HP Scandal Widens With U.S. Probes

Officials want to know what the firm did to find its leak source. Investors appear to be happy with the firm and its CEO.

By Charles Piller and James S. Granelli, Times Staff Writers
September 12, 2006

SAN FRANCISCO — The scandal over the snooping of confidential phone records at Hewlett-Packard Co. widened Monday as Congress and the FBI launched investigations and the company's board debated the fate of Chairwoman Patricia Dunn.

Federal investigators want details on the methods used by HP as it tried to ferret out leaks to the media this year. That hunt, it turned out, included potentially illegal looks at the call records of HP directors and reporters covering the company.

The fresh inquiries follow a statement last week by California Atty. Gen. Bill Lockyer that criminal charges were likely. And on Monday night, HP's board met for the second day in a row to discuss the weeklong drama that has riveted Silicon Valley and the technology industry as a whole.

Throughout it all, though, HP's stock price has barely budged from its five-year high. Investors and customers seem focused less on the day-to-day drama than on the engine behind the company's recent turnaround. The Palo Alto-based company has watched its stock price climb 27% this year — compared with a 4% rise for the blue-chip Standard & Poor's 500 index and a 28% drop for archrival Dell Inc.

"If Hurd were involved," said Charles Elson, chairman of the Center for Corporate Governance at the University of Delaware, "it would make a giant mess catastrophic."

"If Hurd were involved," said Charles Elson, chairman of the Center for Corporate Governance at the University of Delaware, "it would make a giant mess catastrophic." Hurd, recruited from NCR Corp. to succeed CEO Carly Fiorina, is widely seen as the company's chief executive.

Analysts and corporate governance experts said the mounting pressure on Dunn made it unlikely that she would remain nonexecutive chairwoman of the iconic computer and printer maker. But if it turns out that Hurd knew about potentially illegal activities, HP could face a much bigger problem: Where to find a new CEO?

"Hurd cut 15,300 jobs — about 10% of its workforce — and revamped product lines. The company has topped analysts' profit estimates in every quarter since he took over. More low-profile than Fiorina, Hurd immediately began remaking HP, which had floundered in the years after its $19-billion acquisition of rival Compaq Computer Corp. He cut 15,300 jobs — about 10% of its workforce — and revamped product lines. The company has topped analysts' profit estimates in every quarter since he took over.

The continuing "soap opera" shows that the board is nearly irrelevant in day-to-day management of the company, said Daniel Morgan, a portfolio manager at Synovus Investment Advisors, which owns 30,000 HP shares.

Morgan downplayed the new investigations, saying that with so many new laws as well as Securities and Exchange Commission rules dictating how corporate boards should act, investors are beginning to expect that any disclosure will bring a federal inquiry.

"The investigations don't mean as much now as they would have 10 years ago," he said.

Some observers noted that Hurd could even emerge from the scandal with more influence and power within HP — as long as the list of investigations that grows longer...
by the day doesn't become too distracting.

The FBI and the U.S. attorney's office for the Northern District of California announced a joint investigation Monday but otherwise declined to comment. The House Energy and Commerce Committee made a request for information about HP's internal investigation into media leaks.

The scandal erupted last week when it came to light that Dunn in January had hired private investigators to look into leaks of board discussions. Those investigators allegedly used "pretexting" to look at the telephone records of board members and several reporters who cover the company.

Pretexting is a form of subterfuge in which an investigator poses as the account owner to gain access to that person's records. So in this case, it's likely that investigators posed as board members or reporters to get their records. With the increasing popularity of accessing accounts online, pretexting can be done relatively easily if an investigator has enough personal information.

The investigation identified board member George A. Keyworth II as the person sharing internal HP discussions with reporters. He was asked to resign in May but refused. The company has since said it won't renominate Keyworth to the board.

But HP board member Thomas J. Perkins, a venture capitalist whose firm was behind the rise of many top Silicon Valley start-ups, quit the board in protest. He later said his own phone records had been targeted in Dunn's probe. The Securities and Exchange Commission is investigating whether HP properly disclosed the circumstances of Perkins' departure.

HP has said it contracted the leak probe to a private investigation company, which in turn hired another firm to access the phone records. None of the investigation companies have been identified.

Dunn said she did not know of the techniques used to get the phone records and apologized last week to the reporters whose logs were accessed.

Few observers expect Dunn to face criminal charges.

But several suggested that the scandal showed, at best, terrible judgment on Dunn's part. She may be forced out to avoid becoming a distraction that could gradually harm HP's business prospects.

The HP board's actions "give governance a bad name, and governance already has a bad name," said David Yoffie, a professor at Harvard Business School.

The board faces a difficult period, in part because its actions could deter employees from contacting board members with early warnings about business concerns.

"After the pretexting, who is going to call the directors and who can they call?" said Elson, the corporate governance expert. "It emasculates the board — it's like a pre-Enron board, totally dependent on management for information."

Tim Bajarin, president of consulting firm Creative Strategies in Campbell, Calif., said unless Hurd faced criminal charges — "and I can't believe for a second that's an issue with Hurd" — the chief executive should come out of the mess "an even stronger influence on the board."

Even the board could be benefiting from his success, demonstrated by the lack of shareholder efforts to remove any board members, said technology analyst Rob Enderle in San Jose.

"This is a board that ousted Carly and brought in someone who actually raised the performance of the company," he said. "Typically, you don't punish someone for that."