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June 7, 2013

The Honorable Sim Lake
United States District Judge
515 Rusk Avenue
Houston, Texas 77002

Re: Letter relating to the resentencing of Jeffrey Skilling; Civil Action No. H-04-25 in the United States District Court for the Southern District of Texas, Houston Division

Dear Judge Lake:

Rarely in the course of a judicial career does a judge have the opportunity to promote sound judicial policy and convey an important public message at the same time. I believe you have such an opportunity when Jeffrey Skilling comes before you for resentencing later this month. The purpose of this letter is to explain why.

My perspective regarding Mr. Skilling and Enron is different from most people who will write letters to you on his behalf. As a lawyer, I was deeply involved in the Enron case from the beginning. My first involvement was the representation of a prospective asset purchaser in performing due diligence on some of Enron's most valuable assets during the early stages of the bankruptcy case. I later represented three Enron executives – who worked closely with Mr. Skilling while at Enron – in Enron-related civil litigation. Finally, I provided consulting advice to several defense attorneys in connection with Enron-related criminal cases (although not Mr. Skilling's case). These wide-ranging experiences in the Enron case – along with my 30-plus years of experience in complex business litigation and corporate reorganization – provide the basis of my perspective of what happened to Enron and Mr. Skilling.

When what happened to Enron and Mr. Skilling is placed in the context of what has occurred in business markets since Mr. Skilling's original sentencing, I believe that, by imposing the most lenient resentence of Mr. Skilling possible under the circumstances, you will send a vitally important educational message to the markets regarding the nature of investment risk. Stated simply, Mr. Skilling's original sentence was far out of balance with the impact of Mr. Skilling's questionable business judgments on Enron's demise.

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To this day, many myths still surround Enron. The main myth is based on what I call the “Greed Narrative” – that is, that Enron was not really a valuable company, but just an elaborate financial house of cards that a massive conspiracy hid from innocent and unsuspecting investors and employees. The Greed Narrative about Enron is so widely accepted in some circles that otherwise intelligent people reject any notion of ambiguity or fair-minded analysis in addressing facts and issues that call that morality play into question. The primary dynamics by which the myth is perpetuated are scapegoating and resentment, both of which were common themes in the prosecution of Mr. Skilling.

Contrary to the Greed Narrative, the truth is that Enron was actually an example of the beneficial aspects of taking business risk – that is, valuable innovation, wealth creation and generating jobs for communities. Relative to those who embrace the Greed Narrative about Enron, few people remember that Enron quickly grew into one of the nation's largest publicly-owned companies, became a vitally-important market-maker in the natural gas trading industry and was a leader in hedging corporate risk through structured finance transactions.

Even less well understood is that Enron was a trust-based business that fundamentally depended on the trust of the marketplace to sustain its market value. It is a characteristic of any trust-based business that its market value will quickly evaporate if the company loses that trust.

Enron’s collapse caused tremors through various industries -- particularly the energy industry -- because valuable resources for hedging risk of loss evaporated seemingly overnight. The natural gas trading industry nearly fell apart completely, costing companies and their customers billions of dollars that they otherwise could have saved through hedging risk of loss. Similarly, the market for many structured finance transactions dried up, also costing companies another valuable avenue for hedging risk.

Despite the massive costs of Enron’s insolvency, neither Mr. Skilling nor anyone else at Enron ever proposed a government bailout of the company to preserve the huge value of the natural gas trading industry and the market for structured finance transactions. Moreover, it is important to note that the U.S. financial system did not break down over Enron’s collapse. Companies adjusted to the changed circumstances and endured their additional costs. Markets adjusted. Slowly but surely, both the natural gas trading industry and the market for structured finance transactions rebounded so that both are again providing companies with valuable alternatives for hedging risk and saving money.

The instability in financial markets that Enron faced in late 2001 enveloped virtually all of Wall Street in early 2008. As with Enron, dozens of Wall Street firms that depended on the trust of the markets to sustain their market value lost that trust. As a result, the firms quickly suffered huge losses and – but for a governmental bailout that was not available to Enron – faced almost certain insolvency.

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For example, the government-arranged JP Morgan Chase \$236 million purchase of Bear Stearns in mid-March, 2008 came just hours after Bear Stearns' market cap closed at \$3.5 billion on March 14, 2008 (Bear Stearns' market cap had been \$20 billion just a year earlier in January, 2007). Viewed in this context, Enron's similar deterioration in value during 2001 was not unusual for a trust-based business that lost investor trust in the volatile post-9/11 marketplace that was similar in instability to what the Wall Street firms faced in early 2008. Although unfortunate for the owners of those companies, the financial losses that result from a trust-based business losing the confidence of the markets does not mean that any criminal conduct caused or was even involved in the financial losses.

There is no question that society needs criminal prosecutions of true business crimes, such as embezzlement and kickbacks. However, as you know, Mr. Skilling was never accused of such crimes. Rather, Mr. Skilling was primarily prosecuted for questionable business judgment in connection with public statements that he made as Enron's chief executive officer. Criminal prosecutions based on such questionable business judgment are problematic because they obscure the true nature of business risk and fuel the myth that investment loss results primarily from criminal misconduct.

Similarly, outrage over financial losses from such questionable business judgments distorts the key difference between prosecuting questionable business judgments and prosecuting clear-cut corporate crimes, such as embezzlement. The difference relates primarily to the nature of the evidence involved, the relevance of contracts and the subtleties of dividing responsibility between corporate actors.

The late University of Illinois Professor Larry Ribstein put it this way. Suppose somebody mugs you on the street. There is no question that is a crime.

However, what if the alleged mugger asks you first if he can borrow your wallet, you loan it to him, and then he does not give it back in time? What if the alleged mugger asks your employee who is running the store for you whether he can borrow some money, the employee allows it and then the mugger does not pay it back? What if the alleged mugger is another employee who says the manager gave him the money as bonus compensation?

Who is liable in these situations turns on the contracts among the various parties. Proof depends on who said what to whom. Can we rely on what the witnesses say about this? What if the prosecutor tells the employee who's minding the store that he will not face prosecution for conspiracy if he testifies against the other employee who says that the manager gave him bonus compensation?

Society needs to have appropriate punishment and accounting for clear-cut business crimes. But in cases such as Enron or the failed Wall Street firms, the civil lawsuits – unlike the criminal prosecutions – included all the potentially responsible parties involved, such as the directors who approved the questionable business judgments and accountants and lawyers who may have facilitated them. Accordingly, any responsibility that those various corporate actors had for the demise of their companies could be properly allocated in the civil justice system among all the responsible parties. That is a much more rational and effective way to deal with damages from questionable business judgments, which simply are not clear-cut crimes.

The foregoing is underscored by the fact that there is no meaningful difference between the questionable business judgments and public statements that Wall Street executives such as Angelo Mozilo of Countrywide Mortgage or Richard Fuld of Lehman Brothers made, on one hand, with those that Mr. Skilling made on behalf of Enron, on the other, as each of those executives struggled to preserve their respective trust-based businesses in the face of financial losses caused by a loss of trust in the marketplace. Nevertheless, neither Mr. Mozilo, Mr. Fuld nor any other Wall Street executive whose company suffered massive losses during the 2008 financial crisis faced a criminal prosecution over questionable business judgment.

This prosecutorial restraint was the correct policy. Prosecutors – perhaps partly due to the experience in the Enron criminal cases – recognized in regard to the demise of the Wall Street firms that the questionable business judgments were the product of executives taking business risk to preserve wealth and jobs, not criminal acts. Each executive's responsibility for the financial damages to investors was more effectively allocated among all the responsible parties in civil lawsuits involving the Wall Street firms.

Even the unfortunate loss of nest eggs by some investors from Enron's collapse (as well as the collapse of various Wall Street firms in 2008) is an inadequate reason to incarcerate Mr. Skilling any further. One of the main reasons that those investors' nest eggs ever had value in the first place was because Mr. Skilling and other innovative executives transformed Enron into the world's leading energy risk management company through the creative use of futures and options contracts to hedge price risk for natural gas producers and industrial consumers.

Although it is charitable to feel sorry for anyone who loses money on an investment, most of those investors who lost their nest eggs in Enron (or seven years later in Wall Street firms) were imprudent in their investment strategy. Taking Enron as an example, those investors should have diversified their Enron holdings or bought a put on their Enron shares that would have allowed them to enjoy the rise in Enron's stock price while being protected by a floor in that share price if it fell below a certain value. Those are the type of precautions that prudent and well-educated investors take in regard to investing in a trust-based business.

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Incongruously, while virtually all of those Enron investors presumably hedged the risk of loss of their investment in their homes by purchasing homeowner's insurance, few of them hedged the risk of loss of their investment in Enron stock by purchasing similar investment insurance as described above. Most of the investors simply did not understand how Enron's risk management services created value in their nest eggs in the first place and presumed without basis that the risk of loss was small. Thus, when those nest eggs evaporated as Enron lost the trust of the marketplace, those investors did not even attempt to understand the nuanced explanation of what truly had occurred. They simply embraced the Greed Narrative with its easy-to-understand – but fundamentally flawed – morality tale of villains and victims.

Consequently, prosecution of questionable business judgments and harsh prison sentences of the type that Mr. Skilling has endured obscure the true nature of investment risk and fuels the myth that investment loss results primarily from someone else's misconduct. At a time when the United States needs innovators and entrepreneurs to create jobs and wealth, a sounder policy is to educate investors on the true nature of risk in investing in trust-based businesses. You can provide the marketplace with a powerful lesson in that education by re-sentencing Mr. Skilling to the most lenient sentence available and firmly rejecting the Greed Narrative with regard to Enron.

I appreciate your consideration of my perspective in this matter.

With highest personal regards, I remain

Very truly yours,

A handwritten signature in black ink that reads "Tom Kirkendall". The signature is written in a cursive, slightly slanted style.

Tom Kirkendall

c: O'Melveny & Myers, LLP