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IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

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| IN RE: EBAY, INC. | . | CONSOLIDATED |
| SHAREHOLDERS LITIGATION | : | C.A. No. 19988-NC |

**MEMORANDUM OPINION**

Date Submitted: September 16, 2003
Date Decided: January 23, 2004
Date Revised: February 11, 2004

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CHANDLER, Chancellor

Shareholders of eBay, Inc. filed these consolidated derivative actions against certain eBay directors and officers for usurping corporate opportunities.[1] Plaintiffs allege that eBay's investment banking advisor, Goldman Sachs Group, engaged in "spinning," a practice that involves allocating shares of lucrative initial public offerings of stock to favored clients. In effect, the plaintiff shareholders allege that Goldman Sachs bribed certain eBay insiders, using the currency of highly profitable investment opportunities-opportunities that should have been offered to, or provided for the benefit of, eBay rather than the favored insiders. Plaintiffs accuse Goldman Sachs of aiding and abetting the corporate insiders breach of their fiduciary duty of loyalty to eBay.

The individual eBay defendants, as well as Goldman Sachs, have moved to dismiss these consolidated actions for failure to state a claim and for failure to make a pre-suit demand on eBay's board of directors as required under Chancery Court Rule 23.1, For reasons I briefly discuss below, I deny all of the defendants' motions to dismiss.

[1] Two separate derivative actions were filed (CA. No. 19988 and C.A. No. 19996) and the Court consolidated them on December 3, 2002, with the complaint in C.A. No. 19988 treated as the operative complaint.

## I. BACKGROUND FACTS

The facts, as alleged in the complaint, are straightforward. In 1995, defendants Pierre M. Omidyar and Jeffrey Skoll founded nominal‘defendant eBay, a Delaware corporation, as a sole proprietorship. eBay is a pioneer in online trading platforms, providing a virtual auction community for buyers and sellers to list items for sale and to bid on items of interest. In 1998, eBay retained Goldman Sachs and other investment banks to underwrite an initial public offering of common stock. Goldman Sachs was the lead underwriter. The stock was priced at $18 per share. Goldman Sachs purchased about 1.2 million shares. Shares of eBay stock became immensely valuable during 1998 and 1999, rising to $175 per share in early April 1999. Around that time, eBay made a secondary offering, issuing 6.5 million shares of common stock at $170 per share for a total of $1.1 billion. Goldman Sachs again served as lead underwriter. Goldman Sachs was asked in 2001 to serve as eBay's financial advisor in connection with an acquisition by eBay of PayPal, Inc. For these services, eBay has paid Goldman Sachs over $8 million.

During this same time period, Goldman Sachs “rewarded” the individual defendants by allocating to them thousands of IPO shares, managed by Goldman Sachs, at the initial offering price. Because the IPO

market during this particular period of time was extremely active, prices of initial stock offerings often doubled or tripled in a single day. Investors who were well connected, either to Goldman Sachs or to similarly situated investment banks serving as IPO underwriters, were able to flip these investments into instant profit by selling the equities in a few days or even in a few hours after they were initially purchased.

The essential allegation of the complaint is that Goldman Sachs provided these IPO share allocations to the individual defendants to show appreciation for eBay's business and to enhance Goldman Sachs' chances of obtaining future eBay business. In addition to co-founding eBay, defendant Omidyar has been eBay's CEO, CFO and President. He is eBay's largest stockholder, owning more than 23% of the company's equity. Goldman Sachs allocated Omidyar shares in at least forty IPOs at the initial offering price. Omidyar resold these securities in the public market for millions of dollars in profit. Defendant Whitman owns 3.3% of eBay stock and has been President, CEO and a director since early 1998. Whitman also has been a director of Goldman Sachs since 2001. Goldman Sachs allocated Whitman shares in over a 100 IPOs at the initial offering price. Whitman sold these equities in the open market and reaped millions of dollars in profit. Defendant Skoll, in addition to co-founding eBay, has served in

various positions at the company, including Vice-President of Strategic Planning and Analysis and President. He served as an eBay director from December 1996 to March 1998. Skoll is eBay's second largest stockholder, owning about 13% of the company. Goldman Sachs has allocated Skoll shares in at least 75 IPOs at the initial offering price, which Skoll promptly resold on the open market, allowing him to realize millions of dollars in profit. Finally, defendant Robert C. Kagle has served as an eBay director since June 1997. Goldman Sachs allocated Kagle shares in at least 25 IPOs at the initial offering price. Kagle promptly resold these equities, and recorded millions of dollars in profit.

## II. ANALYSIS

### *A. Demand Futility*

Plaintiffs bring these actions on behalf of nominal defendant eBay, seeking an accounting from the individual director defendants of their profits from the IPO transactions as well as compensatory damages from Goldman Sachs for its participation (aiding and abetting) in the eBay insiders' breach of fiduciary duty. Court of Chancery Rule 23.1 requires that a shareholder make a demand that the corporation's board pursue potential litigation before initiating such litigation on the corporation's behalf. When a plaintiff

fails to make a demand on the board of directors, the plaintiff must plead with factual particularity why the demand is excused.

eBay's board of directors consists of seven members. Three are the individual defendants-Whitman, Omidyar and Kagle; defendant Skoll is not presently a director. All four of these individual defendants received IPO allocations from Goldman Sachs. As a result, the three current directors of eBay who received IPO allocations (Omidyar, Whitman and Kagle) are clearly interested in the transactions at the core of this controversy.

Although the other four directors of eBay (Cook, Lepore, Schultz and Bourguignon) did not participate in the "spinning," plaintiffs allege that they are not independent of the interested directors and, thus, demand is excused as futile. Since three of the seven present eBay directors are interested in the transactions that give rise to this litigation, plaintiffs need only demonstrate a reason to doubt the independence of one of the remaining four directors. Plaintiffs allege that directors Cook, Lepore, Schultz and Bourguignon all have "close business and personal ties with the individual defendants" and are incapable of exercising independent judgment to determine whether eBay should bring a breach of fiduciary duty action against the individual defendants. Plaintiffs allege, for example, that Schultz is a member of Maveron LLC, an investment advisory company in which Whitman has

made significant personal investments. More significantly, plaintiffs allege that Cook, Lepore, Schultz and Bourguignon have received huge financial benefits as a result of their positions as eBay directors and, furthermore, that they owe their positions on the board to Omidyar, Whitman, Kagle and Skoll.

eBay pays no cash compensation to its directors, but it does award substantial stock options. For example, in 1998, when Cook joined eBay's board, it awarded him 900,000 options at an exercise price of $1.555. One fourth of these options (225,000) vested immediately, and an additional 2% vests each subsequent month so long as Cook remains a director. In 1998, after Cook had joined the board, eBay adopted a director's stock option plan pursuant to which each non-employee director was to be awarded 30,000 options each year (except for 1999, when no additional options were awarded). As of early 2002, Cook beneficially owned 903,750 currently exercisable options, and an additional 200,000 shares of eBay stock. The complaint notes that the exercise price on 900,000 of the options originally awarded to Cook is $1.555 per share. At the time the complaint was filed in this case, eBay stock was valued at $62.13 per share. At an exercise price of $1.555, Cook's original option grant is thus worth millions of dollars. In

addition, the stock options awarded in 2000, 2001 and 2002, which are not yet fully vested, and will never vest unless Cook retains his position as a director, are worth potentially millions of dollars.

The complaint further alleges that director Schultz, Lepore and Bourguignon are similarly situated. That is, the stock options granted to these directors, which are both vested and unvested, are so valuable that they create a financial incentive for these directors to retain their positions as directors and make them beholden to the defendant directors. As a result, plaintiffs contend that it is more than reasonable to assume that an individual who has already received, and who expects to receive still more, options of such significant value could not objectively decide whether to commence legal proceedings against fellow directors who are directly responsible for the outside directors' continuing positions on the board.

I need not address each of the four outside directors, as I agree with plaintiffs that the particularized allegations of the complaint are sufficient to raise a reasonable doubt as to Cook's independence from the eBay insider directors who accepted Goldman Sachs' IPO allocations. Defendants resist this conclusion by pointing out that Whitman, Kagle, Omidyar and Skoll, collectively with management, control 40% of eBay's common stock, which they argue is insufficient to allege control or domination. Defendants also

contend that the options represent past compensation and would not effectively disable a director from acting fairly and impartially with respect to a demand. These arguments are unpersuasive in these circumstances.

First, defendants must concede that certain stockholders, executive officers and directors control eBay. For example, eBay's form 10-K for the fiscal year ending December 3 1, 2000 notes that eBay's executive officers and directors Whitman, Omidyar, Kagle and Skoll (and their affiliates) own about one-half of eBay's outstanding common stock.[2] As a result, these eBay officers and directors effectively have the ability to control eBay and to direct its affairs and business, including the election of directors and the approval of significant corporate transactions. Although the percentage of ownership may have decreased slightly from the time eBay filed the 2000 10-K, the decrease is insufficient to detract from the company's acknowledgement that these four individual defendants control the company and the election of directors.

Second, although many of the options awarded to Cook and the other purported outside directors have in fact vested, a significant number of options have not yet vested and will never vest unless the outside directors

[2] A 10-K is appropriately considered in ruling on a motion to dismiss, especially when referenced in the complaint.

remain directors of eBay. Given that the value of the options for Cook (and allegedly for the other outside directors) potentially run into the millions of dollars, one cannot conclude realistically that Cook would be able to objectively and impartially consider a demand to bring litigation against those to whom he is beholden for his current position and future position on eBay's board. With the specific allegations of the complaint in mind, I conclude that plaintiffs have adequately demonstrated that demand on eBay's board should be excused as futile.

*B. Corporate Opportunity*

Plaintiffs have stated a claim that defendants usurped a corporate opportunity of eBay. Defendants insist that Goldman Sachs' IPO allocations to eBay's insider directors were "collateral investments opportunities" that arose by virtue of the inside directors status as wealthy individuals. They argue that this is not a corporate opportunity within the corporation's line of business or an opportunity in which the corporation had an interest or expectancy.[3] These arguments are unavailing.

First, no one disputes that eBay financially was able to exploit the opportunities in question. Second, eBay was in the business of investing in

[3] *See Broz v. Cellular Info. Sys. Inc., 673* A.2d 148, 155 (Del. 1996) (listing factors to find corporate opportunity).

securities. The complaint alleges that eBay "consistently invested a portion of its cash on hand in marketable securities." According to eBay's 1999 10-K, for example, eBay had more than $550 million invested in equity and debt securities. eBay invested more than $18 1 million in "short-term investments" and $373 million in "long-term investments." Thus, investing was "a line of business" of eBay. Third, the facts alleged in the complaint suggest that investing was integral to eBay's cash management strategies and a significant part of its business. Finally, it is no answer to say, as do defendants, that IPOs are risky investments. It is undisputed that eBay was never given an opportunity to turn down the IPO allocations as too risky.[4]

Defendants also argue that to view the IPO allocations in question as corporate opportunities will mean that every advantageous investment opportunity that comes to an officer or director will be considered a corporate opportunity. On the contrary, the allegations in the complaint in this case indicate that unique, below-market price investment opportunities were offered by Goldman Sachs to the insider defendants as financial inducements to maintain and secure corporate business. This was not an instance where a broker offered advice to a director about an investment in a

[4] Defendants' counsel implied at oral argument that these investments were so risky that defendants may have lost money on some or all of them. That is a factual assertion that certainly contradicts allegations in the complaint, but of course I may not consider it on a motion to dismiss.

marketable security. The conduct challenged here involved a large investment bank that regularly did business with a company steering highly lucrative IPO allocations to select insider directors and officers at that company, allegedly both to reward them for past business and to induce them to direct future business to that investment bank. This is a far cry from the defendants' characterization of the conduct in question as merely "a broker's investment recommendations" to a wealthy client.

Nor can one seriously argue that this conduct did not place the insider defendants in a position of conflict with their duties to the corporation. One can realistically characterize these IPO allocations as a form of commercial discount or rebate for past or future investment banking services. Viewed pragmatically, it is easy to understand how steering such commercial rebates to certain insider directors places those directors in an obvious conflict between their self-interest and the corporation's interest. It is noteworthy, too, that the Securities and Exchange Commission has taken the position that "spinning" practices violate the obligations of broker-dealers under the "Free-riding and Withholding Interpretation" rules.[5] As the SEC has explained, "the purpose of the interpretation is to protect the integrity of the public offering system by ensuring that members make a bona fide public

[5] *See Approval of Amendments to Free-riding and Withholding Interpretation,* NASD Notice 98-48, 1998 WL 1707944, at *1 (July 1998).

distribution of 'hot issue' securities and do not withhold such securities for their own benefit or use the securities to reward other persons who are in a position to direct future business to the member."[6]

Finally, even if one assumes that IPO allocations like those in question here do not constitute a corporate opportunity, a cognizable claim is nevertheless stated on the common law ground that an agent is under a duty to account for profits obtained personally in connection with transactions related to his or her company. The complaint gives rise to a reasonable inference that the insider directors accepted a commission or gratuity that rightfully belonged to eBay but that was improperly diverted to them. Even if this conduct does not run afoul of the corporate opportunity doctrine, it may still constitute a breach of the fiduciary duty of loyalty.[7] Thus, even if one does not consider Goldman Sachs' IPO allocations to these corporate insiders-allocations that generated millions of dollars in profit-to be a corporate opportunity, the defendant directors were nevertheless not free to accept this consideration from a company, Goldman Sachs, that was doing

[6] SEC Release No. 35059, Release No. 34-35059, 58 SEC Docket 451, 1994 WL 697640, at * 1 (Dec. 7, 1994).
[7] *Gibralt Capital Corp. v. Smith,* 2001 WL *647837,* at *9 (Del. Ch. May 8, 2001); *Thorpe v. CERBCO, Inc., 676* 2d 436,444 (Del. 1996).

significant business with eBay and that arguably intended the consideration as an inducement to maintaining the business relationship in the future.[8]

*C. Aiding and Abetting Claim*

Plaintiffs' complaint adequately alleges the existence of a fiduciary relationship, that the individual defendants breached their fiduciary duty and that plaintiffs have been damaged because of the concerted actions of the individual defendants and Goldman Sachs. Goldman Sachs, however, disputes whether it "knowingly participated" in the eBay insiders' alleged breach of fiduciary duty.[9] The allegation, however, is that Goldman Sachs had provided underwriting and investment advisory services to eBay for years and that it knew that each of the individual defendants owed a fiduciary duty to eBay not to profit personally at eBay's expense and to devote their undivided loyalty to the interests of eBay. Goldman Sachs also knew or had reason to know of eBay's investment of excess cash in marketable securities and debt. Goldman Sachs was aware (or charged with a duty to know) of earlier SEC interpretations that prohibited steering "hot issue" securities to persons in a position to direct future business to the

[8] RESTATEMENT (SECOND) OF AGENCY § *388* (1957).

[9] Knowing participation obviously is the fourth element of the claim for aiding and abetting. *See generally Jackson Nat'l Life Ins. Co. v. Kennedy, 741* A.2d 377,381 (Del. Ch. 1999).

broker-dealer. Taken together, these allegations allege a claim for aiding and abetting sufficient to withstand a motion to dismiss.

## III. CONCLUSION

For all of the above reasons, I deny the defendants' motions to dismiss the complaint in this consolidated action.

IT IS SO ORDERED.