. Mostly, he sits and replays Lehman's calamitous end. "What could I have done differently?" he thinks. "In certain conversations, what should I have said, what could I have done?" How, he wonders, did it all go so disastrously wrong?

Next: Fuld's start at Lehman.

WPN; Joe Tabacca
Bloomberg News/Landov)

Dick Fuld joined Lehman full time in 1969, shortly before Joe Gregory. Soon they were traders together, sitting a few desks from each other, under the powerful influence of Lew Glucksman. Glucksman was a gifted, ferocious trader, driven, in large part, by bristling class resentment. The principal targets of Glucksman's ire were the firm's investment bankers, the Waspy Ivy Leaguers who dropped names and chatted up CEOs. They'd ceased driving revenues but, infuriatingly, still claimed a disproportionate share of the bonus pool.

The conflict came to a head in 1983, when Glucksman walked into the office of Lehman CEO Pete Peterson, a distinguished old-school investment banker who'd served in the Nixon administration and, in his spare time, wrote for the *New York Review of Books*, and told him to leave. "I'm talking about running the business *now*," Glucksman said. Peterson, who'd made Glucksman his co-CEO only eight weeks earlier, knew that his partners understood that the power had tilted—at Lehman, money had talked. Peterson didn't put up a fight. And just like that, the traders were in charge.

Despite having been raised in Westchester's upper-middle class, Fuld seemed to absorb Glucksman's class resentments— "Fucking bankers," he called them. Glucksman liked to frighten the bankers with his crude physicality and wells of anger—in a rage, he once ripped the shirt off his own back. And Fuld followed in the master's footsteps. The bankers condescended to him, calling him "gorilla" because he seemed to grunt rather than speak in full sentences. Fuld, though, made the aggressive image his own, putting a life-size gorilla in his office off the trading floor. He backed it up with action. He was a gifted trader and legendarily fierce. He once cleared the desk of a manager who asked him to wait, sweeping the papers to the floor with his hand.

As a manager, Fuld was demanding and intense. "I take it as a personal failure to lose money," he would say. "He thought he could intimidate you out of losing money," observed one colleague. But to those he favored, he showed a warmer, paternal side. Early on, he took Gregory aside to tell him his wardrobe needed work. "I was one of those people who didn't want to disappoint Dick," Gregory once told a friend.

Glucksman's brilliance as a trader was not matched by a talent for management. By 1984, he'd nearly driven Lehman into the ground. In desperation, Lehman sold itself to American Express. The merged company, though, didn't take: In 1994, American Express spun off Lehman, a small bond shop that few thought would survive. Fuld was named CEO. "I was the only one left standing," Fuld explained later.

The night he was selected, Fuld had an anxiety attack, and stopped breathing for 45 seconds. "I realized I was it," he told the Wharton School online journal. "I didn't want the job, and I wasn't looking for the job." But it was a moment of rebirth. "I came in the next day with terrific resolve."

Fuld quickly cleaned house and promoted Gregory. "You're the best business fixer I have," Fuld told him. In 1996, Fuld formed an executive committee, appointing Gregory and a half-dozen others. "Everybody in his inner circle had equally undistinguished backgrounds, not top schools, not top-decile performers," said one former associate, an investment banker. There was barely an Ivy League degree among them—Fuld had graduated from the University of Colorado, Gregory was a Hofstra alumnus. Still, they had common cause. None felt an iota of entitlement. "We'd all been poor [Fuld was the one exception] and didn't want to be poor again," said one member of the original committee.

Fuld quickly instituted an on-the-team-or-off mentality at Lehman. He paid bonuses largely in stock and wouldn't let the executive committee reap the full benefit for five years. "It was not a good time to tie up your next five years in Lehman stock," said that member of the original executive committee. "You had to decide whether you were going to stay and try to make this work. A lot of people left."

With a single stroke, Fuld remade Lehman in his own image—and he loved what he'd created. One executive recalls a time when Fuld took a family vacation to Africa. At night, he'd hike to a spot where he could get a phone signal and call in to his top executives. "I'm out in the bush," he'd tell them. He wanted to catch up on business. "Little business transpired," recalls one participant. "It was more like he missed us."

Gregory, Fuld's old protégé, thrived in the new regime. Partly he was "a warm and fuzzy" presence—a "Feeler" with a capital *F*, as he'd tell people. He was an easy conversationalist, which relieved Fuld of that burden, and a not a bad golf buddy. He also took conspicuous pleasure in the millions he made, a quality that seemed to amuse Fuld—he famously commuted to work in his own helicopter from one of his sprawling Long Island homes. But Gregory's warmth, and his joie de vivre, extended only so far. "Joe was a killer," said one former Lehman banker. "No one was more deadly in the trenches."

Next: His paranoid view of the world.

Reuters
Landov)

Fuld, no doubt cautioned by what happened between Peterson and Glucksman, took eight years to appoint a No. 2. Finally, in 2004, Fuld elevated Gregory to president—among other qualifications, he made a point that he didn't want Fuld's job.

Fuld and Gregory divided the executive duties. Fuld was the face of the firm. He flew around world on a brutal schedule, meeting CEOs and clients—over the years, he'd become a more comfortable speaker. Gregory was the inside man, running the firm day-to-day. "Dick had to okay them," one former executive explained, "but Joe made all the decisions."

Gregory was not a detail-oriented manager. He believed that culture drove the bottom line and his job was to keep a team-oriented culture on track. "If you got the people and the culture right, they would run the firm day-to-day in a great way," one former executive said, explaining Gregory's view. "He was Mr. Instinct," another executive said. Gregory viewed that as a strength. "Trusting your instincts, trusting your judgment, believing in yourself … and making decisions on the back of that trust is a remarkably powerful thing," he told one group. Sometimes, that instinct meant that Lehman would "decide that we should be doing the exact opposite of what the analysis said," as one analyst put it.

At the top of the organization, Fuld instilled his pugilistic, paranoid view of the world: It's us against them. "Every day is a battle," he told his managing directors. "You've got to kill the enemy. They tried to kill us." Lehman, as he saw it, was always in danger, never getting respect even as it became the country's fourth largest investment bank. "We're going to keep showing people not to underestimate us," he said. And the troops, as Fuld called them, bought in. Turnover was low. "There was a special feeling to the place," says one former executive-committee member. "One of the great parts of the firm is that people put their hearts into it."

Fuld continued to reward employees in Lehman stock, as much as 50 percent of compensation, and as before many couldn't access the full benefit for as long as five years. Few protested as long as the stock continued to climb, and it climbed an average of 25 percent a year for fourteen years.

To push the stock price, Lehman had to continually increase revenues. How to do that wasn't a big mystery. "In the late nineties, Goldman Sachs had made a ton of principal investments which paid off four years later," says one former Lehman executive. "It drove Lehman higher-ups to think we weren't being aggressive enough. We had to keep up."

Leverage was the way to supercharge revenues. At one point, it was said that Lehman had borrowed $32 for every $1 in its coffers. (Compare that to home buying. Usually a buyer must put down 20 percent of the total price. Lehman, in effect, made a down payment of about 3 percent.) By comparison, at Merrill Lynch and Goldman Sachs, the ratio was roughly 25 to one. For all of the firms, a small dip in the value of collateral could prove calamitous.

Lehman quickly put its capital to work in real estate and soon was a dominant force in the subprime-mortgage market, which catered to borrowers with shaky financial backgrounds. An even more significant engine of profit for the firm was commercial real estate. "Mark Walsh [head of commercial real estate] financed a lot of the firm for a number of years," says one person who was above him. Later, Walsh was criticized for doing deals past the market's top. The Archstone-Smith deal was usually named. But in October 2007, when he led the group that snagged Archstone, a high-end apartment owner, for $22 billion, it was the year's trophy deal. "A pretty good deal for the buyer," says one analyst. It was also the largest real-estate deal Lehman had ever done, and approved by the executive committee.

By the end of 2006, some at Lehman had begun to think that real estate was nearing the end of its run. Mike Gelband, who was responsible for commercial and residential real estate, had by then turned decidedly bearish.

"The world is changing," Gelband told Fuld during his 2006 bonus review, according to a person familiar with Gelband's thinking. "We have to rethink our business model."

But given the importance of real estate to Lehman's bottom line, that wasn't what Fuld wanted to hear. Fuld had seen his share of cyclical downturns. "We've been through this before and always come out stronger," was his attitude. "You're too conservative," Fuld told Gelband.

"We've been lifted by the rising tide," Gelband insisted.

Next: Why Fuld instinctively trusted Callan.

Polaris)

Fuld, though, wondered if the problem was with Gelband, not the market. "You don't want to take risk," he said—a deep insult in the trader's vernacular.

At the beginning of March 2007, Gregory took Gelband to lunch in the company dining room. The two had never been close, an ominous sign at Lehman. "When you had no chemistry with Joe, your time was going to be limited," says one person close to him. Complicating Gelband's life, Gregory agreed with Fuld on the market's direction. "If Dick was rosy, Joe was rosier," said one insider.

At lunch, Gregory pointedly told Gelband, according to a person briefed on the conversation, "you're not moving. Either you make a change or I'm going to."

Gelband soon left, an event that for many insiders marked an early sign of the Lehman crisis. "It upset a lot of people when Mike was fired," said one senior Lehman official. Gregory brought in one replacement, then another for Gelband, the last of whom, Andrew Morton, left in September.

None of Gelband's successors had deep experience in real estate. And later, Alex Kirk, who'd worked under Gelband and shared his bearish views, confronted Gregory about the hires. "What are you doing [putting these people in critical jobs]? These people are not experts," Kirk told Gregory, according to people who heard accounts of the conversation.

Gregory disagreed. "No, people need broad experience," he said. "It's the power of the machine. It's not the individual."

After Morton was hired, Gregory told Kirk, "You can stay if you want, but there's no place for you." He got the message and left in February 2008, the culmination of what was sometimes referred to as "a Joe-icide."

"Were there a lot of people in important positions without deep experience at a crucial time?" one senior executive later asked.

"Absolutely."

One person whom Gregory instinctively trusted was Erin Callan, a rising star in the banking division. "She's one of the smartest people I ever met," said a former colleague. "Clients loved her. People who worked for her loved her. She was very confident. Very team-oriented. But naïve." To be sure, Callan had taken some of the country's most prominent hedge funds public, clever deals, shrewdly executed. But when in September 2007 Gregory named the 41-year-old Callan CFO, making her one of the highest-ranking women on Wall Street, some were stunned. Gregory had long wanted to elevate women in the firm. But the move stirred resentment and alarm. "Joe plucked Erin out of obscurity," complained one banker. Many believed she was out of her depth. Even Callan seemed surprised. "It came out of left field," she told one colleague. Another quality that rankled some was what was seen as Callan's love of attention. She appeared, to some, a sponge for credit.

It was a complicated moment to place another less-than-seasoned person, no matter how bright, into a top job, and perhaps that was especially true of the CFO job. The markets had crested and were beginning to break, and some at Lehman were deeply concerned about the firm's exposure.

Still, the official view was, the firm is solid. We just need to get our story out. And Callan was to be the storyteller.

Callan's predecessor had been capable and well regarded but, according to some, lacked gravitas and camera-presence. Callan was a different package: blonde, vivacious, intelligent, articulate, and fashionable. She was an instant business celebrity.

Callan soon faced a giant challenge to the Lehman narrative. On March 16, Bear had been rushed into the arms of JPMorgan Chase, a last-minute fire sale that narrowly saved it from bankruptcy. A lot of people thought Lehman was right behind it.

A couple of days later, Maria Bartiromo of CNBC asked Erin Callan, "Is Lehman next?"

"Categorically no," said Callan—a statement that may well be the "Read My Lips" of the financial crisis.

Around the same time, Callan led Lehman's first-quarter-earnings call with analysts. Citigroup and Merrill Lynch would both announce significant first-quarter losses—Merrill at $1.97 billion, Citigroup at $5.1 billion. Lehman coolly posted a profit of $489 million. It was smaller than usual, and included some "hard-to-repeat gains," as *The Wall Street Journal* put it. Still, it was Lehman's 55th consecutive profitable quarter.

One hedge-fund owner, David Einhorn, later asserted that Lehman had overvalued important assets, in effect fudging its books. In fact, many of Lehman's losses were "back-loaded," already lurking on its books. But that day, Callan's confident, optimistic account prevailed. "The Street believed that Lehman must be better risk managers [than other banks]," one executive explained. Lehman's stock price jumped 46 percent on the earnings report. Later, Callan walked down to the Lehman trading floor and got a standing ovation.

Next: Lehman's stock drops 54 percent.

About a month later, on April 12, Fuld had dinner with Treasury Secretary Paulson, who'd run Goldman Sachs until June 2006. There was, as one Lehman insider reported, "no love lost between them." Yet the dinner went well. Immediately after, Fuld excitedly e-mailed his legal director, Tom Russo, "We have [a] huge brand with Treasury." At the time, Paulson seemed mainly worried about the fate of Merrill Lynch.

Less than two months after that cheerful dinner, on June 9, Lehman reported second-quarter earnings—a $2.8 billion loss. At the same time, Lehman said it was raising $6 billion in new capital from blue-chip investors, which suggested not only that important people believed in Lehman's future but that its balance sheet now looked stronger. (It turned down Warren Buffett—who was trying to extract a 10 percent guaranteed return, similar to the deal he made with Goldman three months later, for a group of investors who would only take 7 percent, though not with anywhere near the Buffett cachet.)

"Senior management believed that if we announced our earnings and our capital raise simultaneously, then the market wouldn't freak out," said one executive close to the situation. But they'd misread the market's skittish state. "The problem was that not many people were dealing with the outside world. Dick didn't talk to outside, Joe didn't, the heads of businesses didn't," the executive said. "So no one had had a sense of how bad the news would be received."

Lehman's stock was down 54 percent for the year.

In the weeks that followed, Fuld spoke frequently to Paulson about his predicament. "Treasury wanted to be helpful," according to a person briefed by Fuld. "But there were limits."

For months, Fuld had been searching for a strategic partner, but some wondered if he wasn't also in denial, still acting as if his fierce will could shape reality. “There would be times that Dick thought that by force of personality he could prevail,” said one former associate. For Fuld, problems—no matter how large—yielded to effort.

Fuld was still cautiously optimistic. He canceled his vacation to get back to work, but he seemed convinced that the market would soon come to its senses. “The feeling was we can’t have a loss the third quarter,” said one senior executive. “And the feeling at the top was we probably wouldn’t.”

To many employees, Fuld, even at 62, was the most intimidating person they’d ever known. “When he said something, you did it,” recalled one. And now he urged people into battle. He got on the public-address system and spoke to traders. He even handed out some plastic swords. They were in a fight, he wanted them to know, but they’d emerge stronger. And most believed, as one said, “some of our best work was done with our back against the wall.”

They’d been through crises before. Many recalled 1998, another year the firm faced down the enemy. That year, when the giant hedge fund Long-Term Capital Management failed, rumors spread that Lehman was on the verge of failing, too, due to its supposed exposure. Fuld boarded a company plane and visited large investors one by one. Fuld also pushed back at the pernicious rumors. A famous story, perhaps apocryphal, that had wide currency at Lehman was that, in the midst of the Long-Term crisis, Fuld encountered John Thain, then Goldman’s CFO. Goldman was thought to be a motor of the rumor mill.

“How’s it going?” asked Thain innocuously.

“Not so well,” Fuld said. “People are spreading nasty rumors.”

“I can’t imagine that,” Thain was supposed to have said.

Fuld paused. “When I find out who it is, I’m going to reach down his throat and tear out his heart,” he told Thain and gave him one of his brutal stares.

The rumors trailed off, especially after the SEC threatened to investigate the rumormongers. “Dick bought us time,” says one executive-committee member. It was the type of action-hero effort people came to expect of Fuld. “Dick saved the firm so many times,” as one investment banker puts it.

This summer, though, the reliable us-against-them mentality seemed to create blind spots. There was a disconnect to the outside world, and the risk was substantial. “The environment had become so insular,” said one former executive. Fuld okayed decisions, but Gregory packaged material so that the choice was obvious. And the executive committee offered no counterweight. “Dick used it to buttress his personality,” says one cynic.

In truth, the relentless optimism, both inside and out, was probably doing as much harm as good. On June 9, the day of the disastrous earnings announcement, McGee forwarded Fuld an e-mail from a former Lehman executive who’d left for a hedge fund: “Senior managers have to be much less arrogant and internally admit that some major mistakes have been made,” the e-mail read. “[They] can’t continue to say, ‘We are great and the market doesn’t understand.’ ”

Next: How Callan reacted to being fired.

Later that week, McGee requested the showdown that stripped Fuld of his lieutenants, and pushed him from the center of power.

After the meeting with the bankers, Gregory walked into Fuld’s office, a modern CEO’s suite with library, shower, and breathtaking views of the Hudson. “It’s not your fault,” Fuld told his ally and friend of 30 years. “This is a market condition. Everyone is going through this.”

“It’s the right thing.” Gregory said, according to people briefed on the conversation. “Everyone wants a head.”

“This is very, very painful,” Fuld told Gregory. “I don’t want to do it.”

Later that day, Gregory went to Callan, “We’re going to go.”

Gregory sat her down. She’d already realized that she could no longer sell the Lehman story. “I’m sorry for ruining your career,” Gregory told her.

At first, Callan was just sad—she’d loved Lehman as much as Fuld—but then she felt humiliated. Partly she blamed those who’d pushed her forward, Gregory and ultimately Fuld. “At the end, when she was being laughed at, Dick let them machine-gun her,” said one of her admirers. “He removed the body.”

On June 12, having pushed out Gregory, Fuld named a new president, Herbert “Bart” McDade, the investment bankers’ choice. (“If

Bart wasn't made president, a lot of people were going to leave," said one investment banker.)

Fuld put the best face on the change. "Bart has been my partner of 25 years and has proven himself to be the firm's best operator," he told analysts. But with McDade's appointment, Fuld's control diminished. As if to make the point, in one of his first acts later that month, McDade brought back Gelband and Kirk. "I'm here because of Bart," Gelband pointedly told Fuld.

If Gregory was Mr. Instinct, McDade was all about analysis. Go to him for a decision, and he wanted endless details and then insisted on thinking about it. McDade brought in a battalion of other analysts, and they didn't like what they saw. Once McDade's team got a look at the books, they were shocked.

Fuld was still ostensibly at the helm, but as one executive put it, "The fabric of what Dick built was visibly cracking." Fuld told McDade, "We're not together." McDade didn't have the time to worry about teamwork, and that seemed to set Fuld on edge. Some took it as a sign that Fuld worried McDade would toss him out, as Glucksman had tossed out his boss. A coup, though, had already taken place. "You need one guy in charge," said one person close to the process. And increasingly that was McDade. "Bart worked with his kitchen cabinet. He worked with them on all issues," said one Fuld loyalist. Decisions still flowed through Fuld, but increasingly it was a struggle. Those who'd once been in Fuld's inner circle now felt like outsiders.

To add to the insult, some on McDade's team felt Fuld was only getting in the way. McDade was respectful and kept Fuld in the loop. But explaining everything to Fuld only slowed the process. "He wasn't a very sophisticated thinker," was the view of some of McDade's team.

By July, short-sellers—who bet on a stock falling and thus put downward pressure on the stock—were closing in on the mother ship, just as they had circled Bear Stearns, which had been rescued at a risk of $29 billion in taxpayer funds. By August, Fuld was desperate to find a buyer. "We contacted virtually every financial institution in the world with the interest and capacity to a deal," says a person close to the process.

After the bankruptcy, Paulson insinuated that Fuld had not searched hard enough for a buyer, but the truth was that he spent his summer in desperate talks. There was little interest, though. Lehman's crown jewel was its real-estate businesses, and real estate was where all the problems were. The search for a buyer was not only frantic but humiliating. Fuld told Bank of America, one potential buyer, "I think I can do a lot if I remain CEO, but it's not a condition," recalled one who was involved in the process. "Near the end, it was said in calls precisely. 'We have two priorities, that the Lehman name and brand survive and that as many employees as possible be saved,' " said a Fuld intimate. It was a carefully crafted script. In conversations with buyers, Fuld added, "You notice our priority isn't price."

Through the summer, Fuld phoned Paulson, sometimes more than once a day. He still counted Paulson a supporter who could save Lehman, though privately the Treasury secretary seemed perplexed by the volume of calls.

Then on September 9, JPMorgan Chase co-chief of investment banking Steven Black spoke to Fuld by phone. Chase brokered the funds that Lehman needed to operate day-to-day. Black told Fuld that JPMorgan needed $5 billion in extra collateral, and in cash. If not, everyone at Lehman understood, JPMorgan would not open for business for Lehman the next day, essentially freezing its accounts. And if that happened, it was over. JPMorgan had clients whose interests it had to defend. Still, as one executive close to Fuld said, "Jamie Dimon [JPMorgan's CEO] was doing whatever was in his own personal interest. He knew the consequence was a huge blow to us, and he didn't give a shit."

Next: Lehman's troubles grow and the political climate gets ugly.

"They drained us of cash," Fuld later told an associate, who added, "They fucked us."

Lehman had planned to announce its third-quarter results on September 18. "The feeling was, if we waited, the market would drill us to a penny stock," said one executive. So on September 10, it reported its third-quarter earnings, a loss of $3.9 billion. Simultaneously it unveiled a plan to go forward. It was putting a majority stake in its investment-management division up for sale and spinning off its troubled commercial-real-estate assets into a separate company.

There were a lot of moving parts, but Fuld tried to sound confident. "We have a long track record of pulling together when times are tough,'' Fuld said on a conference call with analysts. "We are on the right track to put these last two quarters behind us.''

"I really think Fuld believed it," said one manager.

Fuld was not even at the table as Lehman's fate was decided, a tactical move that nonetheless told a larger story. Starting Friday night, September 12, a series of meetings was convened at the Fed's concrete fortress on Liberty Street, which sits atop the largest stockpile of gold in the world. Paulson and Tim Geithner, head of the New York Fed and now secretary-designate of Treasury, had summoned the heads of the country's largest investment banks. McDade and Kirk represented Lehman at the Fed that weekend. By then, McDade was calling most of the shots.

Fuld stayed back in the office and peppered Paulson, Geithner, and members of their teams with phone calls. “He would offer something,” said one person who was with him. “It would come back ‘no.’ He’d take a deep breath, then come back with, ‘How about this? How about this? How about this?’ ”

Lehman was barely alive. And in just the past week, the financial world had become a significantly scarier place. AIG, the giant insurer, also teetered on the edge of bankruptcy. And Merrill, everyone believed, was on life support—Merrill had, as one official put it, a bigger “pile of shit” on its books than Lehman. Neither Goldman nor Morgan Stanley looked entirely stable.

And the political climate had turned ugly. Taxpayers and their congressmen rebelled; they resented footing the bills for a profligate, money-drunk Wall Street. Government officials knew what was in the air. That weekend, they were acutely sensitive to the delicate balancing act: public ire against the future of America’s banking system. So, as one Treasury official explained to the banks, “we didn’t want people to come with the expectation that we were going to fill every hole, solve every problem.” Lehman feverishly pursued a sale that would save it. “We thought we had an understanding with Bank of America on Friday night,” said one Lehman official. By Saturday, though, Bank of America’s CEO Ken Lewis had stopped returning Lehman’s calls.

Lewis, it turned out, had jumped tracks. Thain, now Merrill’s CEO, had supposedly had an epiphany that Saturday—as recently as the previous Wednesday he’d resisted a plan to sell his company. But sitting at the Fed, he panicked. He called Lewis, who’d long been interested in Merrill’s 16,000 retail brokers, and on September 15 they announced a deal. In the dawning era, retail banking was much more attractive than the I-banking model Lehman offered.

That left as a potential buyer only Barclays, the London-based bank that had entered the picture just a few days earlier. Barclays told Treasury it wanted Lehman, but with conditions. “It wanted to scoop out the good assets,” one senior Treasury official says. It wanted to leave behind over $50 billion in bad assets.

Some at Lehman argued that it had plenty of assets to back a loan, the same type that sealed the Bear Stearns sale. But the government wasn’t working on that assumption. “Bank of America, Barclays, and a number of people on the Street had said, ‘With Lehman’s assets, you’re going to lose money,’ ” explained a Treasury official. “The Fed cannot lend money if the indication is that it’s going to lose money.”

Paulson and Geithner sequestered the heads of the leading investment banks in one of the Fed’s many grand, wood-paneled conference rooms. The bankers feared the consequences of a Lehman meltdown, but they were more worried about their own futures. “It’s like Louis the XIVth said: Alone against everyone,” said one Lehman executive.

“Why should we save Lehman?” one asked. “What about AIG? Where does it end?” By Sunday morning, Geithner and Paulson seemed to have persuaded the bankers to guarantee Lehman assets, up to perhaps as much as $70 billion. That appeared to put the Barclays deal on track.

Next: Lehman is forced to file for bankruptcy.

At 10 a.m. Sunday, McDade e-mailed Gelband, who was at Simpson Thacher helping Barclays with its due diligence. They had a deal.

“We were high-fiving,” said one person at Simpson Thacher.

Then at 10:15, McDade e-mailed back: “There might be a problem.”

Barclays, it was later claimed, needed the approval of British regulators. It was Paulson who spoke with regulators. “They did not want the problems of the U.S. banking system infecting the British banking system,” Paulson explained, according to one person at the Fed. Barclays later offered a different version. To Barclays, the problem was not British regulators but shareholder approval, which could take weeks. The Americans in any case couldn’t guarantee the deal until a shareholder vote.

On Sunday night, September 14, McDade returned to Lehman headquarters.

“They’ve mandated that we file for bankruptcy.”

Fuld, until that moment Wall Street’s longest-serving CEO, was shocked. “Can they do that?” he asked. “Dick never believed zero was an option. He believed at end of day, good guys win,” said one Fuld associate. And Fuld believed he was one of the good guys.

“I feel like I want to throw up,” Fuld said. “He looked completely deflated,” said one person close to him.

The next day, Lehman filed for bankruptcy. The day after that, Barclays purchased some of Lehman's North American assets for $1.75 billion—most of that for its building. A couple of days later, Paulson called Fuld, probably the last time they spoke.

"You did everything humanly possible," he said. Later, Fuld took that as one of the ordeal's bitter ironies.

These days, Fuld attends to details of the bankruptcy. He's no longer ensconced at Club 31, as employees once referred to the executive floor. Indeed, most traces of Fuld's Lehman have been assiduously removed. As a first order of business, Barclays hung its own name on each floor, though those who look closely can still see a dusty shadow of the Lehman name. Fuld is in temporary quarters on the 45th floor of the Time & Life Building until the end of the year, when he leaves with no severance or bonus.

Fuld is still in shock, and seething. How could Paulson let Lehman go? "Until the day they put me in the ground, I will wonder [why we weren't saved]," he told Congress.

Fuld understands the political usefulness of Lehman's collapse. The resentful public got to witness the devastating consequences of a financial failure. Four days after Lehman's collapse, the government had to bolster the money markets, once the most secure of investments. Two weeks later, a frightened Congress handed Paulson $700 billion, part of which he quickly doled out to the country's largest investment banks at advantageous interest rates. If only he'd had that money before, he might have been able to save Lehman, Paulson told interviewers. To those close to Fuld, Paulson was simply covering his ass, doctoring the story post facto. "They could have found a way to save Lehman," says a person involved with both the Bear Stearns rescue and the Lehman failure.

But perhaps the worst part for Fuld is that so many of the troops now revile him. He'd been the leader around whom they rallied, the one who'd saved them time and again. Now they believed that through pride or obstinacy Fuld had screwed their futures. For Fuld, it was agonizing. He couldn't speak out. His lawyers kept him cordoned off.

Then one day, Fuld received a letter from a former employee. Michael Petrucelli, who had been at Lehman for fifteen years, had sold mortgage-backed securities. Petrucelli still revered Fuld; it was the old style. He recalled how he'd once introduced himself at Valbella, a Greenwich restaurant. Fuld sat at a front table in a room off to the left, upstairs, Petrucelli recounted, as if to jog Fuld's memory. At the moment of that brief encounter, Lehman was already under siege. "We are with you," he'd told Fuld at the time.

Then a few days before the bankruptcy, Petrucelli had been laid off, seven figures of savings decimated and, to add to the injury, promised severance and health benefits were cut.

"This is all shameful," Petrucelli wrote Fuld.

Shortly thereafter, on October 8, Fuld picked up the phone. It was 1 p.m. He called Petrucelli on his cell. His lawyers might not have liked it, but Fuld had to reach out.

"Mike, I'm sorry you got caught up in this," Fuld began. "I'm going to try to help fix this."

Fuld was anguished. He knew the world was indifferent to his predicament. "Not that anyone on this committee cares," he'd told Congress.

It turned out, that Petro, his nickname at Lehman, did. And so Petro started to console Fuld. Maybe it could only be one of the troops to whom Fuld could open up.

"I can't believe this fucking happened," Fuld told Petrucelli. "I believed in the firm. I thought we were going to get through this."

Petro jumped in. "Think of all the good things you did," he told Fuld.

Fuld took a breath, "I know," he said.

Then he got angry again. "Understand, I spent 42 years there. I spent 42 years building and living this company. I can't believe this happened."

Next: A history of Lehman's near-death experiences.

End of the Line
Over its century and a half, Lehman has had many near-death experiences.

CA. 1850: The Lehman Brothers
Alabama dry-goods dealers turned Manhattan cotton-brokers.

1906–1925: Philip Lehman

Took the firm from commodities to new issues.

1925–1969: Bobbie Lehman
Shepherded the firm through the Depression by focusing on venture capital. Presided over Lehman's golden age.

1969–1973: Frederick L. Ehrman
Would be an interim leader.

1973–1983: Pete G. Peterson
The Bell & Howell CEO was brought in to save the firm. He built it into Wall Street's fourth-largest investment bank.

1983–84: Lewis Glucksman
Increasingly, traders drove the company's profits, pushing Peterson to appoint Lew Glucksman co-CEO. Glucksman pushed out Peterson, after which the company floundered and was taken over by American Express.

1984–1990: Peter A. Cohen
Cohen presided over the firm within American Express. When American Express spun it off, Fuld took over.

1994–2008: Richard Fuld