State Controller Steve Westly defends IPO profits as eBay exec

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Steve Westly made his tax documents public; view them online.

By Chris O'Brien
Mercury News

When he worked as a top executive at eBay, state Controller and gubernatorial candidate Steve Westly made $1.6 million through a controversial but widespread practice involving hot IPO shares.

During the dot-com boom, favored insiders often got lucrative stock from investment banks courting their companies' business. A Mercury News analysis of Westly's tax records shows that in 1999 and 2000, he bought pre-IPO shares in 189 companies — almost one of every five companies that went public — and often sold them on the first day of trading. He got the shares through brokerage accounts with six banks, including three that helped underwrite eBay's stock offerings.

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While Westly did nothing illegal, analysts say his actions could raise ethical issues as he gears up to run for governor next year. Westly said he faced no conflict in taking stock from banks because he was not involved in decisions about eBay's investment banking business. Instead, he said, brokers approached him and other eBay executives simply because of their high net worth.

"They probably went to 40, 50 people at eBay," Westly said. "This was well beyond the executive office. And the amount of shares they gave to each of us was typically small."

But critics say executives such as Westly got special access because of their positions at publicly traded companies. In fact, banks would no longer be allowed to offer Westly such accounts today. And the practice caused widespread anger among smaller investors who viewed it as an insider game that helped stack the deck against them.

"The banks weren't doing it because they liked the color of their eyes," said Nell Minow, chair of the Corporate Library, a governance advisory firm. "Their motto was probably that it couldn't hurt to have a friendly relationship with him because he might be helpful down the road. That's why they do things.

"Did he do anything wrong? No. Would he be allowed to do it again today? No."

The trading came to light last week when Westly released 10 years of federal and state income-tax returns, hoping to score political points. The other contenders in the race, state Treasurer Phil Angelides and Gov. Arnold Schwarzenegger, haven't released their latest returns yet.

Financial analysis

The documents provide an unusually candid look inside the finances of a key executive during the frothy dot-com era. According to a Mercury News analysis of Westly's trades:

■ He received pre-IPO shares in 30.5 percent of Silicon Valley companies and 18.9 percent of U.S. companies that went public in 1999 and 2000.

■ Of the 189 companies for which he got pre-IPO shares, he suffered losses on only 25.

■ He made $209,250 in IPO profits on an account with Goldman Sachs, the lead underwriter for eBay's IPO and secondary stock offerings. By comparison, eBay CEO Meg Whitman, who also sat on Goldman's board of directors, made $1.78 million through Goldman IPO trades.

■ The bulk of Westly's IPO profits — $1,056,000 — came from an account with Robertson Stephens, an underwriter on eBay's IPO and secondary offerings.

■ The next biggest chunk of gains — $329,074 — came through an account with Hambrecht & Quist, which helped underwrite eBay's secondary stock offering in April 1999.

"It certainly looks like the sets of actions that people call 'spinning,' " said Robert Daines, a professor of law and business in the Stanford Law School. "The banks look like they have incentive to do it for reasons that people called spinning. And he's getting a return without much risk."

The U.S. House Committee on Financial Services released a report in October 2002 that found spinning was commonplace during the tech boom. It singled out a handful of executives who had benefited, including three at eBay: Whitman, Jeffrey Skoll and founder Pierre Omidyar.

EBay settlement

In April 2005, the three agreed to settle a shareholder lawsuit over their IPO trades by paying $3 million to eBay.

Westly joined eBay in August 1997. During his three-year tenure, he oversaw at various points the company's international and premium services, marketing and business development.

Over a five-year period ending in 2003, he sold $246 million worth of eBay stock. But his net worth today is about half that. He has paid $63.29 million in state and federal taxes since 1998. He donated $15.76 million to charities. And he took some financial hits along the way.

In October 1999, according to his tax returns, Westly bet the Nasdaq had peaked. He paid $2.93 million for a hedge betting the index would fall. It didn't. And Westly lost $2.77 million in cash.

Post-eBay transactions

After leaving eBay in December 2000, Westly purchased a series of financial hedges and straddles to protect the value of his unsold eBay stock. But eBay's stock unexpectedly rose, and Westly lost about $57 million in cash.

"That is something many, many executives did," Westly said. "And there were many more that wish they didn't. You never know exactly how the market will behave."

At one point, Westly's duties at eBay included responsibility for mergers and acquisitions. But the company purchased only a handful of companies during Westly's time at eBay and never used investment bankers on the deals, according to an eBay spokesman.

Although Westly was one of the top five executives when eBay went public in 1998, he said Whitman and others made the decisions about banking.

After eBay's IPO in August 1998, Westly said he was approached by a number of brokers. He opened accounts in early 1999 at several trading houses to maintain a diversified portfolio.

Over the next two years, Westly said he largely left the day-to-day management of the accounts to his brokers. He typically got only 100 to 500 shares, he noted.

But at the time, such small chunks could lead to big profits, especially because clients like Westly got the stock at below-market value.

"There were no legal rules against spinning," said John Coffee, director of the Center of Corporate Law at Columbia University Law School. "The only question is one of ethics. And there, the question is this: Did Goldman see him as a future dispenser of future business? There's no way to know."

In 2003, as part of a $1.4 billion settlement with regulators, 10 investment banks agreed not to give executive officers "hot" IPO shares. Westly said he hadn't followed these developments closely because he was busy with the election.

"I was now financial officer for the sixth-largest economy in the world," Westly said. "I was quite substantially busy with my new duties."

QUICK RETURNS

Here's an example of how state Controller Steve Westly made money off hot shares he got from investment banks when he was at eBay:

On Dec. 1, 1999, Robertson Stephens allocated 500 shares in McAfee.com to Westly's account at $12 a share.

The stock opened at $38 and closed at $44 on its first day of trading — a gain of nearly 267 percent.

Westly's broker sold all his shares for a gain of $14,515.

Source: Mercury News and Westly's tax records

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