Founders of Web Site Accuse Backers of Cheating Them
By GARY RIVLIN
523 words
26 January 2005
The New York Times
Late Edition - Final
15
English

SAN FRANCISCO, Jan. 25 -- Partners at two prominent Silicon Valley venture capital firms deceived four of the five founders of a start-up company, withholding critical information and thereby cheating them out of tens of millions of dollars, according to a lawsuit.

The suit, filed in Superior Court here last week, was brought on behalf of three of the five founders of Epinions, a consumer product review Web site founded in 1999 that quickly became one of the dot-com era's more celebrated start-ups. The suit named J. William Gurley of Benchmark Capital and John R. Johnston of August Capital, both original investors in Epinions and directors of the company, and an Epinions co-founder, Nirav N. Tolia.

"It's rare for the founders of a company to sue their financial backers," said Paul T. Friedman, a partner at Morrison & Foerster in San Francisco. "Venture is a small world in which relationships are very important. Most people find a way to avoid disputes so they can live another day."
The basis for the suit is the proposal made in February 2003 to merge Epinions and DealTime, a comparison-pricing site. By then four of the company's five founders -- Naval Ravikant, Ramanathan Guha, Mike Speiser and Dion Lim, who did not join the suit -- had left the company but still owned a total of more than six million shares of Epinions common stock.

The four owned enough shares to scuttle the merger but gave their blessing, even though it meant valuing those shares at zero. At the time, investors holding preferred shares, including Benchmark and August Capital, had claim on the $45 million they had invested collectively.

The four founders, the suit says, were led to believe that the company was worth $23 million to $38 million, making common stock worthless.

The suit contends that Mr. Gurley, Mr. Johnston and Mr. Tolia failed to share "material facts concerning Epinions' financial affairs," including news of a deal with Google that the company knew would increase its 2003 profits by 1,400 percent.

The suit cites an e-mail message written by Mr. Tolia in January 2003 -- one month before the former partners approved the merger -- in which he writes about the Google deal. Mr. Tolia's shares were granted to him in the form of equity in the new company, which was named Shopping.com.

Shopping.com filed to go public in April 2004, a year after the Epinions-DealTime merger was completed. Its shares went on sale in October. Mr. Tolia's stake in Shopping.com was worth $38 million after its first day of trading. The two venture capital firms each owned shares worth more than $60 million.
Mr. Johnston declined to comment in response to an e-mail message. Mr. Gurley and Mr. Tolia did not respond to requests for comment.

On Tuesday, Shopping.com acknowledged the suit in a filing with the Securities and Exchange Commission. "The company believes that the allegations of this lawsuit are without merit," it said.

Venture firms sued over shares in start-up
By Matt Marshall
Mercury News
826 words
26 January 2005
San Jose Mercury News
MO1
1
English

Three co-founders of dot-com high-flier Epinions have sued Silicon Valley venture capital firms Benchmark Capital and August Capital, alleging they conspired with fellow founder Nirav Tolia to deprive them of nearly $40 million.

Shopping.com, the Brisbane online advertising company formed from the 2003 merger of Epinions and DealTime, also is named as a defendant.

The suit filed last week in San Francisco Superior Court is just the latest case of a founder of a once-hot valley start-up claiming venture capitalists crossed over the legal line in negotiating secret deals that enriched their own pockets at the expense of the founders. Last year, Nishan Systems founder Aamer Latif sued venture capitalists on his board. That case is still pending. In both cases, the devil is in the details.

Founded at the height of the Internet boom, Epinions allowed users to write product reviews and make personal recommendations.
It was started by Naval Ravikant; R.V. Guha, a former high-ranking Netscape engineer; Michael Speiser, a former consultant with McKinsey & Co.; Tolia, a former Yahoo corporate spokesman; and Dion Lim, a former executive with Quote.com who is not part of the suit.

The three suing co-founders were joined by 40 other former Epinions employees in the suit. Group's claim The group contends venture capitalists Bill Gurley of Benchmark and John R. Johnston of August -- both investors and directors at Epinions -- worked together with Chief Executive Tolia to deceive the employees about the value of their shares.

Neither Gurley nor Johnston responded to a request for comment. Shopping.com spokeswoman Lynn Brinton referred only to the company's Securities and Exchange Commission filing last week, which stated: ``The company believes that the allegations of this lawsuit are without merit and intends to defend vigorously against this matter."

The defendants are accused of telling the plaintiffs in early 2003 that their ownership stakes were worth nothing, and that they should agree to an upcoming merger to allow Epinions to survive, the complaint said.

Epinions' preferred shareholders, including the venture capitalists, had negotiated a deal in which they would receive up to $45 million before any other shareholders could claim a share of merger proceeds, according to the suit. That left nothing over for other shareholders, since Epinions was worth at most $38 million under the merger terms, the defendants allegedly told them.

In truth, according to the suit, the defendants knew the company was worth much more. They withheld many important facts, including the signing of a significant revenue deal with Google -- which guaranteed $6 million in revenue a year for the next two years.

The deal was expected to add $3.4 million in profit for the year, a major boost from the previous year. The plaintiffs claim this information was withheld from them even as they were told Epinions was in danger of going out of business. But the plaintiffs contend the merger partner, DealTime, had discussed with the defendants plans for an upcoming initial public offering that an investment bank had advised would make DealTime worth $300 million to $400 million, according to the suit.

The plaintiffs said Epinions was really worth 35 percent of the combined merger with DealTime, or far more than $45 million.

By February 2003 -- which was when the merger was negotiated -- the founders and other employees had all left the company.

And although the departed common shareholders were told they would be treated equally with other shareholders still at the company, Tolia and others were granted vested options in the post-merger company, Shopping.com.

Public offering On Oct. 24, 2004, less than 18 months after the merger, Shopping.com went public. It traded at a market value of $851 million, giving the former Epinions shareholders who were still at the company shares worth in excess of $250 million, the complaint said.

``As a result, the Epinions corporate insiders and other favored shareholders unjustly gained more than $250 million,'' the complaint said.

Eric Goldman, former general counsel at Epinions, said Tolia worked hard during a critical time for the company and kept it afloat.

``Perhaps with other leaders there would have been nothing for anyone to fight over because the company would have been run into the ground,'' he said.

Goldman said he is not unbiased, having represented the company for a while after the merger. But as a former employee who also gave up his shares, he calculated that ``I'm the single largest cash-loser among the common shareholders.''

The complaint said the shares held by Tolia and other Epinions employees who received favorable treatment were worth more than $37.5 million on the day of the Shopping.com IPO. Benchmark's shares were worth $62.8 million, while August's were worth $61.9 million.

###