FAX COVER PAGE

SULLIVAN & CROMWELL LLP

125 Broad Street
New York, New York 10004
Telephone: (212) 558-4000
Facsimile: (212) 558-3588

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Date: August 21, 2008

FROM:	SENDER'S NUMBER(S)
Robert W. Downes	☎ (212) 558-4312

TO:	COMPANY	NUMBER(S)
1. **John W. White**	**Securities and Exchange Commission**	Fax: 202-772-9212 ☎ 202-551-3110

Message:

Number of pages sent (including cover sheet[s]) **23**

If there are any problems with this facsimile, please call Theresa Killeen at this number: (212) 558-3459.

NY125TG:34925.1

SULLIVAN & CROMWELL LLP

TELEPHONE: 1-212-558-4000
FACSIMILE: 1-212-558-3588
WWW.SULLCROM.COM

125 Broad Street
New York, NY 10004-2498

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August 21, 2008

Mr. John White, Director
Division of Corporation Finance
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: FOIA Confidential Treatment Request of Lehman Brothers Holdings Inc.

Dear John:

On behalf of Lehman Brothers Holdings Inc., and in accordance with Rule 83 of the Rules of Practice of the Commission (17 C.F.R. § 200.83), I request confidential treatment of the enclosed document, pages 1-20, dated August 21, 2008 (the "Confidential Material"). Please promptly inform the undersigned of any request for the Confidential Material made pursuant to the Freedom of Information Act or otherwise so that the undersigned may substantiate the foregoing request for confidential treatment in accordance with Rule 83.

The Confidential Material constitutes privileged or confidential trade secrets or commercial or financial information, and is therefore entitled to confidential treatment under Rule 80(b)(4) of the Rules of Practice of the Commission (17 C.F.R. § 200.80(b)(4)). The Confidential Material has not previously been disclosed or made available to the public.

Pursuant to Rule 83, a copy of this request (but not the Confidential Information) is also being delivered to the Commission's Office of Freedom of Information Act and Privacy Operations.

NY125TG:34845.3

Any questions or notifications with respect to this request for confidential treatment should be directed to Mr. Thomas Russo, Vice Chairman and Chief Legal Officer, Lehman Brothers Holdings Inc., 745 Seventh Avenue, New York NY 10019-6801, at (212) 526-0475.

Very truly yours,

Robert W. Downes

(Enclosure)

cc (without enclosure) Office of Freedom of Information and Privacy Act Operations
Securities and Exchange Commission
Operations Center
6432 General Green Way
Alexandria, Virginia 22312-2413

cc: Mr. Thomas Russo
(Lehman Brothers Holdings Inc.)

NY125TG:34845.3

LEHMAN BROTHERS

CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS INC.

August 21, 2008

Mr. Wayne Carnall
Chief Accountant
Division of Corporation Finance
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Dear Mr. Carnall:

Following our recent discussions, we are pleased to respond to your request that we describe (i) why we have concluded that the transfer of commercial real estate-related assets from Lehman Brothers Holdings Inc. ("Lehman") to a newly organized entity ("Spinco") does not represent the sale of a business; and (ii) why we have concluded that Spinco should apply the accounting policies described in the table on page 10 and not be required to use liquidation accounting or fair value accounting. In making this determination, we note that fair value accounting will be applied to the initial transfer of assets to Spinco and Spinco will disclose the fair value of its financial instruments and consolidated commercial real estate properties in the footnotes to the financial statements in accordance with SFAS 107 or SFAS 157, as applicable.

Overview

Lehman has a concentration of positions in commercial real estate-related assets and the risk embodied within this portfolio has become the predominant concern for Lehman's equity and debt investors. Investors are most concerned with the earnings volatility created by the current lack of liquidity in the market place, compounded by such a large position of commercial real estate-related assets when housed in an entity that is subject to fair value accounting under US generally acceptable accounting principles ("US GAAP"). Hence, investors and creditors have expressed a desire that Lehman (and other companies) eliminate earnings volatility by either selling the positions or by transferring them to entities that can hold the positions through economic cycles.

We have sold significant amounts of illiquid assets over the last twelve months, including leveraged loans, residential mortgages, commercial mortgages and equity investments in operating real estate entities.

We now believe that it is in the best interests of our shareholders, creditors and counterparties (i.e., the financial system) that we find a way to isolate the risk of commercial real estate-related assets from the rest of the firm. Continued piecemeal sales of commercial real estate-related assets also puts the firm and the markets, in general, at considerable risk because piecemeal sales will take too long to result in a meaningful reduction of the commercial real estate-related assets we currently own while putting continuing pressure on market valuations.

CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS INC.

These concerns would be addressed by a decision to transfer the majority of our commercial real estate-related assets to an appropriately capitalized new entity that would not have the pressure of considering the short-term interests of Lehman's shareholders, creditors and counterparties but rather could focus solely on maximizing the value to its own shareholders and creditors. With its own board of directors, shareholders and charter, the management of Spinco will have a very clear business mission and will be able to manage its assets for economic value maximization with a longer time horizon than Lehman would able to have in the current market environment.

We believe that it is critical to Spinco's asset management philosophy, as well as investors in Spinco, that the accounting framework of Spinco reflects fundamental asset valuations realizable over longer time horizons, as opposed to valuations reflective of current market liquidity. This is the foundation of Spinco and the key to its success. In addition, this model would be consistent with the non-fair value model applied by what will be Spinco's peers, including iStar Financial Inc., American Realty Investors, Inc., AmREIT Monthly Income & Growth Fund III, Ltd. and Ocwen Financial Corporation. If Spinco were subject to fair value accounting, we believe that it would be at a competitive disadvantage to its peers and would not be able to manage the assets in a fundamentally different manner than how Lehman must manage the assets now and therefore would not be able to maximize value for its shareholders.

Lehman believes that the future realizable value of its commercial real estate-related assets, assuming they are held to maximize return, is significantly in excess of the current fair value (mark-to-market value) of the assets. Spinco is being established to create an independent commercial real estate-related vehicle which is not subject to the need to actively reduce exposures in an illiquid market. Accordingly, as stated in the Proposed Term Sheet dated August 19, 2008, the principal purpose of Spinco is to hold and manage its assets over time in a manner that maximizes Spinco's shareholder value, which is currently expected to be a 5 to 10 year process. This longer time horizon is necessary to monetize the value of a portfolio which includes a substantial amount of equity investments which are not generating current cash flows and loans and debt investments whose monetization is dependent on re-financing by third parties or by sales.

Further, while any increases to or modifications of the assets initially acquired would only be to maximize the value of Spinco's assets and therefore the returns to Spinco's shareholders, we currently anticipate that approximately $5 billion of additional investment will be made by Spinco to develop properties into more favorable saleable condition.

At inception, Spinco is expected to be capitalized with 25 to 30% of equity and 70 to 75% of debt. It remains to be decided whether that debt will be issued in multiple classes of seniority. Debt financing may include term borrowings, repurchase agreements, short-term borrowings, and/or revolving loan facilities. Initially all debt will be owned by Lehman and will have terms consistent with market rates for seller financing.

The total consolidated assets of Spinco are expected to be approximately $40 billion ($30 billion of total assets less third party debt and equity in consolidated operating real estate assets). The assets will be comprised of in excess of 2,000 geographically diversified positions. No single asset will represent more than 20% of anticipated total consolidated assets and only one asset has been identified as representing over 10% of anticipated total consolidated assets. This asset is not an operating real estate position subject to the requirements of Regulation S-X, Rule 3-14.

On the transfer date, Spinco's assets (the "Initial Assets") are expected to be comprised of the following types:

Asset Type	% of Spinco's $40 bn Total Consolidated Assets	% of Spinco's $30 bn of Total Consolidated Assets less Third Party Debt and Equity[1]
Senior and Mezzanine Loans[2]	50% to 55%	65% to 70%
Debt Securities	10%	10%
Equity Investments	N/A	20% to 25%
Real Estate Assets Held for Sale and Held for Use	40% to 45%	N/A

Appendix A to this letter contains a list of the US GAAP referenced herein.

Why Transfer of Assets to Spinco is Not an Acquisition of a Business

Spinco will be a newly formed entity with no predecessor entity and the assets being transferred to Spinco are not otherwise a "business" for financial reporting purposes (see below for a discussion of EITF 98-3). The assets have never been treated as a separate business or smaller cohesive unit by Lehman. Rather, the Initial Assets represent a diverse group of commercial real estate-related assets that were previously not managed collectively. Specifically, business activities related to commercial real estate-related assets are portions of Lehman's securitized products and real estate groups, which are two of the units within Lehman's fixed income business within its Capital Markets business segment, which is one of three business segments reported within Lehman's consolidated results. Subsequent to the transfer of the Initial Assets, Lehman will continue to operate, at some level, its securitized products and real estate units. Additionally, and to the extent that certain commercial real estate-related assets are not transferred to Spinco (either because third party consents for transfer are not available for transfer or business decisions are made to retain the assets for broader client relationship

[1] Refer to Proposed Term Sheet of August 19, 2008 (Financial Statement Information), particularly for an explanation of gross and net asset composition.

[2] None of the Senior or Mezzanine Loans are real estate acquisition, development, or construction ("ADC") arrangements as contemplated in AICPA Practice Bulletin No. 1, *Purpose and Scope of AcSEC Practice Bulletins and Procedures for Their Issuance*.

purposes), such assets will remain a part of Lehman's fixed income business within its Capital Markets business segment.

For the reasons described below, under Rule 3-05 and Rule 11-01(d) of Regulation S-X, we have concluded that the Initial Assets do not constitute the acquisition of either a business or a lesser component of an entity constituting a business, such that disclosure of prior financial information is material to an understanding of future operations. Therefore audited financial statements pursuant to Rule 3-05 and pro forma financial information pursuant to Rule 11-01(d) with respect to the Initial Assets are not required.

SEC Regulations
Rule 3-05 of Regulation S-X provides the following:

"Rule 3-05 -- Financial Statements of Businesses Acquired or to Be Acquired

a. *Financial statements required.*

1. Financial statements prepared and audited in accordance with this regulation should be furnished for the periods specified in paragraph (b) below if any of the following conditions exist:

    i. Consummation of a business combination accounted for as a purchase has occurred or is probable (for purposes of this rule, the term "purchase" encompasses the purchase of an interest in a business accounted for by the equity method); or

    ii. Consummation of a business combination to be accounted for as a pooling of interests is probable.

2. For purposes of determining whether the provisions of this rule apply, the determination of whether a "business" has been acquired should be made in accordance with the guidance set forth in Rule 11-01(d)."

Rule 11-01(d) of Regulation S-X provides as follows:

> "(d) For purposes of this rule, the term business should be evaluated in light of the facts and circumstances involved and whether there is sufficient continuity of the acquired entity's operations prior to and after the transactions so that disclosure of prior financial information is material to an understanding of future operations. A presumption exists that a separate entity, a subsidiary, or a division is a business. However, a lesser component of an entity may also constitute a business. Among the facts and

circumstances which should be considered in evaluating whether an acquisition of a lesser component of an entity constitutes a business are the following:

(1) Whether the nature of the revenue-producing activity of the component will remain generally the same as before the transaction; or

(2) Whether any of the following attributes remain with the component after the transaction:

(i) Physical facilities,
(ii) Employee base,
(iii) Market distribution system,
(iv) Sales force,
(v) Customer base,
(vi) Operating rights,
(vii) Production techniques, or
(viii) Trade names."

Discussion of SEC Regulations

We do not believe that the transfer of the Initial Assets should be accounted for as an acquisition of a business as contemplated by Rule 3-05. The Initial Assets are a collection of individual assets to be transferred by Lehman and are expected to consist of senior and mezzanine real estate loans, commercial mortgage-backed securities, and mezzanine debt and equity investments in real estate-related assets, including operating real estate assets. The Initial Assets do not have the attributes of a business as set forth in Rule 11-01(d) and the nature of the ongoing revenue-producing activities of Spinco will not be the same as the activities of Lehman prior to or following the transfer.

The Initial Assets have been a part of the consolidated assets of Lehman, and have never been treated as a separate business or smaller cohesive unit by Lehman. They have not comprised a separate legal entity, subsidiary or division and actually represent over 2,000 geographically diversified positions across numerous subsidiaries and legal entities. Therefore, no separate financial statements have ever been prepared for the Initial Assets on a collective basis.

Regarding Rule 11-01(d)(1) and whether the revenue-producing activity will remain generally the same as before the transaction, we have concluded that it will not. The intent of Lehman's commercial mortgage and real estate practices is to originate commercial mortgages or invest in commercial real estate operating entities with a focus of short term syndication of a substantial amount of the risk. The revenue-producing nature of the assets in Spinco will be different in that they will be managed to maximize value over longer time horizons than Lehman.

CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS INC.

In addition, we considered the following attributes, to the extent relevant, as to whether they would be deemed to remain with Spinco after the transaction:

- Physical facilities — These are limited to management office space. None will be transferred; office space may be leased from Lehman at market rates.

- Employee base — Certain employees of Lehman's global real estate practice will transfer to Spinco; however, their job functions will be restricted to activities necessary to manage the Initial Assets. In addition, certain employees outside of Lehman's real estate practice, with certain skill sets necessary to operate Spinco's ongoing operations as a public company (*e.g.*, technology, finance and accounting) may transfer to Spinco. These employees did not work as a collective group in historically managing the Initial Assets, and represent less than 20% of the employees who currently have involvement with Lehman's commercial real estate-related assets. In addition, we expect that the CEO of Spinco will be identified from outside of Lehman's current employee base.

- Market distribution system — No new originations or syndications of new assets.

- Sales force — Spinco will not have an origination sales force and will not have customer coverage teams.

- Customer base — Limited new originations or syndications of new assets.

- Operating rights — Limited new originations or syndications of new assets. It is not expected that any core lending, trading, or real-estate systems will be transferred to Spinco. It is our intention to enter into a limited transition services agreement with Spinco.

- Production techniques — Limited new originations or syndications of new assets.

- Trade names — Spinco will not use Lehman's name.

For the reasons set forth above, we have concluded that the Initial Assets that will be transferred to Spinco are, in fact, assets and not a "business" as contemplated by Rule 3-05 and Rule 11-01(d), and therefore audited financial statements pursuant to Rule 3-05 and pro forma financial information pursuant to Rule 11-01(d) with respect to the Initial Assets would not be required.

We have also considered the definition of a business pursuant to EITF 98-3 and Appendix C of FIN46(R).

EITF 98-3 defines a business as "...a self-sustaining integrated set of activities and assets conducted and managed for the purpose of providing a return to investors. A business consists of (a) inputs, (b) processes applied to those inputs, and (c) resulting outputs that are used to generate revenues. For a transferred set of activities and assets to be a business, it must contain all of the inputs and processes necessary for it to continue to conduct normal operations after the transferred set is separated from the transferor, which includes the ability to sustain a revenue stream by providing its outputs to customers. The elements necessary for a transferred set to continue to conduct normal operations will vary by industry and by the operating strategies of the transferred set."

EITF 98-3 describes "inputs" as (a) long-lived assets, including intangible assets, or rights to the use of long-lived assets; (b) intellectual property; (c) the ability to obtain access to necessary materials or rights; and (d) employees. "Processes" are systems, standards, protocols, conventions, and rules that act to define the processes necessary for normal, self-sustaining operations, such as (i) strategic management processes, (ii) operational processes, and (iii) resource management processes. "Outputs" are the ability to obtain access to the customers that purchase the outputs of the transferred set. EITF 98-3 states that a transferred set of activities and assets fails the definition of a business if it excludes one or more of the foregoing items such that it is not possible for the set to continue normal operations and sustain a revenue stream by providing its products and/or services to customers.

The overarching principle of EITF 98-3's definition of a "business" is the same principle that is articulated in Rule 3-05 and Rule 11-01(d). As noted above, the Initial Assets have been a part of the overall assets of Lehman and have never been treated as a separate business or smaller cohesive unit by Lehman. The Initial Assets are not "...a self-sustaining integrated set of activities and assets." As discussed above, the principal purpose of Spinco is to hold and manage its assets until their maturity or to monetize them in an orderly fashion over 5 to 10 years in order to maximize Spinco's shareholder value, and Spinco will not originate or syndicate new assets, except in those cases where such activity will enhance the value of the Initial Assets. Accordingly, we have concluded that the transfer of assets to Spinco does not meet the EITF 98-3 definition of a business.

Furthermore, pursuant to FIN 46(R), Appendix C, we considered the fact that if Spinco were immediately acquired, there would be no goodwill present as additional support as to why their transfer to Spinco does not represent the acquisition or transfer of a business.

To summarize, the Initial Assets were never operated as a separate business, with consistent systems and personnel, or within a separate entity, subsidiary or division. For these reasons, and the reasons set forth above, we have concluded that the Initial Assets that will be transferred to Spinco are, in fact, assets and not a "business" as contemplated by Rule 3-05 and Rule 11-01(d), and therefore audited financial statements pursuant to Rule 3-05 and pro forma financial information pursuant to Rule 11-01(d), with respect to the Initial Assets, would not be required.

Accounting Discussion Regarding Spinco

Lehman currently accounts for all financial instruments and other inventory positions owned at fair value under either SFAS 157 or SFAS 159. Real Estate Assets Held for Sale and Held for Use are accounted for at the lower of carrying amount or fair value less cost to sell as required by SFAS 144. Real Estate Assets Held for Use are subject to depreciation.

The overarching objective of Spinco's financial reporting and, more specifically, its accounting policies, will be to provide its stakeholders and other users of its financial statements with relevant and meaningful information, including fair value-related information, on which they can perform analysis and utilize to make decisions. The accounting basis should reflect consistency between Spinco's reported earnings and the manner in which the assets are managed. Consistent with Spinco's anticipated asset management philosophy, Spinco's accounting framework should reflect fundamental asset valuations realizable over longer time horizons, as opposed to valuations reflective of current market liquidity. Initially, Spinco's opening balance sheet will present its assets at fair value as required by Issue 11 of EITF 01-2 and SAB 82, supplemented by additional quantitative and qualitative metrics related to the asset portfolios. Subsequent to the transfer of the Initial Assets, the accounting for the assets will be determined based on the asset type, as further outlined in the table following. Spinco's ongoing quarterly and annual filings with the Securities and Exchange Commission ("SEC") will include fair value information required by US GAAP to be disclosed in the footnotes to the financial statements. Additionally, those periodic filings with the SEC will include quantitative and qualitative metrics related to the composition and performance of the asset portfolios in management's discussion and analysis.

Applicable US GAAP for Financial Instruments

Under US GAAP, an entity holding loans that are not debt securities may use one of three accounting models:

1. Lower of cost or fair value;

2. Amortized cost less a reserve for loan losses; or

3. Fair value by election under SFAS 159.

An entity holding marketable equity securities with readily determinable fair values and debt securities (whether marketable or non-marketable) may use one of three accounting models:

1. Held-to-maturity classification for debt securities if the entity can demonstrate the positive intent and ability to hold the debt security to maturity.[3] Under held-to-maturity accounting, debt securities are recorded at amortized cost and subject to review for other-than-temporary declines in value;

[3] Because equity securities, as defined by US GAAP, do not have a stated maturity they cannot be classified as held-to-maturity.

2. Available-for-sale classification for marketable equity securities and debt securities. Under available-for-sale accounting, unrealized gains/losses are recorded in other comprehensive income, and any other-than-temporary declines in value are recognized in earnings; or

3. Trading classification for marketable equity securities and debt securities. Under trading accounting, all gains/losses are recorded in earnings.

An entity holding non-marketable equity securities records them at cost or uses the equity method of accounting if the entity has the ability to exercise significant influence over operating and financial policies of the investee.

Under all of the above accounting models, the measurement of fair value is in accordance with SFAS 157 and the disclosure requirements of SFAS 157 (quarterly disclosure of fair values for assets measured at fair value on a recurring basis and annual disclosure of fair values for assets measured at fair value on a non-recurring basis; see Appendix B to this letter for SFAS 157 disclosure requirements) are applicable and will be presented in Spinco's financial statements.

Applicable US GAAP for Real Estate Assets Held for Sale and Held for Use
Under SFAS 144, the accounting model for long-lived assets to be disposed of by sale is used for all long-lived assets, whether previously held and used or newly acquired. That accounting model requires an entity to measure a long-lived asset classified as held for sale at the lower of its carrying amount or fair value less cost to sell and to depreciate a long-lived asset that is held for use. SFAS 144 requires an impairment loss to be recognized when the carrying amount of a long-lived asset (asset group) is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset (asset group) is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset (asset group). That assessment is based on the carrying amount of the asset (asset group) at the date it is tested for recoverability, whether in use or under development. An impairment loss is measured as the amount by which the carrying amount of a long-lived asset (asset group) exceeds its fair value.

SFAS 144 states the changes to reporting required when it became effective (fiscal years beginning after December 15, 2001) improved financial reporting by requiring that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and by broadening the presentation of discontinued operations to include more disposal transactions in order to ensure the accounting for similar events and circumstances would be the same and thus the information value of reported financial information would be improved. In addition, SFAS 144 was introduced to resolve significant implementation issues which improved comparability among entities and the representational faithfulness of reported financial information.

Proposed Accounting Framework for Spinco

In accordance with Issue 11 of EITF 01-2 and SAB 82, Spinco's Initial Assets will be recorded at fair value on their transfer date. Subsequently, the significant accounting policies that will be used for Spinco's assets are anticipated to be:

Asset Type	US GAAP References	Overview of Proposed Accounting Policies
Senior Loans and Mezzanine Loans[4]	SFAS 5 SFAS 65 SFAS 91 SFAS 107 SFAS 114 SFAS 157 FIN 46(R)	Loans initially at fair value and then at amortized cost with amortization of discount or premium under the effective yield method and subject to reserve for loan losses. Interest income recorded as earned using effective yield method. Quarterly disclosure of fair values for assets measured at fair value on a recurring basis and annual disclosure of fair values for assets measured at fair value on a non-recurring basis (see Appendix B to this letter for SFAS 157 disclosure requirements).
Debt Securities	SFAS 107 SFAS 115 SFAS 157 FSP FAS 115-1/124-1 FIN 46(R)	Held-to-maturity items initially at fair value then subsequently at amortized cost with amortization of discount or premium under the effective yield method and recognition of any other-than-temporary declines in value in earnings. Available-for-sale items initially at fair value and subsequently at fair value through other comprehensive income with recognition of any other-than-temporary declines in value in earnings. Quarterly disclosure of fair values for assets measured at fair value on a recurring basis and annual disclosure of fair values for assets measured at fair value on a non-recurring basis (see Appendix B to this letter for SFAS 157 disclosure requirements).

[4] None of the Senior or Mezzanine Loans are real estate acquisition, development, or construction ("ADC") arrangements as contemplated in AICPA Practice Bulletin No. 1, *Purpose and Scope of AcSEC Practice Bulletins and Procedures for Their Issuance.*

CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS INC.

Asset Type	US GAAP References	Overview of Proposed Accounting Policies
Equity Investments	APB 18 ARB 51 SoP 78-9 SFAS 94 SFAS 107 SFAS 115 SFAS 157 FIN 46(R)	Available-for-sale items initially at fair value and subsequently at fair value through other comprehensive income with recognition of any other-than-temporary declines in value in earnings. Non-marketable equity securities for which the entity does not has the ability to exercise significant influence initially at fair value and subsequently at cost with recognition of any other-than-temporary declines in value in earnings. Equity method for investments when Spinco has the ability to exercise significant influence. Consolidation of underlying entity if ARB 51, SFAS 94 and/or FIN 46(R) rules are met. Quarterly disclosure of fair values for assets measured at fair value on a recurring basis and annual disclosure of fair values for assets measured at fair value on a non-recurring basis (see Appendix B to this letter for SFAS 157 disclosure requirements).
Real Estate Assets Held for Sale and Real Estate Assets Held for Use	SFAS 66 SFAS 144 SFAS 157	Initially at fair value and subsequently at lower of carrying amount or fair value less cost to sell. Regular assessment for impairment. Depreciation over expected useful life for Assets Held for Use. Quarterly disclosure of fair values for assets measured at fair value on a recurring basis and annual disclosure of fair values for assets measured at fair value on a non-recurring basis (see Appendix B to this letter for SFAS 157 disclosure requirements).

CONFIDENTIAL TREATMENT REQUESTED BY LEHMAN BROTHERS HOLDINGS INC.

Asset Type	US GAAP References	Overview of Proposed Accounting Policies
Derivatives[5]	SFAS 133 SFAS 157 SFAS 161	All derivatives at fair value with the use of hedge accounting as applicable. Quarterly disclosure of fair values (derivative financial instruments, whether assets or liabilities, are measured at fair value on a recurring basis) under SFAS 157 (see Appendix B to this letter for SFAS 157 disclosure requirements).

Fair value disclosures will be provided in the footnotes for all financial instruments and consolidated commercial real estate properties, as applicable and during periods as prescribed by the accounting policy being followed. That is, quarterly disclosure of fair values for assets and liabilities, as applicable, measured at fair value on a recurring basis and annual disclosure of fair values for assets and liabilities, as applicable, measured at fair value on a non-recurring basis (see Appendix B to this letter for SFAS 157 disclosure requirements).

The proposed basis of accounting for the assets by Spinco subsequent to the date of transfer is consistent with the manner under which the assets will be managed, as well as consistent with how Spinco's peers account for their assets. As noted above, the principal purpose of Spinco is to hold and manage its assets over time in a manner that maximizes the value of Spinco's assets and therefore returns to Spinco's shareholders. The time frame under which Spinco will hold and manage its assets until their maturity and/or dispose of them is currently expected to be 5 to 10 years. As explained below, we have concluded that US GAAP does not require Spinco to apply fair value accounting to its assets on an ongoing basis.

Spinco does not meet the definition of an investment company or broker-dealer for which the relevant AICPA Industry Guides would separately require fair value accounting. Spinco has employees, and representatives of Spinco will be involved in the day-to-day management of its assets. This level of involvement with its assets is inconsistent with investment company classification. In addition, Spinco will not have defined exit strategies for each of its investments. As described previously, while Spinco is expected to monetize its assets when appropriate, additional activities may be undertaken to enhance the assets' values (for example, property improvements), and a definitive exit plan for each and every asset does not exist. Furthermore, Spinco will not be a registered broker dealer engaging in active trading.

We also considered whether liquidation accounting was required. The ongoing operations of Spinco do not represent a "liquidating trust" structure whose purpose is to sell nonperforming assets in as quick and orderly a fashion as possible. Kearny Street, which used liquidation accounting, had an expected (and actual) life of only three years and had a portfolio which

[5] Spinco may enter into derivative financial instruments subsequent to the transfer of the Initial Assets in order to economically hedge risk exposures in its assets and liabilities. Hedge accounting may be used.

consisted of loans with maturity dates, and not any equity positions. Spinco will not have a set time frame for the disposition of its assets. We view the profile of the Initial Assets and the actions necessary to monetize them to be inconsistent with the basic principles of a liquidating trust, for which fair value accounting would be required.

US accounting and auditing guidance related to the preparation of liquidation basis financial statements is principally limited to that provided in AU 9508.33-38, SoP 93-3 and EITF 88-25. It is generally acknowledged that judgment is required in determining when an entity should report on the liquidation basis of accounting and the overarching principle for using liquidation accounting is that the entity is not a going concern. It is our view that Spinco is a going concern; it will acquire its Initial Assets at fair value and manage the assets in order to maximize their value and therefore returns to Spinco's shareholders.

To further elaborate, AU 9508.34 states that the liquidation basis of accounting may be considered US GAAP for entities in liquidation or *for which liquidation appears imminent* (emphasis added). Thus, once it becomes imminent that the entity will liquidate, the application of the liquidation basis of accounting is required and is not a policy election. This is consistent with the guidance provided in FRP 607.02, in which the SEC asserts that financial statements will be considered false and misleading if such statements are prepared on the assumption of a going concern but should more appropriately be based on the assumption of liquidation or if the classification and amounts of assets and liabilities should otherwise be adjusted. Spinco is a going concern with public ownership, independent management and an indeterminate life. Because Spinco is deemed a going concern, and liquidation is not imminent, we have concluded that Spinco is not an entity in liquidation for which the liquidation basis of accounting would be required.

Information relevant to the ability of Spinco to monetize the value of its assets, and the current expectation regarding the timing of these monetizations is summarized below.

- Approximately 28% of the Initial Assets will be comprised of equity, with no underlying cash flows.
- Of the remaining 62% of the Initial Assets will be comprised of debt positions, approximately 53% are generating current interest payments.

The current cash flow model of Spinco assumes the following approximate ending book values (across both debt and equity positions) by year:

	Book value of commercial real estate assets ($ billion)[6]
At Closing	30
2009	25
2010	20
2011	15
2012	7
2013	4

Additional investments necessary to further develop the Initial Assets into favorable conditions to maximize their value are expected to approximately $5 billion.

We also considered EITF 88-25 which provides guidance on the application of the liquidation basis of accounting in the circumstance in which a bank with a substantial amount of nonperforming assets transfers some or all of those assets to a newly created bank whose stock will be distributed to existing shareholders or to new investors. The newly created bank is specifically designed to be a liquidating bank that will manage the assets it receives and collect cash from loan repayments or dispositions of assets. In most of these so called "good bank/bad bank" structures, the transferring bank sold nonperforming assets and was the entity that managed the assets.

We have concluded that EITF 88-25 is not applicable and should not be analogized to because (i) Spinco is not a bank (ii) the assets being transferred to it are not comprised of a substantial amount of nonperforming assets (iii) Lehman will not be employed by Spinco to manage or service the assets and (iv) Spinco is designed to be an independent public company with an indeterminate life. In addition, we believe that the level of ongoing management associated with certain equity positions (continued investment and/or development of properties to maximize value, etc.) owned by Spinco is also inconsistent with this banking analogy.

We have considered SoP 90-7 and Topic 5-S. SoP 90-7 provides guidance for financial reporting by entities that have filed petitions with the Bankruptcy Court and expect to reorganize as going concerns under Chapter 11. Topic 5-S addresses quasi-reorganizations and describes them as occurring after a company has incurred significant operating losses and/or recent write-downs of property, plant and equipment, such that the company's financial statements reflect an accumulated deficit. We have concluded that this guidance is not applicable because (i) Spinco is not subject to Chapter 11; and (ii) Lehman does not have an accumulated deficit, so the initial transfer of assets to Spinco is not a quasi-reorganization.

[6] These balances are presented on a net asset basis. Refer to Proposed Term Sheet of August 19, 2008 (Financial Statement Information) for an explanation of gross and net asset composition.

As we have concluded that as there is no specialized accounting that requires fair value accounting for Spinco's assets on a prospective basis. We believe that the proposed accounting under US GAAP outlined in the table on page 10 above is appropriate and is consistent with Article 5 of Regulation S-X.

In addition, we have identified the following operating entities with activities similar to those of Spinco, which have adopted accounting policies similar to those we have proposed for Spinco. Based on our review of the financial statements for these entities, it appears that none of these entities apply fair value accounting to all of their assets. Examples of the entities are as follows:

- iStar Financial Inc.;
- American Realty Investors, Inc.;
- AmREIT Monthly Income & Growth Fund III, Ltd., and
- Ocwen Financial Corporation.

While Spinco will not account for its assets at fair value on an ongoing basis, we believe investors will have sufficient information regarding fair value and composition of the underlying assets. As noted above, the Initial Assets will be recorded on Spinco's opening balance sheet at their fair value at the date of transfer. This information is relevant and useful to Spinco's shareholders at the date ownership of the assets changes. Furthermore, because Spinco intends to monetize its assets over time in an orderly fashion, any gains or losses on sales will be reflected in earnings as realized. To the extent that assets become impaired, unrealized losses will be reflected within Spinco's periodic earnings. Spinco's ongoing quarterly and annual filings with the SEC will include an updated discussion of Spinco's business in management's discussion and analysis (including disclosures regarding attributes of Spinco's assets by type, loan pool characteristics, geographic breakdowns of commercial real estate assets, reserves for loan losses, etc.), and fair value information required by US GAAP in Spinco's audited financial statements and footnotes. Taken in the aggregate, Spinco's stakeholders and other users of its financial statements will have access to relevant and meaningful information, including a basis of accounting for the assets consistent with how the assets are managed and fair value-related information in footnotes or supplemental disclosures.

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We have prepared this letter to respectfully ask for your concurrence with our conclusions described herein; namely (i) that the transfer of the Initial Assets from Lehman to Spinco does not represent the sale of a business; and (ii) that Spinco should account for its commercial real estate-related assets pursuant to the accounting policies described in the table on page 10 and Spinco should not use the liquidation basis of accounting or fair value accounting in its financial statements. It is our opinion that both of these items are necessary for the success of Spinco and to provide relief to Lehman and the accounting framework used by Spinco must be reflective of

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these goals. We have discussed these matters with our independent auditors, Ernst & Young LLP, and they concur with our view.

We are available to either meet with you or discuss these matters at any time by telephone (212-526-3606).

Very truly yours,

Martin B. Kelly
Managing Director and
Global Financial Controller
Lehman Brothers Holdings Inc.

Appendix A — US Generally Accepted Accounting Principles (US GAAP) References
The following are the US GAAP references relied upon or referenced in this letter.

- Accounting Principles Board (ABP) Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, (ABP 18).
- ABP Statement No.4, Basic Concepts and Accounting Principles Underlying Financial Statements, (ABPS 4). (Rescinded by AICPA SoP 93-3.)
- Accounting Research Bulletin (ARB) No. 51, Consolidated Financial Statements, (ARB 51).
- SFAS No. 94, Consolidation of All Majority-Owned Subsidiaries, (SFAS 94).
- Statement of Financial Accounting Standards (SFAS) No. 5, Accounting for Contingencies, (SFAS 5).
- SFAS No. 65, Accounting for Certain Mortgage Banking Activities, (SFAS 65).
- SFAS No. 66, Accounting for Sales of Real Estate, (SFAS 66).
- SFAS 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases—an amendment of FASB Statements No. 13, 60, and 65 and a rescission of FASB Statement No. 17, (SFAS 91).
- SFAS No. 107, Disclosures about Fair Value of Financial Instruments, (SFAS 107).
- SFAS No. 114, Accounting by Creditors for Impairment of a Loan, (SFAS 114).
- SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, (SFAS 115).
- SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, (SFAS 133).
- SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144).
- SFAS No. 157, Fair Value Measurements, (SFAS 157).
- SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, (SFAS 159).
- SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, (SFAS 161).
- Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 46, Consolidation of Variable Interest Entities (revised December 2003)—an interpretation of ARB No. 51, (FIN 46(R)).
- FASB Staff Position (FSP) FAS115-1/124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, (FSP FAS 115-1/124-1).
- FASB Q&A 115, A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers, (FAS 115 Q&A).
- Emerging Issues Task Force (EITF) Issue No. 88-25, Ongoing Accounting and Reporting for a Newly Created Liquidating Bank, (EITF 88-25).
- EITF Issue No. 98-3, Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business, (EITF 98-3).
- EITF No. 01-2, Interpretations of ABP Opinion No. 29, (EITF 01-2).
- Securities and Exchange Commission (SEC) Regulation S-X Rule 3-05.

- SEC Regulation S-X Rule 11-01(d).
- SEC Codification of Staff Accounting Bulletins Topic 1-I: SAB 71 and SAB 71A, Financial Statements of Properties Securing Mortgage Loans, (Topic 1-I).
- SEC Codification of Staff Accounting Bulletins Topic 5-S: SAB 78 and SAB 86, Quasi-Reorganization (Topic 5-S).
- SEC Codification of Staff Accounting Bulletins Topic 5-V: SAB 82, Accounting for transfers of nonperforming loans by financial institutions, (Topic 5-V or SAB 82).
- SEC Codification of Financial Reporting Policies (FRP) 607.02, Uncertainty About an Entity's Continued Existence, (FRP 607.2).
- AICPA Audit and Accounting Guide, Investment Companies.
- AICPA Statement of Position (SoP) 78-9, Accounting for Investments in Real Estate Ventures, (SoP 78-9).
- AICPA SoP 93-3, Rescission of Accounting Principles Board Statements, (SoP 93-3).
- AICPA SoP 90-7, Financial Reporting by Entities in Reorganization Under the Bankruptcy Code, (SOP 90-7).
- AICPA SoP 03-3, Accounting for Certain Loans or Debt Securities Acquired in a Transfer, (SoP 03-3).
- AICPA Practice Bulletin No. 1, Purpose and Scope of AcSEC Practice Bulletins and Procedures for Their Issuance, (PB 1).
- AICPA Practice Bulletin No. 11, Accounting for Preconfirmation Contingencies in Fresh-Start Reporting (PB 11) (Note that PB 11 will be nullified by SFAS 141R which is effective for periods beginning after December 15, 2008).
- AICPA Auditing Interpretation No. 8 of Statement of Auditing Standards (SAS) No. 58, Reporting on Financial Statements Prepared on a Liquidation Basis of Accounting, (AU 9508).
- AICPA TIS Section 9110 Special Reports: Item 14, Liquidation Basis Financial Statements, (TIS Section 9110).

Appendix B — SFAS 157 Disclosure Requirements
Paragraphs 32 through 35 which enumerate the disclosures required by of SFAS 157 are as follows:

32. For assets and liabilities that are measured at fair value on a recurring basis in periods subsequent to initial recognition (for example, trading securities), the reporting entity shall disclose information that enables users of its financial statements to assess the inputs used to develop those measurements and for recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on earnings (or changes in net assets) for the period. To meet that objective, the reporting entity shall disclose the following information for each interim and annual period (except as otherwise specified) separately for each major category of assets and liabilities:

a. The fair value measurements at the reporting date

b. The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)

c. For fair value measurements using significant unobservable inputs (Level 3), a reconciliation of the beginning and ending balances, separately presenting changes during the period attributable to the following:

(1) Total gains or losses for the period (realized and unrealized), segregating those gains or losses included in earnings (or changes in net assets), and a description of where those gains or losses included in earnings (or changes in net assets) are reported in the statement of income (or activities)

(2) Purchases, sales, issuances, and settlements (net)

(3) Transfers in and/or out of Level 3 (for example, transfers due to changes in the observability of significant inputs)

d. The amount of the total gains or losses for the period in subparagraph (c)(1) above included in earnings (or changes in net assets) that are attributable to the change in unrealized gains or losses relating to those assets and liabilities still held at the reporting date and a description of where those unrealized gains or losses are reported in the statement of income (or activities)

e. In annual periods only, the valuation technique(s) used to measure fair value and a discussion of changes in valuation techniques, if any, during the period.

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33. For assets and liabilities that are measured at fair value on a nonrecurring basis in periods subsequent to initial recognition (for example, impaired assets), the reporting entity shall disclose information that enables users of its financial statements to assess the inputs used to develop those measurements. To meet that objective, the reporting entity shall disclose the following information for each interim and annual period (except as otherwise specified) separately for each major category of assets and liabilities:

a. The fair value measurements recorded during the period and the reasons for the measurements

b. The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (Level 1), significant other observable inputs (Level 2), and significant unobservable inputs (Level 3)

c. For fair value measurements using significant unobservable inputs (Level 3), a description of the inputs and the information used to develop the inputs
d. In annual periods only, the valuation technique(s) used to measure fair value and a discussion of changes, if any, in the valuation technique(s) used to measure similar assets and/or liabilities in prior periods.

34. The quantitative disclosures required by this Statement shall be presented using a tabular format. (See Appendix A [of SFAS 157].)

35. The reporting entity is encouraged, but not required, to combine the fair value information disclosed under this Statement with the fair value information disclosed under other accounting pronouncements (for example, FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*) in the periods in which those disclosures are required, if practicable. The reporting entity also is encouraged, but not required, to disclose information about other similar measurements (for example, inventories measured at market value under ARB 43, Chapter 4), if practicable.