

Dunn and Dusted
By Viet D. Dinh
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Justice Felix Frankfurter once wrote, "Wisdom too often never comes, and so one ought not to reject it merely because it comes late." So it is with Hewlett-Packard's decision on Friday to come clean with the available facts about Chairman Patricia Dunn's ill-advised investigation into board members and journalists, as well as to replace her with CEO Mark Hurd and appoint respected prosecutor Bart Schwartz to mop up the mess. Belated but welcome, these actions show that Mr. Hurd's steady hand will guide H-P out of the scandal and back to its rightful place as the icon of Silicon Valley.

For me the whole saga started in June with dinner at a London restaurant. The News Corporation was welcoming Spanish President José María Aznar to its board, on which venture capitalist Tom Perkins and I also serve as independent directors. Between drinks and glimpses at a World Cup match, as this paper has reported, Mr. Perkins asked me for advice on a confidential matter. He had resigned several weeks earlier from the H-P board, where he chaired the Nominations and Governance Committee, to protest an investigation into disclosures of board information and the decision to ask a fellow director, George "Jay" Keyworth, to resign.

H-P Sauce

That night and on the plane the next day, Mr. Perkins described a four-month operation instigated by Ms. Dunn, which we now know as Kona, to uncover contacts between members of her board and reporters covering H-P. That investigation, according to Mr. Perkins, pointed to Mr. Keyworth as the unnamed source for a January article on the trade Web site CNET.com.

My immediate reaction was that it was unconscionable for a chairman to spy on her own directors. Having participated in and observed a number of leak investigations as a Justice Department official, I also thought it nearly impossible to uncover a confidential source without using government subpoenas, which H-P did not have, or resorting to likely illegal methods, which at the time was unthinkable. Mr. Perkins asked me to serve as his counsel, and I agreed.

Most perplexing was the supposed trigger for this unfortunate foray into corporate intrigue. The CNET article, if anything, burnished the image of H-P and its management. There was no disclosure of material nonpublic financial information to trigger regulatory or legal issues. Amid banal details about how long the days were and how hard the directors worked were glimpses into the company's general strategic and competitive vision. Mr. Hurd was engineering an impressive turnaround, and the article showed that H-P was not simply cutting costs and laying off workers but rather executing a shrewd strategic plan to best its competitors.

It is difficult to see how a puff piece with nuggets already publicized by H-P could be viewed as harmful. The board has since acknowledged that "at H-P's request, Dr. Keyworth often had contacts with the press to explain H-P's interests. The board does not believe that Dr. Keyworth's contact with CNET in January 2006 was vetted through appropriate channels, but also recognizes that his discussion with the CNET reporter was undertaken in an attempt to further H-P's interests." And there is no general duty of confidentiality for directors, only a duty of loyalty to act in the best interests of the corporation and its shareholders.

So the whole thing boils down to Mr. Keyworth deciding to speak favorably to a reporter without asking for permission. The answer to this question of authority is not self-evident as a legal matter. The chairman of the board is first among equals -- entrusted with the responsibility to set agendas, conduct meetings and interact with management. But each board member individually owes a legal duty to act in the best interests of the corporation, a personal duty that cannot and should not be delegated or transferred to anyone else.

It is true that unauthorized disclosures of board information would violate a mutual commitment of confidentiality that H-P directors made to prevent such disclosures following the ouster of Carly Fiorina as chairman and CEO. This is a serious matter, but one that could and should be handled, as Mr. Perkins suggested to Ms. Dunn early on, by a direct personal conversation with the directors. It is therefore understandable for Mr. Keyworth to reportedly exclaim, when confronted with the CNET investigation results, "I would have told you all about this. Why didn't you just ask?"

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Overlaying these minutiae is a broader morality tale for the modern era of corporate governance. Enron and WorldCom prompted Sarbanes-Oxley, SEC regulations and a host of corporate "best practices." These requirements emphasized internal controls, divided corporate authority and instituted checks and balances. Essential as these requirements may be to ensure technical compliance with the new rules, they cannot substitute for the guiding light of director conduct: business judgment.

Patricia Dunn reportedly is a "governance perfectionist." When Mr. Perkins's objections to Ms. Dunn's investigation surfaced publicly, she called the conflict "part of the board's progression from one that was more personality driven to one that is process driven and capable of upholding today's highest governance standards." Her supporters whispered that Mr. Perkins had challenged her proposal for a mandatory director education program on corporate compliance. And in resigning last week she emphasized, "I followed the proper processes by seeking the assistance of H-P security personnel." Left unanswered was whether the sub rosa investigation was a good idea or whether the reaction was reasonable to the infraction.

Meanwhile, in June, Tom Perkins wrote to Larry Sonsini, outside counsel to the H-P board, and passed on my view that the investigation was unconscionable and likely illegal. After conversations with staff, Mr. Sonsini confirmed that Ms. Dunn's Kona

investigation "did obtain information regarding phone calls made and received by the cell or home phones of directors" and that it was "done through a third party that made pretext calls to phone service providers." Questions have been raised about Mr. Sonsini's role, but Mr. Perkins's and my impression is that Mr. Sonsini was simply a good, honest lawyer doing his best to represent his client in very difficult situations.

It was Mr. Sonsini's candid acknowledgment of pretexting that prompted Mr. Perkins to contact telephone companies and obtain evidence that his records had been accessed. Wherever responsibility for such actions lie are for prosecutors to determine, but one thing is clear: Using false pretenses to obtain telephone records without the subscriber's consent is illegal under state and federal law.

The Department of Justice wrote to Congress in March that pretexting of telephone records is, under current law, a violation of the Computer Fraud and Abuse Act, the wire fraud statute and the identity theft statute. The Bush administration nevertheless advocated passage of H.R. 4709, the "Law Enforcement and Phone Privacy Protection Act of 2006," because it "would impose sanctions for certain sales of phone records, would criminalize some conduct that is harmful to consumers but that is not addressed by current criminal law." The House heeded the call and unanimously passed the bill, which is currently pending in the Senate.

What happened to Tom Perkins is unique only because of the players involved. Thousands have had their phone records illegally accessed. Ironically, the pervasiveness of the trade in illegally obtained phone records has led many buyers of illicit records to believe that they were not dealing in stolen goods. Perhaps that is one silver lining to this episode: Henceforth, no one, least of all corporate America, should be able to claim that they didn't know that obtaining telephone records without consent is improper and illegal.

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H-P is now charting the right course, with Mark Hurd firmly at the helm. There is no better indication of his commitment to doing the right thing than the appointment of Bart Schwartz as counsel to review and revamp H-P's security processes. "Bart is an outstanding lawyer and investigator with excellent judgment and immense integrity," former FBI director Louie Freeh told me. "He will act independently and provide to H-P a 'best practices' architecture for investigations and procedures which is thorough, fair and sensitive to privacy requirements."

Mr. Hurd himself has frankly acknowledged his specific interactions with Ms. Dunn's investigation. Like any good scandal, Kona has sucked everything and everyone, however peripheral, into its vortex. But based on all available information, I believe that his knowledge was tangential and his involvement indirect. It would be surprising -- and much more disturbing -- if Mr. Hurd had zero knowledge of, or involvement in, actions of H-P employees and contractors under the direction of the board chairman.

One may well ask whether Mr. Hurd should have done less to help or could have done more to stop the investigation. But here, too, I think he should get the benefit of any

doubt. As CEO, Mr. Hurd was charged with the management and operations of H-P, in the process engineering one of the most remarkable turnarounds in recent corporate history. Even if he had the will, he did not have the unilateral authority to challenge Ms. Dunn's management of the board. Mr. Hurd was, and should have been, doing his job to increase shareholder value; and the machinations of an increasingly dysfunctional board were a distraction.

Hopefully, those distractions are now over. By stepping aside, Ms. Dunn proved her personal commitment to H-P and its shareholders. It is never easy to let go under pressure, and her decision speaks volumes about her courage, her grace and, in Mr. Hurd's words, "her ability to put the interests of H-P before her personal interests."

In the final analysis, the best thing that the H-P board did was to appoint Mark Hurd as CEO. But then it failed him. Ironically, the three persons most instrumental in recruiting Mr. Hurd -- Patricia Dunn, Jay Keyworth and Tom Perkins -- have all resigned, and he is now in charge of both the company and the board. The task may be more challenging, but the odds are good that he will succeed in leading the board as he did in leading the company.

'Dear Mark'

On July 18, the same day that Tom Perkins formally confirmed his protest to the entire board, he wrote Mr. Hurd a personal email that bears quoting in its entirety:

"Dear Mark: A while back I promised you that we directors would clean up our act, and free you from worries about the H-P board. I am really sorry that I didn't deliver on this, and I apologize for the necessity of raising the issue of illegal activity by the board chairman in today's email to the board. But, it's an extremely serious matter, and I have legal obligations.

"Aside from this, I worry that Pattie, as new chair of N&G, will 'pack' the board with the kind of directors she so admires -- ciphers from high cap companies, with no fast-cycle technology background, and certainly no Valley entrepreneurial genes.

"I worry that you will wind up with a 'blue ribbon' board that will be of zero, or even negative, value to you when the going gets tough. I don't wish you bad luck -- but life eventually delivers tough scenarios to CEOs of big companies -- and I doubt if H-P will prove to be the exception.

"Anyway, I am rooting for you still, and I hope everything works out as you wish best.

"Sincerely, -- Tom."

As Mr. Perkins has said, "This, too, shall pass." Hopefully, soon.

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