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Wal-Mart's Firing Of a Security Aide Bites the Firm Back

He Knew of 'Project Red,'
Secret Plan Mulling Ideas
Like a Sam's Club Spinoff

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Wal-Mart Stores Inc. is embroiled in a messy fight with a security engineer whom it fired last month - but who it now fears left with information about a secret plan to boost the giant retailer's lagging stock price.

The program, called "Project Red," included a consideration of, among other ideas, a possible spinoff of Wal-Mart's Sam's Club warehouse-store unit.

So secret was Project Red that its reports were encrypted, and consultants who worked on it last fall toiled in a locked office that was swept for electronic bugs. But this weekend, it turned out that computer hard drives Wal-Mart believes contain Project Red information were in the car of the wife of Bruce Gabbard, a security engineer Wal-Mart had once entrusted with guarding its secrets. The company fired him early last month for taping calls between a Wal-Mart executive and a New York Times reporter.


On Saturday, Mr. Gabbard's attorneys were eventually able to reach the security engineer's wife and the hard drives were delivered to the Benton County, Ark., prosecutor's office. As of yesterday, Bentonville-based Wal-Mart had not yet retrieved them.



On Friday, Wal-Mart sued Mr. Gabbard, accusing him of leaking trade secrets in articles published in The Wall Street Journal. The suit in Benton County circuit court said Mr. Gabbard possessed "highly confidential information about Wal-Mart's strategic planning," an apparent reference to Project Red. A judge granted a temporary restraining order barring Mr. Gabbard from disclosing confidential information.

Wal-Mart wouldn't comment on any specifics of Project Red. In a statement, it said: "Our senior management, our board and their advisors regularly conduct thorough, strategic reviews of all aspects of our business. That's just good

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governance. We look at a full range of alternatives, many of which are considered and rejected, and we will not comment specifically on any of them."

Wal-Mart, long widely admired as a smooth-running retail machine, lately has been on the defensive over its labor policies, health benefits and stock price. Its shares are off 20% over the past five years, versus a 75% gain for rival **Target** Corp. Though Wal-Mart remains robustly profitable -- earning \$11.28 billion last year -- some investors are clamoring for it to take radical steps to become even more so.

Some episodes at the company have had the flavor of a corporate soap opera. A former vice chairman pleaded guilty last year to fraud and tax evasion related to using company funds for custom-made alligator boots and a dog kennel, among other things. He had said he was reimbursing himself for payments he made to help keep unions out of Wal-Mart. In December, Wal-Mart fired a senior marketing executive, saying she had had a personal relationship with a subordinate and accepted gifts such as pricy vodka from a vendor. When she sued, Wal-Mart filed in court what it said were suggestive emails.

Mr. Gabbard, a 44-year-old Marine Corps veteran and former reserve deputy sheriff, spent 19 years at Wal-Mart, the last few in the Threat Research and Assessment Group. The team hunted computer hackers outside the company and regularly searched emails and monitored phones looking for misbehavior or leaks. It worked in a highly secure area nicknamed the Bat Cave.

Mr. Gabbard says he was tasked with the electronic monitoring of directors' meetings, in a hunt for anyone who might be spying on them. This gave him unusual access to information. He says that two years ago, while manning a countersurveillance desk during a board meeting in Puerto Rico, he listened as directors debated a multibillion-dollar settlement offer in a big lawsuit alleging sex bias in pay and promotions. The board voted to reject it for several reasons, including the bad publicity it would generate, Mr. Gabbard said in an interview in late March. Wal-Mart declined to comment.

Mr. Gabbard was part of the security team for Project Red. Wal-Mart hired two teams of McKinsey & Co. consultants, so neither could have a full grasp of the project. Cameras inside a room recorded their activities, according to Mr. Gabbard. The security team was responsible for encrypting data and reports and for creating passwords to keep the work under electronic lock and key. The project, involving heads of domestic and overseas units, finance, legal, procurement and a firm that manages money for the founding Walton family, finished late last year, an internal document shows. McKinsey declined to comment, citing client confidentiality.

In January, an outside attorney for Wal-Mart questioned Mr. Gabbard and some colleagues about unauthorized taping of phone calls between a Times reporter and Mona Williams, Wal-Mart vice president of corporate communications. Mr. Gabbard says he was asked what gave him the right to eavesdrop on a vice president's conversation. He says he replied: "I'm the guy listening to the board of directors when Lee Scott is excused from the room," referring to the Wal-Mart chief executive. He says the lawyer dropped the topic.

But Wal-Mart put Mr. Gabbard on paid leave as an outside forensics team investigated his group's activities. The team came across a project -- which Mr. Gabbard maintains was authorized -- in which he intercepted workers' pager messages containing sensitive information. Because the pager frequency isn't secure, he also intercepted outsiders' calls.

Mr. Gabbard returned to work in mid-February and got a written rebuke for using bad judgment in taping a reporter's calls without authorization. No contention was made that the taping was illegal. About two weeks later, Wal-Mart fired him and said the U.S. attorney for the Western District of Arkansas was investigating possible violations of law. U.S. Attorney Bob Balfe yesterday said he was reviewing the latest allegations and declined further comment.

Mr. Gabbard admits he wasn't authorized to record calls with a reporter. He says he felt pressured to find the source of leaks that painted Wal-Mart in an unflattering light, and felt betrayed by his public dismissal. "When Wal-Mart fired me and went public with it, I felt it was character assassination. They were trying to make me look like I was a whack job and they were taking the moral high ground," Mr. Gabbard says.

In a Journal story on Wednesday, Mr. Gabbard outlined the breadth of his group's activities. The article said his group's activities included sending an undercover operative wearing a microphone to spy on a protest group that planned to attend the 2006 annual meeting.

In a recent email, Mr. Gabbard said he was "going underground" as a result of the furor created by that article. An attorney for him, W.H. Taylor, yesterday said a three-hour meeting he had with Wal-Mart on Saturday was "very congenial." Declining to give specifics, the lawyer added, "I'm hopeful I can negotiate an end to it."

It isn't clear why Mr. Gabbard was willing to talk to reporters about Project Red. But he recently said that rather than splitting itself up to increase the stock price, in his view Wal-Mart should return to founder Sam Walton's values of "customer service and respect for the individual."

Wal-Mart initially suspected Mr. Gabbard knew more about Project Red than he should when he turned his laptop in after he was fired. It contained references to the project. Mr. Gabbard's job was to make sure the information was secure, but not to look at it.

But Wal-Mart took no action until this weekend, after the Journal started asking questions about Project Red. Wal-Mart outside counsel Marshall Ney met Saturday with Mr. Gabbard's attorney and learned that the former employee had two disk-drives containing Wal-Mart material -- which had been double and triple encrypted to prevent access.

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