

# DM EXTRA!

October 5, 2006

## Beyond the ABCs of Pretexting

What is "pretexting" and how has it become a matter of concern to directors?

### Director Summary >

This DMX A) defines pretexting, B) explains why it is in the news, and C) suggests what lessons directors can derive from the current pretexting scandal.

#### Pretexting Defined

Pretexting means inventing a story (or pretext) to trick someone to tell you something they might not tell you otherwise. The term is so new that the spell check function on most computers will inform you there's no such word. Yet now, because of a scandal that has occurred at **Hewlett-Packard** (described on the next page) many directors are looking it up.

Clearly, pretexting is unethical. Soon it will be illegal. Right now, the legal issues are murky.

The practice could be found illegal under the **Uniform Deceptive Trade Practices Act** of 1964/1966. Although this Act has been

adopted in most states, it has not been tested in court.

Furthermore, under the **Gramm-Leach-Bliley Act** of 1999, it is illegal for anyone to:

- use false, fictitious or fraudulent statements or documents to get customer information from a financial institution or directly from a customer of a financial institution.
- use forged, counterfeit, lost, or stolen documents to get customer information from a financial institution or directly from a customer of a financial institution.
- ask another person to get someone else's customer information using false, fictitious, or fraudulent statements or using false, fictitious, or fraudulent documents or forged, counterfeit, lost, or stolen documents.

In the case of Hewlett-Packard, the information was not obtained from a financial insti-

### About NACD

**National Association of Corporate Directors (NACD)**, an independent not-for-profit organization founded in 1977, is the country's only membership organization devoted exclusively to improving corporate board performance. The NACD conducts educational programs and standard-setting research, and provides information and guidance on a variety of board governance issues and practices. Membership comprises board members from U.S. and overseas companies ranging from large publicly held corporations to small over-the-counter, closely held, and private firms. NACD lists all interested members on The Director's Registry, which is used by member companies and others that seek qualified directors. With chapters in many major cities providing educational programs and networking opportunities, NACD operates at both a national and local level. To educate the corporate community and to provide networking links among NACD members, the NACD holds an annual Corporate Governance Conference, where it presents a Director of the Year Award.



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tution, so Gramm-Leach-Bliley does not directly apply. There are 10 bills against pretexting pending in Congress. Although none has yet been signed into law, the bills provide a strong indication that at the very least, the practice is unethical.

### Why Pretexting Is in the News

According to Hewlett-Packard's most recent quarterly report (the [Form 8-K filed in September 2006 for the third quarter](#)) investigators hired by the company impersonated seven board members, two executives, and nine reporters—as well as some extended family members—to obtain phone records in the search to identify a director, ultimately identified as **George Keyworth**, who was allegedly “leaking” information to the press (see page 4). In its September filing, HP said that the company had suffered “multiple leaks of confidential HP information,”

including information relating to board meetings, dating back to at least 2005.

The admission of pretexting has triggered Congressional hearings, as well as investigations by the **Securities and Exchange Commission (SEC)**, the **Department of Justice**, and the **state of California**.

The HP board did not nominate Mr. Keyworth for another term; he is no longer on the board. Another board member, **Thomas Perkins**, resigned in May 2006—reportedly in protest of how HP handled the matter. In September 2006, **Ann Baskins**, HP's chief counsel, resigned over the matter, after 24 years at the company, 21 of them as an officer. A report prepared by an independent law firm not previously associated with the company stated that Ms. Baskins had been briefed on the practice. The company's chief ethics officer, senior counsel **Kevin Hunsucker**, had told Ms. Baskins that the practice was

## LETTER FROM ROGER RABER

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“One should expect that the expected can be prevented, but the unexpected should have been expected.”  
**Norman Augustine\***

This Law #55 in Norm Augustine's classic book on business risks, captures well the challenge of being a director. That's fitting, since the author, retired CEO and Chair of Lockheed-Martin and a member of the NACD board of directors, has served on several major company boards.

Directors must constantly learn new lessons about risks. With every new season there's a new previously “unexpected” issue that must now be monitored—and to some extent “expected” according to Law #55, and according to life.

These days, the new “#55” issue is “pretexting,” which by company admission occurred at Hewlett-Packard. Pretexting is the practice of obtaining information under false pretenses (using a “pretext”). Press reports say Hewlett Packard managers used this technique to find out which of their directors had spoken (“leaked”) to the press. So pretexting, once relegated to the world of small-time telemarketers, has grown overnight to become the subject of high-profile Congressional hearings. It's the scandal du jour.

Many if not most conscientious directors have

studied up on the term “pretexting” in recent days. The rush to understand recalls directors taking crash courses in “speculative derivatives” (after Barings Bank), “off-balance sheet partnerships” (after Enron), and most recently “options repricing” and “options backdating” (tarnishing too many companies to mention).

The Monday morning quarterbacks will say “You should have known.” But directors can't possibly know about every potential risk. Once a behavior does prove to be risky, however, directors must add it to their vocabulary and understanding. Hence this DMX on the once-arcaic, now mainstream topic of “pretexting.”

As educators of directors, we at NACD pledge to keep up with “unexpected” risks, try to “expect” them, and—best of all—prevent them from happening in the first place. The topic goes deeper than pretexting. Taking a cautionary lesson from this complex story, directors need to establish a strong system of risk oversight, cultivate healthy board dynamics, and above all set a strong ethical example.

Roger W. Raber

\**Augustine's Laws*, Sixth Edition. New York: Viking Press, 1997

“not unlawful,” elaborating on this assertion in a memo. He has since been fired.

Prior to the scandal, the company had separated the chair and CEO positions, with **Patricia Dunn** serving as chair and **Mark Hurd** serving as CEO. Ms. Dunn has resigned and Mr. Hurd has become chair and CEO, asking an independent law firm to investigate and report on the scandal. When Ms. Dunn resigned, both she and Mr. Hurd made statements that would indicate mutual respect and trust, but there has been speculation that the blame game may begin soon.

Ms. Dunn, Mr. Hurd, Mr. Hunsucker, and **Anthony Gentilucci**, global security manager, have all been asked or subpoenaed to testify before the Oversight and Investigations subcommittee of the House Energy and Commerce Committee, chaired by **Rep. Ed Whitfield** (R-KY).

The subcommittee had been investigating the relationship between data brokers and pretexting for more than seven months before this scandal broke. The HP scandal increases the chances that this will be a high-profile issue in 2007 and beyond. (Congress adjourned at the end of September to prepare for November elections, but will be back for its traditional “lame duck” session in December.)

Energy Committee Chair **Rep. John Dingell** (D-MI), asked Ms. Dunn: “Why weren’t you paying attention at briefings and why didn’t you read the reports that raised red flags?” and added “Where was your board leadership and responsibility?”

Mr. Hurd has spoken, along with several others (see links at the end of this report). (The other three, and seven private investigators, invoked their Fifth Amendment right to remain silent.) In addition, testimony has come from several employees—including one who sent an email to Mr. Gentilucci questioning the legality of pretexting. Mr. Gentilucci never sent that memo on to company lawyers, however.

Broadening the pretexting problem is the issue of spying. The *New York Times* has reported that HP conducted feasibility studies on planting spies in the San Francisco news bureaus of CNET and the *Wall Street Journal* as part its leak investigation.

### **What Directors Can Do About Pretexting—And More**

Directors are not powerless when a crisis like this hits. Individual directors can resign, and the board and committees can take action. This is a key point in our publication, *Board Leadership for the Company in Crisis* by **Suzanne Hopgood** and **Michael Tankersley**.

The pretexting storm is a typical example of how important it is to have a code of ethics in place—and,

**“Why weren’t you paying attention at briefings and why didn’t you read the reports that raised red flags?”**

**– Rep. John Dingell**

most importantly, in mind—so that things like this don’t happen.

Directors need to use their common sense to ask “Does this seem right to me?” If not, they need to object and resist.

The same goes for CEOs. On September 25, 2006, Mr. Hurd told *BusinessWeek*: “I’m a detail-oriented guy by trade. But when you have a place of this scale, you have to pick your spots where you’re going to go dive. Compliance wasn’t the first process I was going to go look at. I was going to go look at the performance of the company.” In retrospect, he may wish he had gotten back up on that diving board and taken a “deep dive” into ethics.

Having an ethics code can help, and is in fact required of public companies. Under Section 406 of the Sarbanes-Oxley Act, all public companies registered to sell securities in the U.S. must disclose in their annual report whether or not the company has adopted a written code of ethics. If they don’t have a code, they have to explain why. Company codes can vary, but to meet the SEC requirements developed after Sarbanes-Oxley, a company’s code of ethics should be designed to prevent fraud or other illegal behavior and promote the following:

1. Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
2. Full, fair, accurate, timely and understandable disclosure in reports and documents that an issuer files with, or submits to, the SEC and in other public communications made by the issuer;
3. Compliance with applicable governmental laws, rules and regulations;
4. Prompt internal reporting of code violations to “an appropriate person or persons” identified in the code; and
5. Accountability for adherence to the code.

Some HP board members have already taken some individual actions and, despite reported infighting, some collective ones. Before his resignation, Mr. Perkins asked HP’s nominating and governance committee to investi-

## The entire HP story reveals the importance of board dynamics.

gate the techniques used to conduct the investigation. The investigation turned up pretexting, and outside counsel reported that it “could not confirm that the techniques employed by the outside consulting firm, and the party retained by that firm complied in all respects with applicable law.”

Also, with respect to the problem of leaks, HP management did ask external legal counsel to interview all HP board members in early 2005 and got each of them to recommit to their duty of confidentiality. Unfortunately, though, the leaks continued. When pretexting revealed Mr. Keyworth as the one talking to the press, the board asked Mr. Keyworth to resign. He refused, but Mr. Perkins then quit.

Following these developments, the HP governance committee recommended that HP strengthen controls relating to investigations be strengthened and that HP management ensure that all aspects of HP’s investigations comply with applicable laws and with HP’s code of ethics. Separately, HP agreed to reimburse directors Perkins and Keyworth for any expenses they incur as a result of the pretexting investigation. The agreements give Perkins and Keyworth the right to try to sue private investigators and other third parties who may have used unlawful methods to obtain personal information about them or their family members.

### Lessons Learned

All these measures, while commendable, were either too much, too little, and/or too late. Having the board involved in setting and promulgating a code of ethics could have prevented both the leak and the pretexting following the leak. Two wrongs don’t make a right, and boards should make sure the right things happen from the start. For a good NACD handbook on ethics, see *The Corporate Directors Ethics and Compliance Handbook*, by Ronald Zall, et alia.

Furthermore, the entire HP story reveals the importance of board dynamics. Directors need to communicate openly and work effectively with each other and with management, as recommended in NACD’s *Board Dynamics Handbook*, by Lorin Letendre and Ann James.

Such skills, along with impeccable ethics, could have saved this situation before it spiraled into a crisis.

## LEAKING: A PRIMER

HP reportedly authorized pretexting based on suspicions that one of its outside directors had “leaked” company news to the press. This raises more legal issues.

The duty of loyalty implies a duty to keep undisclosed company information confidential. Most companies, including HP, have written policies reminding directors of that duty. But in the case of HP, the director may have believed that his comments to the press were in fact authorized by HP. According to some HP press releases, the company had asked the director to talk to the press. For a discussion of the HP facts, see <http://www.ffhsj.com/secreg/pdf/sc060928.pdf>

Is there a strict duty of confidentiality under the director’s duty of loyalty? According to Reginald Brown, an attorney with Wilmer Hale who represents Mr. Keyworth, “As for the duty of confidentiality, there is no such duty under Delaware law, or at least no per se duty separate and apart from the duty of loyalty and duty of care, both of which may actually require directors to speak to the press on certain occasions.”