

From: Klein, Henry [Henry.Klein@lehman.com].

Sent:5/1/2008 6:11 PM.

To: O'Meara, Chris M (NY) [comeara@lehman.com].

Cc: .

Bcc: .

Subject: Fw: KSK.

Chris

Thanks for your time today. Always helpful. I am sending you the email that I sent to Dave as it explains my perspective clearly. I realize this is not top priority for anyone at this time but there is a simple and fair solution which we already agreed with our consultants in order to solve the same problem. Both Emmert and Dave were closely involved in that solution. I cannot imagine that anyone at the Firm would think it reasonable that an employee's compensation be totally exposed to some external event after producing hundreds of millions of dollars of profit over a 4 year period (we are all exposed in any single year). It would be the worst possible message to send to anyone in the firm that might have the potential to produce a similarly successful investment. Apart from the risk to me of leaving this unaddressed, I believe it is sub-optimal for the firm and gts as the management of the position going forward should be done on a coordinated basis and not just within gts. Resolving it will also allow me to become more productive for the firm as I have the skills and an evolving team that can deal with many of the illiquid opportunities that the firm is interested in. This will not happen as we are currently set up and has implications for sourcing, Romita, etc.

Regards
Henry

----- Original Message -----

From: Klein, Henry

To: Goldfarb, David

Sent: Sun Apr 20 17:07:08 2008

Subject: KSK

Dave,

As a follow up to our discussion regarding KSK compensation, I think putting my perspective in writing will be more efficient for you than ongoing lengthy discussions. There are three outcomes that are relevant to the discussion:

Scenario A - probable

KSK mark and ultimate realization are not materially different and existing GTS arrangement works well for the KSK team and for Lehman

Scenario B - unlikely but possible

KSK mark at year end turns out to be much higher than ultimate realization of investment in which case including it in GTS P&L for compensation purposes puts Lehman at risk of paying out compensation based on profits which are not yet realized and potentially may never be realized.

Scenario C - unlikely but possible

GTS as a group including the KSK mark is flat for the year in which case the GTS would in future years 'owe' the KSK team compensation for its contribution this year. Bob has a history of being fair about this, but it does depend on GTS making sufficient profits in future years and the KSK team being around to collect. This may not happen for a number of (fairly remote) reasons. GTS might just perform poorly, GTS could be shut down, something could happen to Bob or me (I can be fired or get sick), Lehman could get acquired, etc. Unlikely, but certainly not impossible.

I do not agree with the argument that the KSK profit is different than those on other GTS investments - it is large, but is not different. GTS is paid on the basis of the market value of its portfolio at year end as reflected on Lehman's books. The Firm is always at risk that we have a very profitable year, it pays out a lot of compensation and then we lose money and never make profits again. Any compensation paid by Lehman to GTS employees is based on the assumption that GTS continues to exist and continues to be profitable over time (there is no formal clawback). This is the same risk that exists in the compensation structure of every hedge fund. KSK is marked to fair market value defined as the value that we believe we could sell the position for. Last year, the mark was included in GTS P&L for compensation purposes, last year and this year it is included in the P&L of the Firm and is also included in the P&L for the leveraged partnership. Choosing to exclude the mark for compensation purposes when it is included for every other purpose seems arbitrary to me. To the extent that KSK goes public and the mark is based on a public market value, I think the argument to exclude KSK becomes even weaker.

Having said this, I agree with the concept that the KSK team only gets paid upon realization of the KSK investment and the Firm not being exposed to paying compensation on a book profit on a private equity investment that ultimately may not be realized. What I think is not fair is to change the arrangement by excluding KSK from the P&L for compensation purposes to protect the firm against scenario B, but when I ask to be protected against scenario C to say that that is the deal I signed up for. Either a deal is a deal and we all live with it as is or we are prepared to revisit the existing arrangement and fix it to avoid the possibility of unintended consequences for both sides. As I pointed out to you in our meeting, the GTS arrangement is simply not very well suited to dealing with long term illiquid investments - our incentives are essentially designed to have us focus on investments in liquid situations that realize profits in a year or two.

To my mind, there are two approaches that would be fair:

The first is to include the KSK mark and leave the GTS arrangement as is. I do not think this should be the preferred arrangement since exposes each party to a low probability very negative outcome that was not intended - I don't think Lehman should pay for KSK unless we can ultimately turn the investment into a realized gain and I also don't think the KSK team should be exposed to the risk that we ultimately realize the gain, but are not compensated.

The second is for Lehman to commit to compensate the KSK team based on realized profits. This approach eliminates the risk of scenario B for Lehman and eliminates the risk of scenario C for the KSK team. It would be set at a discount (like we did for our consultants) to the existing arrangement so that the expected payout for the firm is lower in all cases except for scenario C. Lehman already takes the risk of scenario C and I doubt that you would view scenario C as a fair outcome for the KSK team were it to occur. It is very typical of private equity arrangements including those that exist at Lehman. I also think that this approach will make more sense overall for Lehman and GTS (but this is obviously Bob's call) as the position would be better managed going forward as a joint position of Lehman and GTS with respect to hedging and liquidation strategies. Leaving it on GTS's balance sheet could create issues for GTS as its performance could be dominated for several years by a very large mark to market situation.

Hopefully this is helpful and not too long winded

Regards

Henry