

## Corporate & Financial Weekly Digest

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### **Craigslist Poison Pill and Right of First Refusal Rescinded by Delaware Chancery Court**

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On September 9, the Delaware Court of Chancery issued its decision in *eBay Domestic Holdings, Inc. v. Newmark, et al.*, which arose from a dispute between eBay and craigslist concerning eBay's decision to compete with craigslist in the online classifieds business while at the same time owning a substantial minority stake in craigslist.

In August 2004, eBay acquired a 28.4% interest in craigslist, becoming one of three shareholders in the privately held company. The terms of eBay's investment were memorialized in a Shareholders' Agreement, which set forth: (1) eBay's confidentiality obligations as a craigslist stockholder; (2) eBay's right to consent to certain transactions in which craigslist may engage; (3) numerous transfer restrictions on the shares owned by the three craigslist shareholders; (4) eBay's right to compete with craigslist, subject to certain consequences; and (5) the consequences if eBay chose to compete with craigslist. The Stock Purchase Agreement required eBay to approve a new charter for craigslist which provided for a three-person board of directors to be elected based on cumulative voting. The voting arrangement was such that each of the three shareholders—eBay, Craig Newmark and James Buckmaster—could elect one of three directors.

On June 29, 2007, eBay launched a direct competitor site to craigslist. Upon learning of the new site, craigslist sent eBay a "Notice of Competitive Activity" pursuant to the Shareholders' Agreement, which notice provided a 90-day cure period before eBay would lose (1) its consent rights, (2) its preemptive rights over the issuance of new shares, and (3) its right of first refusal over the remaining shareholders' shares. Upon eBay's failure to cure within the 90-day period, in January 2008, Mr. Newmark and Mr. Buckmaster, in their capacity as directors: (1) adopted a stockholder Rights Plan that restricted eBay from purchasing additional craigslist shares and limited eBay's ability to freely sell its craigslist shares to third parties; (2) implemented a staggered board through amendments to the craigslist charter that made it impossible for eBay to ever unilaterally elect another board member; and (3) sought to obtain a right of first refusal (ROFR) in favor of craigslist by offering to issue one new share of craigslist stock for every five shares held by a craigslist stockholder who granted an ROFR in craigslist's favor. Both Mr. Newmark and Mr. Buckmaster accepted the right of first refusal offer in their capacity as

stockholders and received new shares. eBay declined the offer and did not receive any new shares, and its ownership became diluted as a result of the ROFR.

In April 2008, eBay filed suit in the Delaware Court of Chancery, claiming that the January 2008 board actions breached Mr. Newmark's and Mr. Buckmaster's fiduciary duties to eBay as a minority shareholder.

First, the court applied the enhanced scrutiny test set forth in *Unocal Corp. v. Mesa Petroleum Co.* to determine whether the Rights Plan was a proportional response to a perceived threat to craigslist's corporate policy and effectiveness. In the court's view, poison pills "fundamentally are defensive devices" subject to Unocal scrutiny. The court determined that craigslist did not adopt the Rights Plan as a reasonable response to a perceived threat to corporate policy, but rather, that Mr. Newmark and Mr. Buckmaster resented eBay's decision to compete, and therefore adopted the Rights Plan as a punitive measure. Accordingly, the court rescinded the Rights Plan.

Second, the court applied the business judgment rule to the adoption of the staggered board because, in the court's view, the staggered board was not "a defensive measure at all" in light of the parties' circumstances. The court deemed the staggered board amendments to be a sound business judgment, noting that, "[p]reventing a competitor that is also a minority stockholder from unilaterally placing a director on the board so that confidential corporate information will not be freely shared with that competitor is a legitimate and rational business purpose." Thus, the court held that there was no breach of fiduciary duty by approving the staggered board amendment.

Finally, the court applied the entire fairness test to the passage of the ROFR, rather than the business judgment rule, because both Mr. Newmark and Mr. Buckmaster stood on both sides of the transaction. To prove that the ROFR was entirely fair, they had to prove that the transaction was effectuated at a fair price, and the product of fair dealing. In finding that the price was unfair, the court explained: "Although each craigslist stockholder had to grant a right of first refusal over the same number of shares to obtain a newly issued share, eBay had to surrender full transferability of its shares to craigslist, but [Buckmaster] and [Newmark] only had to substitute craigslist for themselves as the party holding a right of first refusal on their shares." The court ultimately held that Mr. Newmark and Mr. Buckmaster breached their fiduciary duty of loyalty by using their power as directors and majority shareholders to implement an interested transaction that was not entirely fair to eBay, and therefore the court rescinded the ROFR. (*eBay Domestic Holdings, Inc. v. Newmark*, 2010 WL 3516473 (Del. Ch. Sept. 9, 2010))

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