

EBAY INC
Form PRE 14A
March 09, 2009

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

**SCHEDULE 14A
Proxy Statement Pursuant to Section 14(a) of the Securities
Exchange Act of 1934 (Amendment No.)**

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material Pursuant to §240.14a-12

eBay Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

Fee paid previously with preliminary materials.

Edgar Filing: EBAY INC - Form PRE 14A

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

Table of Contents

**eBay Inc.
2145 Hamilton Avenue
San Jose, California 95125**

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To Be Held On April 29, 2009**

To the Stockholders of eBay Inc.:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders of **eBay Inc.**, a Delaware corporation, will be held on Wednesday, April 29, 2009, at 8:00 a.m. Pacific time at Town Square, 2161 North First Street, San Jose, California 95131 for the following purposes:

1. To vote on the election of Marc L. Andreessen, William C. Ford, Jr., Dawn G. Lepore, Pierre M. Omidyar and Richard T. Schlosberg, III as directors, to hold office until our 2012 Annual Meeting of Stockholders.
2. To approve amendments to certain of our existing equity incentive plans to allow for a one-time option exchange program for employees other than our named executive officers and directors.
3. To approve the amendment and restatement of our 2008 Equity Incentive Award Plan to increase the aggregate number of shares authorized for issuance under the plan by 50 million shares and to add market share and volume metrics as performance criteria under the plan.
4. To ratify the selection of PricewaterhouseCoopers LLP as our independent auditors for our fiscal year ending December 31, 2009.
5. To transact such other business as may properly come before the meeting or any adjournment or postponement of the meeting.

These business items are described more fully in the Proxy Statement accompanying this Notice.

The Board of Directors has fixed the close of business on March 4, 2009 as the record date for identifying those stockholders entitled to notice of and to vote at this Annual Meeting and at any adjournment or postponement of this meeting.

By Order of the Board of Directors

Michael R. Jacobson
Secretary

San Jose, California
March [], 2009

All stockholders are cordially invited to attend the Annual Meeting in person. Whether or not you expect to attend the Annual Meeting, you are urged to submit your proxy or voting instructions as soon as possible so that your shares can be voted at the Annual Meeting in accordance with your instructions. Telephone and

Internet voting are available. For specific instructions on voting, please refer to the instructions on the proxy card or voting instruction form.

Table of Contents

**eBay Inc.
2145 Hamilton Avenue
San Jose, California 95125**

PROXY STATEMENT

**QUESTIONS AND ANSWERS ABOUT THE PROXY MATERIALS AND
OUR 2009 ANNUAL MEETING**

Q: Why am I receiving these materials?

A: eBay's Board of Directors, or the Board, is providing these proxy materials to you in connection with the Board's solicitation of proxies for use at eBay's 2009 Annual Meeting of Stockholders, or the Annual Meeting, which will take place on April 29, 2009. Stockholders are invited to attend the Annual Meeting and are requested to vote on the proposals described in this proxy statement. The proxy statement and the accompanying proxy card are being mailed on or about March 19, 2009 in connection with the solicitation of proxies on behalf of the Board.

Q: What information is contained in these materials?

A: The information included in this proxy statement relates to the proposals to be voted on at the Annual Meeting, the voting process, the compensation of our most highly paid executive officers and our directors, and certain other required information. eBay's 2008 Annual Report, which includes eBay's audited consolidated financial statements, is also enclosed with this proxy statement.

Q: What proposals will be voted on at the Annual Meeting?

A: There are four proposals scheduled to be voted on at the Annual Meeting:

the election as directors of the five nominees named in this proxy statement to serve for a three-year term (Proposal 1);

the approval of amendments to certain of our existing equity incentive plans to allow for a one-time option exchange program for employees other than our named executive officers and directors (Proposal 2);

the approval of the amendment and restatement of our 2008 Equity Incentive Award Plan to increase the aggregate number of shares authorized for issuance under the plan by 50 million shares and to add market share and volume metrics as performance criteria under the plan (Proposal 3); and

the ratification of the appointment of PricewaterhouseCoopers LLP as our independent auditors for our fiscal year ending December 31, 2009 (Proposal 4).

Q: What are eBay's Board's voting recommendations?

A: eBay's Board recommends that you vote your shares as follows:

FOR each of the five nominees to the Board named in this proxy statement (Proposal 1);

FOR the approval of amendments to certain of our existing equity incentive plans to allow for a one-time option exchange program for employees other than our named executive officers and directors (Proposal 2);

FOR the approval of the amendment and restatement of our 2008 Equity Incentive Award Plan to increase the aggregate number of shares authorized for issuance under the plan by 50 million shares and to add market share and volume metrics as performance criteria under the plan (Proposal 3); and

FOR the ratification of the appointment of PricewaterhouseCoopers LLP as our independent auditors for our fiscal year ending December 31, 2009 (Proposal 4).

Q: How many shares are entitled to vote?

A: Each share of eBay's common stock outstanding as of the close of business on March 4, 2009, the record date, is entitled to one vote at the Annual Meeting. At the close of business on March 4, 2009, 1,286,261,230 shares of common stock were outstanding and entitled to vote. You may vote all of the shares owned by you as of the

Table of Contents

close of business on the record date of March 4, 2009, and you are entitled to cast one vote per share of common stock held by you on the record date. These shares include shares that are (1) held of record directly in your name, including shares purchased through eBay's equity incentive plans, and (2) held for you as the beneficial owner through a stockbroker, bank, or other nominee.

Q: What is the difference between holding shares as a stockholder of record and as a beneficial owner?

A: Most stockholders of eBay hold their shares beneficially through a broker, bank, or other nominee rather than directly in their own name. There are some distinctions between shares held of record and shares owned beneficially, specifically:

Shares held of record

If your shares are registered directly in your name with eBay's transfer agent, BNY Mellon Shareowner Services, you are considered the stockholder of record with respect to those shares, and these proxy materials are being sent directly to you by eBay. As the stockholder of record, you have the right to grant your voting proxy directly to eBay or to vote in person at the Annual Meeting. eBay has enclosed a proxy card for you to use. You may also submit voting instructions via the Internet or by telephone as described below under "How can I vote my shares without attending the Annual Meeting?"

Shares owned beneficially

If your shares are held in a stock brokerage account or by a broker, bank, or other nominee, you are considered the beneficial owner of shares held in street name, and these proxy materials are being forwarded to you by your broker, bank, or nominee, who is considered the stockholder of record with respect to those shares. As the beneficial owner, you have the right to direct your broker or other nominee on how to vote the shares in your account, and you are also invited to attend the Annual Meeting. However, since you are not the stockholder of record, you may not vote these shares in person at the Annual Meeting unless you request and receive a valid proxy from your broker, bank, or nominee. Your broker, bank, or nominee has enclosed a voting instruction form for you to use in directing the broker, bank, or nominee regarding how to vote your shares. Many brokers or banks also offer voting by Internet or telephone. Please refer to your voting instruction form for instructions on the voting methods offered by your broker or bank.

Q: Can I attend the Annual Meeting?

A: You are invited to attend the Annual Meeting if you are a stockholder of record or a beneficial owner as of March 4, 2009. If you are a stockholder of record, you must bring proof of identification. If you hold your shares through a stockbroker or other nominee, you will need to provide proof of ownership by bringing either a copy of the voting instruction form provided by your broker or a copy of a brokerage statement showing your share ownership as of March 4, 2009. If you do not attend the Annual Meeting, you can listen to a webcast of the proceedings at eBay's investor relations site at <http://investor.ebay.com>.

Q: How can I vote my shares in person at the Annual Meeting?

A: Shares held directly in your name as the stockholder of record may be voted in person at the Annual Meeting. If you choose to vote in person, please bring proof of identification. Even if you plan to attend the Annual Meeting, eBay recommends that you submit a proxy with respect to the voting of your shares in advance as described below so that your vote will be counted if you later decide not to attend the Annual Meeting. Shares held in street name through a brokerage account or by a broker, bank, or other nominee may be voted in person by you if you

obtain a valid proxy from your broker, bank or nominee giving you the right to vote the shares.

Q: How can I vote my shares without attending the Annual Meeting?

A: Whether you hold shares directly as the stockholder of record or beneficially in street name, you may vote by proxy or submit a voting instruction form without attending the Annual Meeting via the Internet, by telephone, or by completing and mailing your proxy card or voting instruction form in the enclosed pre-paid envelope. Please refer to the enclosed materials for details.

Table of Contents

Q: Can I change my vote or revoke my proxy?

A: If you are the stockholder of record, you may change your proxy instructions or revoke your proxy at any time before your proxy is voted at the Annual Meeting. Proxies may be revoked by any of the following actions:

filing a timely written notice of revocation with our Corporate Secretary at our principal executive office (2145 Hamilton Avenue, San Jose, California 95125);

submitting a new proxy at a later date on the Internet, by telephone, or by mail to our Corporate Secretary at our principal executive office; or

attending the Annual Meeting and voting in person (attendance at the Annual Meeting will not, by itself, revoke a proxy).

If your shares are held in a brokerage account by a broker, bank, or other nominee, you should follow the instructions provided by your broker, bank, or nominee.

Q: How are votes counted?

A: In the election of directors, you may vote FOR, AGAINST, or ABSTAIN with respect to each of the nominees. If you elect to abstain from the election of directors, the abstention will not have any effect on the election of directors. In tabulating the voting results for the election of directors, only FOR and AGAINST votes are counted.

You may vote FOR, AGAINST, or ABSTAIN with respect to the proposals to approve (1) amendments to certain of our existing equity incentive plans to allow for a one-time option exchange program for employees other than our named executive officers and directors, and (2) the amendment and restatement of our 2008 Equity Incentive Award Plan to increase the aggregate number of shares authorized for issuance under the plan by 50 million shares and to add market share and volume metrics as new performance criteria under the plan. If you elect to abstain from voting on either of these proposals, the abstention will not have any effect on the approval of the respective proposal. In tabulating the voting results for the approval of (1) the proposed amendments to certain of our existing equity incentive plans to allow for a one-time option exchange program for employees other than our named executive officers and directors and (2) the proposed amendment and restatement of our 2008 Equity Incentive Award Plan to increase the aggregate number of shares authorized for issuance under the plan by 50 million shares and to add market share and volume metrics as new performance criteria under the plan, only FOR and AGAINST votes with respect to each proposal will be counted.

You may vote FOR, AGAINST, or ABSTAIN with respect to the proposal to ratify the selection of PricewaterhouseCoopers LLP as our independent auditors. If you elect to abstain, the abstention will have the same effect as a vote AGAINST.

If you sign and return your proxy card or voting instruction form without giving specific voting instructions, your shares will be voted as recommended by our Board. If you are a beneficial holder and do not return a voting instruction form, your broker may only vote on the election of directors and the ratification of the selection of PricewaterhouseCoopers LLP.

Q: Who will count the votes?

A: A representative of Broadridge Financial Solutions, Inc. will tabulate the votes and act as the inspector of election.

Q: What is the quorum requirement for the Annual Meeting?

A: The quorum requirement for holding the Annual Meeting and transacting business is a majority of the outstanding shares entitled to be voted at the Annual Meeting. The shares may be present in person or represented by proxy at the Annual Meeting. Both abstentions and broker non-votes are counted as present for the purpose of determining the presence of a quorum.

Q: What is the voting requirement to approve each of the proposals?

A: In an uncontested election of directors, such as this election, each director must be elected by the affirmative vote of a majority of the votes cast with respect to such director by the shares of common stock present in

Table of Contents

person or represented by proxy and entitled to vote. A majority of votes cast means that the number of votes FOR a director nominee must exceed the number of votes AGAINST that director nominee.

The proposals to approve (1) amendments to certain of our existing equity incentive plans to allow for a one-time option exchange program for employees other than named executive officers and directors and (2) the amendment and restatement of our 2008 Equity Incentive Award Plan to increase the aggregate number of shares authorized for issuance under the plan by 50 million and to add market share and volume metrics as new performance criteria under the plan, each require the affirmative vote of a majority of the votes cast with respect to the proposal by the shares present in person or represented by proxy and entitled to vote. A majority of votes cast means that the number of votes FOR the approval of the proposal must exceed the number of votes AGAINST the approval of the proposal. If you are a beneficial owner and do not provide the stockholder of record with voting instructions, your shares may constitute broker non-votes (see What are broker non-votes and what effect do they have on the proposals? below).

The proposal to ratify the selection of PricewaterhouseCoopers LLP as our independent auditors requires the affirmative vote of a majority of the shares of common stock present in person or represented by proxy and entitled to vote on the proposal.

Q: What happens if a nominee who is duly nominated does not receive the required majority vote?

A: Each current director who is standing for re-election at the Annual Meeting has tendered an irrevocable resignation from the Board that will become effective if the Corporate Governance and Nominating Committee or another committee of the Board determines to accept it after the director fails to receive the required majority vote. This determination will be made within 90 days of the Annual Meeting and will be publicly reported promptly after it is made.

Q: What are broker non-votes and what effect do they have on the proposals?

A: Generally, broker non-votes occur when shares held by a broker in street name for a beneficial owner are not voted with respect to a particular proposal because the broker (1) has not received voting instructions from the beneficial owner and (2) lacks discretionary voting power to vote those shares. A broker is entitled to vote shares held for a beneficial owner on routine matters, such as the election of our directors and the ratification of the appointment of PricewaterhouseCoopers LLP as independent auditors, without instructions from the beneficial owner of those shares. On the other hand, absent instructions from the beneficial owner of such shares, a broker is not entitled to vote shares held for a beneficial owner on certain non-routine items, such as the approval of (1) amendments to certain of our existing equity incentive plans to allow for a one-time option exchange program for employees other than named executive officers and directors and (2) the amendment and restatement of our 2008 Equity Incentive Award Plan to increase the aggregate number of shares authorized for issuance under the plan by 50 million and to add market share and volume metrics as performance criteria under the plan. Broker non-votes count for purposes of determining whether a quorum exists but do not count as entitled to vote with respect to individual proposals. Thus, if you do not give your broker specific instructions, your shares may not be voted on these matters and will not be counted in determining the number of shares necessary for approval, although they will count for purposes of determining whether a quorum exists.

Q: What does it mean if I receive more than one proxy card or voting instruction form?

A: It means your shares are registered differently or are in more than one account. Please provide voting instructions for each proxy card and voting instruction form you receive to ensure that all of your shares are voted.

Q: Where can I find the voting results of the Annual Meeting?

A: eBay will announce preliminary voting results at the Annual Meeting and will publish final results in eBay's quarterly report on Form 10-Q for the second quarter of 2009.

Q: Who will bear the cost of soliciting votes for the Annual Meeting?

A: eBay will pay the entire cost of preparing, assembling, printing, mailing, and distributing these proxy materials. eBay will provide copies of these proxy materials to banks, brokerage houses, fiduciaries, and

Table of Contents

custodians holding in their names shares of our common stock beneficially owned by others so that they may forward these proxy materials to the beneficial owners. eBay has retained the services of D.F. King & Co., Inc., a professional proxy solicitation firm, to aid in the solicitation of proxies. D.F. King may solicit proxies by personal interview, mail, telephone, facsimile, email, or otherwise. eBay expects that it will pay D.F. King its customary fee, estimated to be approximately \$12,500, plus reasonable out-of-pocket expenses incurred in the process of soliciting proxies. In addition, eBay may reimburse brokerage firms and other persons representing beneficial owners of shares for their expenses in forwarding solicitation materials to such beneficial owners. Solicitations may also be made by personal interview, mail, telephone, facsimile, email, or otherwise by directors, officers, and other employees of eBay, but eBay will not additionally compensate its directors, officers, or other employees for these services.

Q: May I propose actions for consideration at next year's Annual Meeting or nominate individuals to serve as directors?

A: You may submit proposals for consideration at future annual stockholder meetings. In order for a stockholder proposal to be considered for inclusion in the proxy materials for our 2010 Annual Meeting of Stockholders, your proposal must be received by our Corporate Secretary no later than November 19, 2009. A stockholder proposal or a nomination for director that is received after this date will not be included in our proxy statement and proxy, but will otherwise be considered at the 2010 Annual Meeting of Stockholders so long as it is submitted to our Corporate Secretary no earlier than December 30, 2009 and no later than January 29, 2010. We advise you to review our Bylaws, which contain these and other requirements with respect to advance notice of stockholder proposals and director nominations, including certain information that must be included concerning the stockholder and each nominee and proposal. Our Bylaws were filed with the Securities and Exchange Commission, or SEC, on Form 8-K on October 3, 2008, and can be viewed by visiting our investor relations website at <http://investor.ebay.com/sec.cfm>. You may also obtain a copy by writing to our Corporate Secretary at our principal executive office (2145 Hamilton Avenue, San Jose, California 95125).

Q: How can I get electronic access to the Proxy Statement and Annual Report?

A: This proxy statement and our 2008 Annual Report may be viewed online on our investor relations website at <http://investor.ebay.com/annuals.cfm>. You can also elect to receive an email that will provide an electronic link to future annual reports and proxy statements rather than receiving paper copies of these documents. Choosing to receive your proxy materials electronically will save us the cost of printing and mailing documents to you. You can choose to receive future proxy materials electronically by visiting our investor relations website at <http://investor.ebay.com/annuals.cfm>. If you choose to receive future proxy materials electronically, you will receive an email next year with instructions containing a link to those materials and a link to the proxy voting site. Your choice to receive proxy materials electronically will remain in effect until you contact eBay Investor Relations and tell us otherwise. You may visit our investor relations website at <http://investor.ebay.com> or contact eBay Investor Relations by mail at 2145 Hamilton Avenue, San Jose, California 95125 or by telephone at 866-696-3229.

Q: How do I obtain a separate set of proxy materials if I share an address with other stockholders?

A: To reduce expenses, in some cases, we are delivering one set of proxy materials to certain stockholders who share an address, unless otherwise requested. A separate proxy card is included in the proxy materials for each of these stockholders. If you reside at such an address and wish to receive a separate copy of the proxy materials, including our annual report, you may contact eBay Investor Relations at the website, address, or phone number in the previous paragraph. You may also contact eBay Investor Relations if you would like to receive separate proxy materials in the future or if you are receiving multiple copies of our proxy materials and would like to receive

only one copy in the future.

Table of Contents

Q: How can I obtain an additional proxy card or voting instruction form?

A: If you lose, misplace, or otherwise need to obtain a proxy card or voting instruction form, and:

you are a stockholder of record, contact eBay Investor Relations by mail at 2145 Hamilton Avenue, San Jose, California 95125 or by telephone at 866-696-3229; or

you are the beneficial owner of shares held indirectly through a bank, broker, or similar institution, contact your account representative at that organization.

2009 ANNUAL MEETING OF STOCKHOLDERS

PROXY STATEMENT

TABLE OF CONTENTS

<u>QUESTIONS AND ANSWERS ABOUT THE PROXY MATERIALS AND OUR 2009 ANNUAL MEETING</u>	1
<u>TABLE OF CONTENTS</u>	7
<u>CORPORATE GOVERNANCE</u>	8
<u>Our Corporate Governance Practices</u>	8
<u>Board Committees and Meetings</u>	10
<u>Audit Committee</u>	10
<u>Compensation Committee</u>	11
<u>Corporate Governance and Nominating Committee</u>	11
<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT</u>	12
<u>Section 16(a) Beneficial Ownership Reporting Compliance</u>	14
<u>CERTAIN TRANSACTIONS WITH DIRECTORS AND OFFICERS</u>	14
<u>PROPOSALS REQUIRING YOUR VOTE</u>	16
<u>PROPOSAL 1 Election of Directors</u>	16
<u>PROPOSAL 2 Approval of Amendments to Certain of Our Existing Equity Incentive Plans to Allow for a One-Time Stock Option Exchange Program for Employees Other Than Our Named Executive Officers and Directors</u>	20
<u>PROPOSAL 3 Approval of Amendment and Restatement of Our 2008 Equity Incentive Award Plan</u>	33
<u>PROPOSAL 4 Ratification of Selection of Independent Auditors</u>	42
<u>Audit and Other Professional Fees</u>	42
<u>Audit Committee Pre-Approval Policy</u>	42
<u>AUDIT COMMITTEE REPORT</u>	43
<u>OUR EXECUTIVE OFFICERS</u>	45
<u>COMPENSATION DISCUSSION AND ANALYSIS</u>	46
<u>Introduction: Objectives of Compensation Programs</u>	46
<u>Role of the Compensation Committee</u>	47
<u>Role of Executive Officers and Consultants in Compensation Decisions</u>	47
<u>Competitive Considerations</u>	48
<u>Elements of Compensation/Executive Compensation Practices</u>	50
<u>Equity Compensation Grant Practices</u>	57
<u>Employment Agreements, Change-in-Control Arrangements, and Severance Arrangements with Executive Officers</u>	58
<u>Stock Ownership Guidelines</u>	59
<u>Impact of Accounting and Tax Requirements on Compensation</u>	59
<u>Conclusion</u>	59
<u>COMPENSATION COMMITTEE REPORT</u>	60
<u>COMPENSATION TABLES</u>	61
<u>Summary Compensation Table</u>	61
<u>Grants of Plan-Based Awards</u>	66
<u>Outstanding Equity Awards at Fiscal Year-End</u>	68
<u>Option Exercises and Stock Vested</u>	71
<u>COMPENSATION OF DIRECTORS</u>	71

<u>Director Summary Compensation Table</u>	72
<u>EQUITY COMPENSATION PLAN INFORMATION</u>	73
<u>OTHER MATTERS</u>	75
<u>APPENDIX A: Amendment and Restatement of Our 2008 Equity Incentive Award Plan</u>	A-1

Table of Contents

CORPORATE GOVERNANCE

Our business is managed by our employees under the direction and oversight of the Board of Directors. Except for Mr. Donahoe, none of our Board members is an employee of eBay. We keep Board members informed of our business through discussions with management, materials we provide to them, visits to our offices, and their participation in Board and Board committee meetings.

The Board has adopted corporate governance guidelines that, along with the charters of the principal Board committees and our Code of Business Conduct and Ethics, which we refer to as our Code of Conduct, provide the framework for the governance of the company. A complete copy of our governance guidelines, the charters of our principal Board committees, and our Code of Conduct may be found on our investor relations website at <http://investor.ebay.com/governance>. Information contained on our website is not part of this proxy statement. The Board regularly reviews corporate governance developments and modifies these policies as warranted. Any changes in these governance documents will be reflected in the same location on our website.

OUR CORPORATE GOVERNANCE PRACTICES

We believe that open, effective, and accountable corporate governance practices are key to our relationship with our stockholders. To help our stockholders understand our commitment to this relationship and our governance practices, the Board has adopted a set of governance guidelines to set a framework within which the Board will conduct its business. The governance guidelines can be found on our website at <http://investor.ebay.com/governance> and are summarized below along with certain other of our governance practices.

Committee Responsibilities. Board committees help the Board run effectively and efficiently, but do not replace the oversight of the Board as a whole. There are currently three principal Board committees: the Audit Committee, the Compensation Committee, and the Corporate Governance and Nominating Committee. Each committee meets regularly and has a written charter that has been approved by the Board. In addition, at each regularly scheduled Board meeting, a member of each committee reports on any significant matters addressed by the committee since the last Board meeting. Each committee performs an annual self-assessment to evaluate its effectiveness in fulfilling its obligations.

Independence. The rules of The Nasdaq Stock Market require listed companies to have a board of directors with at least a majority of independent directors. These rules have both objective tests and a subjective test for determining who is an independent director. The objective tests state, for example, that a director is not considered independent if he or she is an employee of the company, or is a partner in, or a controlling shareholder or executive officer of, an entity to which the company made, or from which the company received, payments in the current or any of the past three fiscal years that exceed 5% of the recipient's consolidated gross revenue for that year. The subjective test requires our Board to affirmatively determine that the director does not have a relationship that would interfere with the director's exercise of independent judgment in carrying out his or her responsibilities. On an annual basis, each member of our Board is required to complete an independence questionnaire designed to provide information to assist the Board in determining whether the director is independent under the listing standards of the Nasdaq Global Select Market and our corporate governance guidelines. Our Board has adopted guidelines setting forth certain categories of transactions, relationships, and arrangements that it has deemed immaterial for purposes of making its determination regarding a director's independence, and does not consider any such transactions, relationships, and arrangements in making its subjective determination.

Our Board has determined that each of the following directors is independent under the listing standards of the Nasdaq Global Select Market: Mr. Anderson, Mr. Andreessen, Mr. Barnholt, Mr. Bourguignon, Mr. Cook, Mr. Ford, Ms. Lepore, Mr. Moffett, Mr. Schlosberg, and Mr. Tierney. Also, our Board determined that Mr. Kagle, who served as a director until his term expired upon the conclusion of our 2008 Annual Meeting of Stockholders held on June 19, 2008, was independent under the listing standards of the Nasdaq Global Select Market. In making this assessment, the Board considered the transactions, relationships, and arrangements described under the heading Certain Transactions with Directors and Officers below. In addition, certain of our directors serve as members of the board of directors for the same company or have investments in venture funds where another director serves as a general partner. The Board was aware of these relationships when it made its determination.

Table of Contents

The Board limits membership on the Audit Committee, the Compensation Committee, and the Corporate Governance and Nominating Committee to independent directors. Our governance guidelines require any director who has previously been determined to be independent to inform the Chairman of the Board and our Corporate Secretary of any change in circumstance that may cause his or her status as an independent director to change.

Lead Independent Director. Our Board has a designated lead independent director who chairs and may call formal closed sessions of the independent directors, leads Board meetings in the absence of the Chairman, and leads the annual Board self-assessment. In addition, the lead independent director, together with the chair of the Corporate Governance and Nominating Committee, conducts interviews to confirm the continued qualification and willingness to serve of each director whose term is expiring at an annual meeting prior to the time at which directors are nominated for re-election. Mr. Barnholt is currently the lead independent director, having been appointed to a two-year term in June 2008. He will serve as lead independent director until the Board meeting following our 2010 Annual Meeting of Stockholders.

Stockholder Communication. Stockholders may communicate with the Board or individual directors care of the Corporate Secretary, eBay Inc., 2145 Hamilton Avenue, San Jose, California 95125. The Corporate Governance and Nominating Committee has delegated responsibility for initial review of stockholder communications to our Corporate Secretary. In accordance with the committee's instructions, our Corporate Secretary will summarize all correspondence and make it available to each member of the Board. In addition, the Corporate Secretary will forward copies of all stockholder correspondence to each member of the Corporate Governance and Nominating Committee, except for communications that are (1) advertisements or promotional communications, (2) solely related to complaints by users with respect to ordinary course of business customer service and satisfaction issues, or (3) clearly unrelated to our business, industry, management, or Board or committee matters.

Attendance at Annual Meetings. Absent exigent circumstances, all directors are expected to attend eBay's annual meeting of stockholders. All of our directors serving on our Board at the time of our last annual meeting of stockholders, which was held in June 2008, attended such meeting except for Mr. Kagle, whose term as a director expired upon the conclusion of that meeting.

Formal Closed Sessions. At the conclusion of each regularly scheduled Board meeting, the outside directors have the opportunity to meet without our management or the other directors. The lead independent director leads the discussions.

Board Compensation. Board compensation is determined by the Compensation Committee. Since 2003, Board compensation has consisted of a mixture of equity compensation and cash compensation. Board compensation is reviewed annually by the Compensation Committee. A more detailed description of current Board compensation can be found under the heading "Compensation of Directors" below.

Stock Ownership Guidelines. In September 2004, our Board adopted stock ownership guidelines to better align the interests of our directors and executive officers with the interests of our stockholders and further promote our commitment to sound corporate governance. Under these guidelines, our executive officers are required to achieve ownership of eBay common stock valued at three times their annual base salary (five times in the case of our Chief Executive Officer, or CEO). The guidelines provide that the required ownership level for each executive officer is re-calculated whenever an executive officer changes pay grade, and as of January 1 of every third year. Until an executive officer achieves the required level of ownership, he or she is required to retain 25% of the after-tax net shares received as the result of the exercise of eBay stock options or the vesting of restricted stock or restricted stock units. Directors are required to achieve ownership of eBay common stock valued at three times the amount of the annual retainer paid to directors within three years of joining the Board, or in the case of directors serving at the time the guidelines were adopted, within three years of the date of adoption of the guidelines. A more detailed summary of

our stock ownership guidelines can be found on our website at <http://investor.ebay.com/governance>. The ownership levels of our executive officers and directors as of March 3, 2009 are set forth in the section entitled "Security Ownership of Certain Beneficial Owners and Management" below.

Outside Advisors. The Board and each of its principal committees may retain outside advisors and consultants of their choosing at the company's expense. The Board need not obtain management's consent to

Table of Contents

retain outside advisors. In addition, the principal committees need not obtain either the Board's or management's consent to retain outside advisors.

Conflicts of Interest. eBay expects its directors, executives, and employees to conduct themselves with the highest degree of integrity, ethics, and honesty. eBay's credibility and reputation depend upon the good judgment, ethical standards, and personal integrity of each director, executive, and employee. In order to better protect eBay and its stockholders, eBay regularly reviews its Code of Conduct and related policies to ensure that it provides clear guidance to its directors, executives, and employees.

Transparency. eBay believes it is important that stockholders understand the governance practices of eBay. In order to help ensure the transparency of our practices, we have posted information regarding our corporate governance procedures on our website at <http://investor.ebay.com/governance>.

Board Effectiveness and Director Performance Reviews. It is important to eBay that the Board and its committees are performing effectively and in the best interest of the company and its stockholders. The Board performs an annual self-assessment, led by the lead independent director, to evaluate its effectiveness in fulfilling its obligations. As part of this annual self-assessment, directors are able to provide feedback on the performance of other directors. The lead independent director then follows up on this feedback and takes such further action with directors receiving comments and other directors as he or she deems appropriate.

Succession Planning. The Board recognizes the importance of effective executive leadership to eBay's success. eBay conducts an annual review process that includes succession plans for eBay's senior leadership positions. These succession plans are reviewed and approved by our CEO, and details on these succession plans, including potential successors for members of eBay's executive staff (including the CEO), are presented to the Board. In addition, the Board reviews and updates eBay's CEO succession plan, which includes formal criteria for the CEO position used to evaluate potential successors and addresses the possibility of an emergency situation. In conducting this review, the Board considers, among other factors, organizational and operational needs, competitive challenges and leadership/management potential and development.

Auditor Independence. eBay has taken a number of steps to ensure continued independence of its outside auditors. eBay's independent auditors report directly to the Audit Committee, and eBay limits the use of its auditors for non-audit services. The fees for services provided by eBay's auditors in 2008 and 2007 and eBay's policy on pre-approval of non-audit services are described under Proposal 4 Ratification of Selection of Independent Auditors below.

Corporate Hotline. eBay has established a corporate hotline (operated by a third party) to allow any employee to confidentially and anonymously lodge a complaint about any accounting, internal control, auditing, or (where legally permissible) other matters of concern.

BOARD COMMITTEES AND MEETINGS

During 2008, our Board held five meetings, and each Board member attended at least 75% of the aggregate of all of our Board meetings and committee meetings for committees on which such director served. The Board has three principal committees: an Audit Committee, a Compensation Committee, and a Corporate Governance and Nominating Committee.

Audit Committee

Our Board has a separately-designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended, which we refer to as the Exchange Act. Our Audit Committee consists of Mr. Anderson, Ms. Lepore, Mr. Moffett and Mr. Schlosberg, each of whom is independent in accordance with the rules and regulations of the Nasdaq Global Select Market and the SEC. Mr. Anderson is the chairman of the committee. The Audit Committee held 12 meetings during 2008. The primary responsibilities of the Audit Committee are to meet with our independent auditors to review the results of the annual audit and to discuss our financial statements, including the independent auditors' judgment about the quality of accounting principles, the reasonableness of significant judgments, the clarity of the disclosures in our financial

Table of Contents

statements, eBay's internal control over financial reporting, and management's report with respect to internal control over financial reporting. Additionally, the Audit Committee meets with our independent auditors to review the interim financial statements prior to the filing of our Quarterly Reports on Form 10-Q, recommends to the Board the independent auditors to be retained by us, oversees the independence of the independent auditors, evaluates the independent auditors' performance, reviews and approves the fees of the independent auditors, and receives and considers the independent auditors' comments as to controls, adequacy of staff and management performance and procedures in connection with audit and financial controls, including our system to monitor and manage business risks and legal and ethical compliance programs. The Audit Committee approves the compensation of our Vice President of Internal Audit, who meets with the committee regularly without other members of management present.

The Audit Committee also prepares the Audit Committee Report for inclusion in our proxy statement, approves audit and non-audit services provided to us by our independent auditors, considers conflicts of interest and reviews all transactions with related persons involving executive officers or Board members that are reasonably expected to exceed specified thresholds, and meets with our General Counsel to discuss legal matters that may have a material impact on our financial statements or our compliance policies and with other members of management to discuss other areas of risk to the company. Our Board has determined that Mr. Anderson is an audit committee financial expert as defined by the SEC. You can view our Audit Committee Charter on the corporate governance section of our investor relations website at <http://investor.ebay.com/governance>.

Compensation Committee

Our Compensation Committee consists of Messrs. Barnholt, Bourguignon, Ford and Tierney. Mr. Ford joined the committee on March 27, 2008. Mr. Kagle was a member of the committee until his term as a director expired upon the conclusion of our 2008 Annual Meeting of Stockholders held on June 19, 2008. Mr. Barnholt is the chairman of the committee. The committee met nine times during 2008. The Compensation Committee reviews and approves all compensation programs applicable to directors and executive officers, the overall strategy for employee compensation, and the compensation of our CEO and our other executive officers. The committee also reviews the Compensation Discussion and Analysis contained in our proxy statement and prepares the Compensation Committee Report for inclusion in our proxy statement. All members of our Compensation Committee are independent under the listing standards of the Nasdaq Global Select Market. The Compensation Committee Charter permits the committee to, in its discretion, delegate all or a portion of its duties and responsibilities to a subcommittee of the committee. You can view our Compensation Committee Charter on the corporate governance section of our investor relations website at <http://investor.ebay.com/governance>.

A more detailed description of the role of the committee, including the role of executive officers and consultants in compensation decisions, can be found under "Compensation Discussion and Analysis - Role of the Compensation Committee" and "Role of Executive Officers and Consultants in Compensation Decisions" below.

Compensation Committee Interlocks and Insider Participation. All members of the Compensation Committee during 2008 were independent directors, and no member was an employee or former employee of eBay. No Compensation Committee member had any relationship requiring disclosure under Item 404 of Regulation S-K promulgated by the SEC. During 2008, none of our executive officers served on the compensation committee (or its equivalent) or board of directors of another entity whose executive officer served on our Compensation Committee or Board.

Corporate Governance and Nominating Committee

Our Corporate Governance and Nominating Committee consists of Mr. Cook, Ms. Lepore, Mr. Schlosberg, and Mr. Tierney. Mr. Ford served on the committee until March 27, 2008. Mr. Cook is the chairman of the committee. The committee met four times during 2008. The Corporate Governance and Nominating Committee makes

recommendations to the Board as to the appropriate size of the Board or any Board committee, reviews the qualifications of candidates for the Board of Directors, and makes recommendations to the Board of Directors on potential Board members (whether as a result of vacancies, including any vacancy created by an increase in the size

Table of Contents

of the Board, or as part of the annual election cycle). The committee considers nominee recommendations from a variety of sources, including nominees recommended by stockholders. The committee has from time to time retained an executive search firm to help facilitate the screening and interview process of director nominees. The committee has not established specific minimum age, education, experience, or skill requirements for potential members, but, in general, expects that qualified candidates will have high-level managerial experience in a complex organization and will be able to represent the interests of the stockholders as a whole rather than special interest groups or constituencies. The committee considers each candidate's integrity, judgment, skill, diversity of background, and time available to devote to Board activities, among other factors. The committee will also consider the interplay of a candidate's skill and experience with that of other Board members, and the extent to which a candidate may be a desirable addition to any committee of the Board.

In addition to recommending director candidates, the Corporate Governance and Nominating Committee establishes procedures for the oversight and evaluation of the Board and management, reviews correspondence received from stockholders, and reviews on an annual basis a set of corporate governance guidelines for the Board. Stockholders wishing to submit recommendations or director nominations for our 2010 Annual Meeting of Stockholders should submit their proposals to the Corporate Governance and Nominating Committee in care of our Corporate Secretary in accordance with the time limitations, procedures, and requirements described under the heading "May I propose actions for consideration at next year's Annual Meeting or nominate individuals to serve as directors?" in the section entitled

Questions and Answers about the Proxy Materials and Our 2009 Annual Meeting above. All members of our Corporate Governance and Nominating Committee are independent under the listing standards of the Nasdaq Global Select Market. You can view our Corporate Governance and Nominating Committee Charter on the corporate governance section of our investor relations website at <http://investor.ebay.com/governance>.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth certain information known to us with respect to beneficial ownership of our common stock as of March 3, 2009, by (i) each stockholder known to us to be the beneficial owner of more than 5% of our common stock, (ii) each director and nominee for director, (iii) each of the executive officers named in the Summary Compensation Table below, and (iv) all executive officers and directors as a group.

Name of Beneficial Owner	Shares Beneficially Owned(1)	
	Number	Percent
Pierre M. Omidyar(2)	167,250,408	13.0%
Morgan Stanley(3)	65,770,981	5.1
John J. Donahoe(4)	1,767,102	*
Margaret C. Whitman(5)	21,731,035	1.7
Robert H. Swan(6)	607,029	*
Elizabeth L. Axelrod(7)	943,729	*
Lorrie M. Norrington(8)	738,401	*
Scott Thompson(9)	1,012,088	*
Rajiv Dutta(10)	49,233	*
Fred D. Anderson(11)	67,875	*
Marc L. Andreessen(11)	0	*
Edward W. Barnholt(11)	36,375	*
Philippe Bourguignon(11)	127,875	*
Scott D. Cook(12)	644,881	*

Edgar Filing: EBAY INC - Form PRE 14A

William C. Ford, Jr.(13)	143,275	*
Dawn G. Lepore(14)	419,875	*
David M. Moffett(15)	5,000	*
Richard T. Schlosberg, III(16)	67,875	*
Thomas J. Tierney(17)	115,875	*
All directors and executive officers as a group (19 persons)(18)	177,384,784	13.7

Table of Contents

* Less than one percent.

- (1) This table is based upon information supplied by officers, directors, and principal stockholders and Schedules 13D and 13G filed with the SEC. Beneficial ownership is determined in accordance with the rules of the SEC and generally includes voting or investment power with respect to securities. Unless otherwise indicated in the footnotes to this table, the persons and entities named in the table have sole voting and sole investment power with respect to all shares beneficially owned, subject to community property laws where applicable. Shares of our common stock subject to options that are currently exercisable or exercisable within 60 days of March 3, 2009 are deemed to be outstanding for the purpose of computing the percentage ownership of the person holding those options, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person. The percentage of beneficial ownership is based on 1,286,264,017 shares of common stock outstanding as of March 3, 2009.
- (2) Mr. Omidyar is our founder and Chairman of the Board. Includes 100,000 shares held by his spouse as to which he disclaims beneficial ownership, and 37,730,230 shares Mr. Omidyar has pledged as security. The address for Mr. Omidyar is c/o eBay Inc., 2145 Hamilton Avenue, San Jose, California 95125.
- (3) The address for Morgan Stanley is 1585 Broadway, New York, New York 10036. This information is based solely upon a Schedule 13G filed by Morgan Stanley on February 17, 2009.
- (4) Mr. Donahoe is our President and CEO. Includes 1,680,048 shares Mr. Donahoe has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009. The address for Mr. Donahoe is c/o eBay Inc., 2145 Hamilton Avenue, San Jose, California 95125.
- (5) Ms. Whitman is our former President and CEO, and subsequently served as a special advisor to the President and CEO and a member of the Board until December 31, 2008. Includes 4,000,000 shares pledged as security, 15,210,492 shares held by the Griffith R. Harsh, IV & Margaret C. Whitman TTEES of Sweetwater Trust U/A/D 10/15/99, 9,584 shares held by the Whitford Limited Partnership and 2,490,000 shares held by the Sheridan Investments Limited Partnership. The Managing General Partner for both is Griffith R. Harsh, IV, not individually but as trustee of the Griffith R. Harsh, IV & Margaret C. Whitman TTEES of Sweetwater Trust U/A/D 10/15/99. The address for Ms. Whitman is c/o eBay Inc., 2145 Hamilton Avenue, San Jose, California 95125.
- (6) Mr. Swan is our Senior Vice President, Finance and Chief Financial Officer. Includes 533,167 shares Mr. Swan has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009. The address for Mr. Swan is c/o eBay Inc., 2145 Hamilton Avenue, San Jose, California 95125.
- (7) Ms. Axelrod is our Senior Vice President, Human Resources. Includes 902,215 shares Ms. Axelrod has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009. The address for Ms. Axelrod is c/o eBay Inc., 2145 Hamilton Avenue, San Jose, California 95125.
- (8) Ms. Norrington is our President, eBay Marketplaces. Includes 686,926 shares Ms. Norrington has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009. The address for Ms. Norrington is c/o eBay Inc., 2145 Hamilton Avenue, San Jose, California 95125.
- (9) Mr. Thompson is our President, PayPal. Includes 955,510 shares Mr. Thompson has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009. The address for Mr. Thompson is c/o eBay Inc., 2145 Hamilton Avenue, San Jose, California 95125.

- (10) Mr. Dutta is our former President, eBay Marketplaces. The address for Mr. Dutta is c/o eBay Inc., 2145 Hamilton Avenue, San Jose, California 95125.
- (11) Includes, in the case of Mr. Anderson, 61,875 shares Mr. Anderson has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009, in the case of Mr. Barnholt, 31,875 shares Mr. Barnholt has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009, and, in the case of Mr. Bourguignon, 121,875 shares Mr. Bourguignon has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009. The address for each of Messrs. Anderson, Andreessen, Barnholt, and Bourguignon is c/o eBay Inc., 2145 Hamilton Avenue, San Jose, California 95125.

Table of Contents

- (12) Includes 481,875 shares Mr. Cook has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009. The address for Mr. Cook is c/o Intuit Inc., 2535 Garcia Avenue, Mountain View, California 94043.
- (13) Includes (a) 25 shares held by Mr. Ford's spouse as a custodian for the trust for his children and as to which Mr. Ford disclaims beneficial ownership and (b) 750 shares held in a trust for two of Mr. Ford's children as to which Mr. Ford is trustee and as to which Mr. Ford disclaims beneficial ownership. Includes 17,500 shares Mr. Ford has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009. The address for Mr. Ford is c/o Ford Motor Company, One American Road, Dearborn, Michigan 48126.
- (14) Includes 399,875 shares Ms. Lepore has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009. The address for Ms. Lepore is c/o drugstore.com, inc., 411 108th Avenue NE, Suite 1400, Bellevue, Washington 98004.
- (15) The address for Mr. Moffett is c/o eBay Inc., 2145 Hamilton Avenue, San Jose, California 95125.
- (16) Includes 61,875 shares Mr. Schlosberg has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009. The address for Mr. Schlosberg is Bank of San Antonio, 800 E. Sonterra Blvd., Suite 140, San Antonio, Texas 78257.
- (17) Includes 111,875 shares Mr. Tierney has the right to acquire pursuant to outstanding options exercisable within 60 days of March 3, 2009. The address for Mr. Tierney is c/o The Bridgespan Group, 535 Boylston Street, 10th Floor, Boston, Massachusetts 02116.
- (18) Includes 8,989,675 shares subject to options exercisable within 60 days of March 3, 2009. Excludes shares beneficially owned by Ms. Whitman and Mr. Dutta because they were not executive officers as of March 3, 2009.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our directors, executive officers, and holders of more than 10% of our common stock to file reports regarding their ownership and changes in ownership of our securities with the SEC, and to furnish us with copies of all Section 16(a) reports that they file.

We believe that during the fiscal year ended December 31, 2008, our directors, executive officers, and greater than 10% stockholders complied with all applicable Section 16(a) filing requirements, except that (i) one Form 4 involving an option exercise and sale of shares held by Mr. Cook was filed late, and (ii) one Form 4 involving the vesting of restricted stock units held by Mr. Thompson was filed late.

In making this statement, we have relied upon a review of the copies of Section 16(a) reports furnished to us and the written representations of our directors, executive officers, and greater than 10% stockholders.

CERTAIN TRANSACTIONS WITH DIRECTORS AND OFFICERS

The Audit Committee is charged with reviewing reports relating to (1) compliance program activities, and (2) the adjudication of potential conflict of interest situations under our Code of Business Conduct. The Audit Committee also reviews and approves all transactions with related persons that are required to be disclosed in this section of our proxy statement. The charter of our Audit Committee and our Code of Conduct may be found on our investor relations

website at <http://investor.ebay.com/governance>.

Our Board has adopted a written policy for the review of related person transactions. For purposes of the policy, a related person transaction includes transactions in which (i) the amount involved is more than \$120,000 in any consecutive twelve-month period, (ii) eBay is a participant, and (iii) any related person has a direct or indirect material interest. The policy defines a related person to include directors, nominees for director, executive officers, holders of more than 5% of eBay's outstanding common stock and their respective immediate family members. Pursuant to the policy, all related person transactions must be approved by the Audit Committee or, in the event of an inadvertent failure to bring the transaction to the Audit Committee for pre-approval, ratified by the Audit Committee. In the event that a member of the Audit Committee has an interest in a related person transaction, the

Table of Contents

transaction must be approved or ratified by the disinterested members of the Audit Committee. In deciding whether to approve or ratify a related person transaction, the Audit Committee will consider the following factors:

whether the terms of the transaction are (1) fair to eBay and (2) at least as favorable to eBay as would apply if the transaction did not involve a related person;

whether there are demonstrable business reasons for eBay to enter into the transaction;

whether the transaction would impair the independence of an outside director under eBay's director independence standards; and

whether the transaction would present an improper conflict of interest for any director or executive officer, taking into account the size of the transaction, the overall financial position of the related person, the direct or indirect nature of the related person's interest in the transaction and the ongoing nature of any proposed relationship, and any other factors the committee deems relevant.

From time to time, we have entered into and may continue to enter into commercial arrangements with companies with which our directors or executive officers may have relationships (including as a director or executive officer of such other companies), but with respect to which our directors or executive officers do not have a material interest and, thus, are not required to be disclosed. These commercial arrangements are entered into in the ordinary course of business and on an arm's-length basis.

In July 2008, PayPal entered into an ordinary course commercial transaction with Intuit Inc. involving the integration and promotion of PayPal as a preferred payment option in Intuit's online Quickbooks Merchant Services. In connection with the transaction, PayPal agreed to pay Intuit a revenue share for PayPal Merchant Services accounts acquired through Intuit on terms consistent with the terms PayPal had offered other merchants in similar situations. Mr. Cook, a member of our Board, is a director and the Chairman of the Executive Committee of Intuit. The Audit Committee pre-approved this transaction. We believe this transaction was made on terms no less favorable to us than we could have obtained from unaffiliated third parties and did not present an improper conflict of interest. While we do not believe that Mr. Cook had a direct or indirect material interest in this transaction, and thus it is not required to be disclosed, we are disclosing its existence as a matter of good corporate governance.

Ms. Whitman, our former President and CEO and a former member of our Board, entered into an aircraft time sharing agreement with eBay Inc., effective April 1, 2008, pursuant to which she agreed to reimburse us for her personal use of the corporate aircraft following her resignation as President and Chief Executive Officer on March 31, 2008. Under the terms of the agreement, Ms. Whitman agreed to reimburse us at the maximum amount allowable under applicable law. Ms. Whitman fulfilled her obligations under the agreement and reimbursed us \$145,747, which exceeded the incremental cost incurred by us. The Audit Committee pre-approved the agreement. Given that Ms. Whitman reimbursed us in an amount that exceeded the incremental cost related to the operation of the corporate aircraft for her personal use after March 31, 2008, we do not consider such use to be a perquisite or to provide any other personal benefit to Ms. Whitman.

Mr. Omidyar from time to time makes his personal aircraft available to our officers for business purposes at no cost to us. No use of Mr. Omidyar's personal aircraft was made by our officers during 2008.

We have entered into indemnification agreements with each of our directors and executive officers. These agreements require us to indemnify such individuals, to the fullest extent permitted by Delaware law, for certain liabilities to which they may become subject as a result of their affiliation with eBay.

Table of Contents

PROPOSALS REQUIRING YOUR VOTE

PROPOSAL 1

ELECTION OF DIRECTORS

Our Certificate of Incorporation and Bylaws, each as amended to date, provide for the Board to be divided into three classes, with each class having a three-year term. The first class currently consists of four directors, the second class currently consists of five directors and the third class currently consists of three directors. The term of office for the first class expires at our 2011 Annual Meeting, the term of office for the second class expires at our upcoming Annual Meeting, and the term of office for the third class expires at our 2010 Annual Meeting. A director elected to fill a vacancy (including a vacancy created by an increase in the size of the Board) will serve for the remainder of the term of the class of directors in which the vacancy occurred and until his or her successor is elected and qualified, or until his or her earlier death, resignation, or removal.

Our Board is presently composed of 12 members, 10 of whom are currently independent directors within the meaning of the listing standards of the Nasdaq Global Select Market. The five nominees standing for election at the Annual Meeting are from the class whose term of office expires at the upcoming Annual Meeting. These five nominees are all currently members of the Board of Directors, and, except for Mr. Andreessen, have been previously elected by the stockholders. If elected at the Annual Meeting, each of the nominees would serve until our 2012 Annual Meeting and until his or her successor is elected and qualified, or until his or her earlier death, resignation, or removal.

Majority Vote Standard for Election of Directors; Director Resignation Policy. Our Bylaws require that each director be elected by the affirmative vote of a majority of the votes cast with respect to such director in uncontested elections such as this one (the number of shares voted FOR a director nominee must exceed the number of votes cast AGAINST that nominee). In a contested election, the standard for election of directors would be the affirmative vote of a plurality of the votes cast by the shares represented in person or by proxy at any such meeting and entitled to vote on the election of directors. A contested election is one in which the Board has determined that the number of nominees exceeds the number of directors to be elected at the meeting and has not rescinded this determination by the date that is at least 20 days prior to the date of the meeting as initially announced.

If a nominee who is serving as a director is not elected at the annual meeting, under Delaware law the director would continue to serve on the Board as a holdover director until his or her successor is elected and qualified, or until his or her earlier resignation or removal pursuant to our Bylaws. In accordance with our governance guidelines, our Board expects each incumbent director who is nominated for re-election to resign, in accordance with the procedure set forth in our Bylaws, from the Board if he or she fails to receive the required number of votes for re-election in accordance with our Bylaws. Our governance guidelines provide that, in considering whether to nominate any incumbent director for re-election, the Board will take into account whether the director has tendered an irrevocable resignation that will be effective upon the Board's acceptance of such resignation in the event the director fails to receive the required vote to be re-elected. In the case of a proposed nominee who is not an incumbent director, the Board will take into account whether the individual has agreed to tender such a resignation prior to being nominated for re-election. If a nominee who is an incumbent director does not receive the required vote for re-election, the Corporate Governance and Nominating Committee or another committee of the Board will decide whether to accept or reject such director's resignation (if the director has tendered such a resignation), or whether to take other action, within 90 days after the date of the certification of the election results (subject to an additional 90-day period in certain circumstances). In reaching its decision, the committee will review factors it deems relevant, which may include any stated reasons for against votes, whether the underlying cause or causes of the against votes are curable, criteria considered by the

committee in evaluating potential candidates for the Board, the length of service of the director, the size and holding period of such director's stock ownership in the company, and the director's contributions to the company. The committee's decision will be publicly disclosed in a filing with the SEC. If a nominee who was not already serving as a director fails to receive the required votes to be elected at the annual meeting, he or she will not become a member of the Board. Each director nominee is currently serving on the Board and has submitted an irrevocable resignation of the type described above.

Table of Contents

Set forth below is biographical information for each of the nominees as well as for each director whose term of office will continue after the upcoming Annual Meeting.

NOMINEES FOR ELECTION FOR A THREE-YEAR TERM EXPIRING AT OUR 2012 ANNUAL MEETING

Marc L. Andreessen

Marc L. Andreessen, age 37, has served as a director of eBay since September 2008. Mr. Andreessen is a co-founder and chairman of Ning Inc., an online platform for people to create their own social networks founded in late 2004. From September 1999 to July 2007, Mr. Andreessen co-founded and served as the Chairman of the board of directors of Opsware, Inc. (formerly known as Loudcloud Inc.). From March 1999 to September 1999, Mr. Andreessen served as Chief Technology Officer of America Online, Inc. From April 1994 to March 1999, Mr. Andreessen was a co-founder of Netscape Communications Corporation, a software company, serving in various positions, including Chief Technology Officer and Executive Vice President of Products. Mr. Andreessen also serves on the board of directors of Facebook Inc., Stanford Hospital and Room to Read. Mr. Andreessen holds a B.S. degree in Computer Science from the University of Illinois at Urbana-Champaign.

William C. Ford, Jr.

William C. Ford, Jr., age 51, has served as a director of eBay since July 2005. Mr. Ford has served as Executive Chairman of the Board of Directors of Ford Motor Company, a company that manufactures and distributes automobiles, since September 2006 and has served as Chairman of the Board of Ford since January 1999. Mr. Ford also serves as Chairman of Ford's Finance Committee and as a member of Ford's Environmental and Public Policy Committee. From October 2001 to September 2006, Mr. Ford was Ford's Chief Executive Officer. Mr. Ford has held a number of management positions at Ford since 1979. Mr. Ford serves as Vice Chairman of The Detroit Lions, Inc. and Chairman of the Board of Trustees of The Henry Ford. He is also a Vice Chairman of Detroit Renaissance. Mr. Ford holds a B.A. degree from Princeton University and a M.S. degree in management from the Massachusetts Institute of Technology.

Dawn G. Lepore

Dawn G. Lepore, age 54, has served as a director of eBay since December 1999. Ms. Lepore has served as Chief Executive Officer and Chairman of the Board of drugstore.com, inc., a leading online provider of health, beauty, vision, and pharmacy solutions, since October 2004. From August 2003 to October 2004, Ms. Lepore served as Vice Chairman of Technology, Active Trader, Operations, Business Strategy, and Administration for the Charles Schwab Corporation and Charles Schwab & Co, Inc., a financial holding company. Prior to this appointment, she held various positions with the Charles Schwab Corporation including: Vice Chairman of Technology, Operations, Business Strategy, and Administration from May 2003 to August 2003; Vice Chairman of Technology, Operations, and Administration from March 2002 to May 2003; Vice Chairman of Technology and Administration from November 2001 to March 2002; and Vice Chairman and Chief Information Officer from July 1999 to November 2001. Ms. Lepore also serves on the board of directors of The New York Times Company. Ms. Lepore holds a B.A. degree from Smith College.

Pierre M. Omidyar

Pierre M. Omidyar, age 41, founded eBay as a sole proprietorship in September 1995. He has been a director and Chairman of the Board since eBay's incorporation in May 1996 and also served as its Chief Executive Officer, Chief Financial Officer, and President from inception to February 1998, November 1997 and August 1996, respectively.

Prior to founding eBay, Mr. Omidyar was a developer services engineer at General Magic, a mobile communications platform company, from December 1994 to July 1996. Mr. Omidyar co-founded Ink Development Corp. (later renamed eShop) in May 1991 and served as a software engineer there from May 1991 to September 1994. Prior to co-founding Ink, Mr. Omidyar was a developer for Claris, a subsidiary of Apple Inc., and for other Macintosh-oriented software development companies. Mr. Omidyar is currently co-founder and chairman of Omidyar Network, a philanthropic investment firm committed to creating opportunity for individuals to improve

Table of Contents

their lives. He serves on the Board of Trustees of Tufts University, Omidyar-Tufts Microfinance Fund, the Santa Fe Institute and the Punahou School, and as a director of Meetup, Inc. Mr. Omidyar holds a B.S. degree in Computer Science from Tufts University.

Richard T. Schlosberg, III

Richard T. Schlosberg, III, age 64, has served as a director of eBay since March 2004. From May 1999 to January 2004, Mr. Schlosberg served as President and Chief Executive Officer of the David and Lucile Packard Foundation, a private family foundation. Prior to joining the foundation, Mr. Schlosberg was Executive Vice President of The Times Mirror Company and publisher and Chief Executive Officer of the Los Angeles Times. Prior to that, he served in the same role at the Denver Post. Mr. Schlosberg serves on the board of directors of Edison International, and is also a member of the USO World Board of Governors, a trustee of Pomona College and a founding Director of the U.S. Air Force Academy Endowment. Mr. Schlosberg is also Chairman of the Board of the Kaiser Family Foundation. Mr. Schlosberg is a graduate of the United States Air Force Academy and holds an M.B.A. degree from the Harvard Business School.

**THE BOARD OF DIRECTORS RECOMMENDS
A VOTE IN FAVOR OF EACH NAMED NOMINEE.**

DIRECTORS CONTINUING IN OFFICE UNTIL OUR 2010 ANNUAL MEETING

Philippe Bourguignon

Philippe Bourguignon, age 61, has served as a director of eBay since December 1999. Mr. Bourguignon has been Vice Chairman of Revolution Resorts, a division of Revolution LLC, a company focused on health, living, and resort investments and operations, since January 2006. From April 2004 to January 2006, Mr. Bourguignon served as Chairman of Aegis Media France, a media communications and market research company. From September 2003 to March 2004, Mr. Bourguignon was Co-Chief Executive Officer of The World Economic Forum (The DAVOS Forum). From August 2003 to October 2003, Mr. Bourguignon served as Managing Director of The World Economic Forum. From April 1997 to January 2003, Mr. Bourguignon served as Chairman of the Board of Club Méditerranée S.A., a resort operator. Prior to his appointment at Club Méditerranée S.A., Mr. Bourguignon was Chief Executive Officer of Euro Disney S.A., the parent company of Disneyland Paris, since 1993, and Executive Vice President of The Walt Disney Company (Europe) S.A. since October 1996. Mr. Bourguignon was named President of Euro Disney in 1992, a post he held through April 1993. He joined The Walt Disney Company in 1988 as head of Real Estate Development. Mr. Bourguignon holds a Masters Degree in Economics at the University of Aix-en-Provence and holds a post-graduate diploma from the Institut d'Administration des Entreprises (IAE) in Paris.

Thomas J. Tierney

Thomas J. Tierney, age 55, has served as a director of eBay since March 2003. Mr. Tierney is the founder of The Bridgespan Group, a non-profit consulting firm serving the non-profit sector, and has been its Chairman of the Board since late 1999. Prior to founding Bridgespan, Mr. Tierney served as Chief Executive Officer of Bain & Company, a consulting firm, from June 1992 to January 2000. Mr. Tierney holds a B.A. degree in Economics from the University of California at Davis and an M.B.A. degree with distinction from the Harvard Business School. Mr. Tierney is the co-author of a book about organization and strategy called *Aligning the Stars*.

David M. Moffett

David Moffett, age 57, has served as a director of eBay since July 2007. Mr. Moffett served as Chief Executive Officer of Federal Home Loan Mortgage Corp. (Freddie Mac) from September 2008 to March 2009, as a director of Freddie Mac from December 2008 to March 2009. Mr. Moffett has more than 30 years of strategic finance and operational experience in banking and payment processing. He joined Star Banc Corporation in 1993 as CFO and played integral roles as Star Banc Corporation acquired Firststar Corporation in 1998, which then acquired U.S. Bancorp in February 2001, retaining the U.S. Bancorp name. Prior to 1993, Mr. Moffett held executive

Table of Contents

level positions at some of the nation's leading financial services companies, including Bank of America and Security Pacific Corp. Mr. Moffett holds a B.S. degree in Economics from the University of Oklahoma and a Master's degree from Southern Methodist University.

DIRECTORS CONTINUING IN OFFICE UNTIL OUR 2011 ANNUAL MEETING***Fred D. Anderson***

Fred D. Anderson, age 64, has served as a director of eBay since July 2003. Mr. Anderson has been a Managing Director of Elevation Partners, a private equity firm focused on the media and entertainment industry, since July 2004. From March 1996 to June 2004, Mr. Anderson served as Executive Vice President and Chief Financial Officer of Apple Inc., a manufacturer of personal computers and related software. Prior to joining Apple Inc., Mr. Anderson was Corporate Vice President and Chief Financial Officer of Automatic Data Processing, Inc., an electronic transaction processing firm, from August 1992 to March 1996. On April 24, 2007, the SEC filed a complaint against Mr. Anderson and another former officer of Apple Inc. The complaint alleged that Mr. Anderson failed to take steps to ensure that the accounting for an option granted in 2001 to certain executives of Apple Inc., including himself, was proper. Simultaneously with the filing of the complaint, Mr. Anderson settled with the SEC, neither admitting nor denying the allegations in the complaint. In connection with the settlement, Mr. Anderson agreed to a permanent injunction from future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 and Section 16(a) of the Exchange Act and Rules 13b2-2 and 16a-3 thereunder, and from aiding and abetting future violations of Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 14(a) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13, and 14a-9 thereunder. He also agreed to disgorge approximately \$3.5 million in profits and interest from the option he received and to pay a civil penalty of \$150,000. Under the terms of the settlement, Mr. Anderson may continue to act as an officer or director of public companies. Mr. Anderson also serves on the board of directors of Move, Inc. and Palm, Inc. Mr. Anderson holds a B.A. degree from Whittier College and an M.B.A. degree from the University of California, Los Angeles.

Edward W. Barnholt

Edward W. Barnholt, age 65, has served as a director of eBay since April 2005. Mr. Barnholt served as President and Chief Executive Officer of Agilent Technologies, Inc., a measurement company, from May 1999 until March 2005, and served as Chairman of the Board of Agilent from November 2002 until March 2005. Before being named Agilent's Chief Executive Officer, Mr. Barnholt served as Executive Vice President and General Manager of Hewlett-Packard Company's Measurement Organization from 1998 to 1999. From 1990 to 1998, he served as General Manager of Hewlett-Packard Company's Test and Measurement Organization. He was elected a Senior Vice President of Hewlett-Packard Company in 1993 and an Executive Vice President in 1996. Mr. Barnholt also serves as the Non-Executive Chairman of the Board of KLA-Tencor Corporation, a member of the Board of Directors of Adobe Systems Incorporated, and a member of the Board of Trustees of the David and Lucile Packard Foundation. Mr. Barnholt holds a B.S. and an M.S. degree in electrical engineering from Stanford University.

Scott D. Cook

Scott D. Cook, age 56, has served as a director of eBay since June 1998. Mr. Cook is the founder of Intuit Inc., a maker of business and financial management technology solutions, including Quickbooks, Quicken and TurboTax. Mr. Cook has been a director of Intuit since March 1984 and is currently Chairman of the Executive Committee of the Board of Intuit. From March 1993 to July 1998, Mr. Cook served as Chairman of the Board of Intuit. From March 1984 to April 1994, Mr. Cook served as President and Chief Executive Officer of Intuit. Mr. Cook also serves on the board of directors of The Procter & Gamble Company, The Asia Foundation and The Intuit Scholarship Foundation. Mr. Cook holds a B.A. degree in Economics and Mathematics from the University of Southern California and an

M.B.A. degree from the Harvard Business School.

John J. Donahoe

John J. Donahoe, age 48, serves eBay as its President and CEO. He has served in that capacity since March 2008, as a director of eBay since January 2008. From January 2008 to March 2008, Mr. Donahoe served as CEO-

Table of Contents

designate. From March 2005 to January 2008, Mr. Donahoe served as President, eBay Marketplaces. From January 2000 to February 2005, Mr. Donahoe served as Worldwide Managing Director for Bain & Company, a global business consulting firm. Mr. Donahoe serves on the Board of Trustees for Dartmouth College. Mr. Donahoe holds a B.A. in Economics from Dartmouth College and an M.B.A. degree from the Stanford Graduate School of Business.

PROPOSAL 2

APPROVAL OF AMENDMENTS TO CERTAIN OF OUR EXISTING EQUITY INCENTIVE PLANS TO ALLOW FOR A ONE-TIME STOCK OPTION EXCHANGE PROGRAM FOR EMPLOYEES OTHER THAN OUR NAMED EXECUTIVE OFFICERS AND DIRECTORS

We are asking you to approve amendments to certain of our existing equity incentive plans to allow for a one-time stock option exchange program. Our Board of Directors, upon recommendation by our Compensation Committee, authorized the stock option exchange program on March 4, 2009, subject to stockholder approval of the equity incentive plan amendments. If implemented, this one-time stock option exchange program, or option exchange, would permit some of our employees, including employees of our majority-owned subsidiaries, to surrender certain outstanding stock options that are significantly underwater (i.e., those options with an exercise price that is significantly greater than our current trading price) for cancellation in exchange for a lesser number of restricted stock units, or RSUs, to be granted under the eBay Inc. 2008 Equity Incentive Award Plan, or the 2008 Plan. Each RSU issued in the option exchange program will represent an unfunded right to receive one share of our common stock on one or more specified future dates when the RSU vests.

We believe this option exchange program, as designed, is in the best interests of our stockholders and our employees. If approved by stockholders, we believe the option exchange would enable us to:

Motivate and engage our eligible employees to continue to build stockholder value;

Reduce the total number of our outstanding stock options, or overhang, since a substantially smaller number of RSUs will be granted for the surrendered stock options; and

Recapture value from the compensation expense that we record in our financial statements with respect to certain eligible options.

In designing our option exchange, we have taken into account our stockholders' interests by focusing on the following exchange principles:

Named executive officers and members of our Board will be excluded from participating in the option exchange. All other employees holding eligible grants of stock options will generally be eligible to participate.

To ensure that only those stock options that are significantly underwater may be exchanged, only stock options with a per share exercise price greater than or equal to the highest per share trading price of our common stock for the 52-week period immediately preceding the start of the option exchange will be eligible to be exchanged for RSUs.

Stock options granted within the 12-month period immediately prior to the start of the option exchange and options that will expire within the 12-month period immediately following the completion of the option exchange will not be eligible for exchange.

The exchange ratios will be determined so that the new RSUs will have a fair value equal to approximately 90% of the fair value of the surrendered options.

None of the new RSUs will be vested on the date of grant. The new RSUs will be scheduled to vest at least 12 months later than the options for which they are exchanged would have otherwise vested.

The stock options surrendered in the exchange will be cancelled and shares subject to the cancelled options will not be available for future issuance under our equity incentive plans.

Table of Contents

In certain instances, instead of RSUs, a lesser number of new stock options or a small cash payment will be issued in exchange for surrendered options, in each case, calculated so as to reflect the same approximate discount to fair value.

Stockholder approval of the amendments to our equity incentive plans to permit the option exchange is required under the Nasdaq listing rules and the terms of certain of our equity incentive plans.

Our ability to effect the option exchange is also contingent upon stockholder approval of Proposal 3 of this proxy statement at the Annual Meeting, which would amend the 2008 Plan to increase the number of shares of our common stock issuable under the plan by 50 million and would amend certain of our other equity incentive plans to decrease the number of shares issuable under those plans. If our stockholders approve Proposal 3 of this proxy statement and this proposal, and our Board, Compensation Committee or CEO determines to implement the option exchange, the option exchange would commence within 12 months of the date of the Annual Meeting.

Stockholder approval of this proposal requires the affirmative vote of a majority of the votes cast with respect to this proposal by the shares present in person or represented by proxy and entitled to vote thereon at the Annual Meeting. A majority of votes cast means that the number of votes FOR the approval of the option exchange must exceed the number of votes AGAINST the approval of the option exchange.

OVERVIEW

Like many companies, we have experienced a significant decline in our stock price over the last year in light of the current global financial and economic crisis. Our Marketplaces and Payments segments have been directly impacted by the global economic environment as buyers reduce their spending. Additional pressure on our stock price has been caused by the anticipated decrease in our net revenue and earnings per diluted share as a result of (i) the strengthening U.S. dollar, (ii) lower global interest rates, (iii) the uncertain global consumer spending environment, and (iv) the long-term slowing of our Marketplaces business. While we have made significant changes to simplify and streamline our organization, improve our cost structure, and strengthen our competitiveness, and we continue to make changes to enhance and diversify our portfolio of ecommerce businesses, our stock price has nevertheless declined. As a result, a considerable number of our employees hold stock options with exercise prices significantly above the recent trading prices of our common stock. In addition, the market for key employees remains extremely competitive, notwithstanding the current economic turmoil.

Because of the continued challenging economic environment and the uncertain impact of our efforts to change our business, we believe these underwater stock options are no longer effective as incentives to motivate and retain our employees. We believe that employees perceive that these options have little or no value. In addition, although these stock options are not likely to be exercised as long as our stock price is lower than the applicable exercise price, they will remain on our books with the potential to dilute stockholders' interests for up to the full remaining term of these options, while delivering little or no retentive or incentive value and no opportunity to recapture value from the associated compensation expense, unless they are surrendered or cancelled.

The objective of our equity incentive plans has been, and continues to be, to link the personal interests of equity incentive plan participants to those of our stockholders. We believe that, if approved by our stockholders, the option exchange would be an important component in our efforts to:

Motivate eligible employees to continue to build stockholder value and achieve future stock price growth by exchanging underwater stock options for RSUs with new extended vesting periods, and which have a value that moves directly in line with our stock price. As of February 17, 2009, assuming the per share trading price of

our common stock was \$12.00 per share, approximately 96% of stock options held by our employees were underwater. We believe that those stock options that are significantly underwater no longer serve to motivate or help retain our employees. We believe that the option exchange would aid both motivation and retention of those employees participating in the option exchange, while better aligning the interests of our employees with the interests of our stockholders.

Reduce our total number of outstanding stock options, or overhang, since a substantially smaller number of RSUs will be granted for the surrendered stock options. Based on the assumptions described under [Details](#)

Table of Contents

of the Stock Option Program Exchange Ratios below, the number of underwater stock options that would be eligible for the option exchange is approximately 62.53 million. Because we will be exchanging a substantially smaller number of RSUs for those options surrendered, our overhang and the potential dilution of stockholders' interests provided by these awards will decrease. We believe that after the option exchange, the overhang provided by our equity awards, including the newly granted RSUs, would represent an appropriate balance between the objectives of our equity incentive plans and our stockholders' interest in minimizing overhang and potential dilution.

Recapture value from the compensation expense that we record with respect to certain eligible options. If this proposal is not approved by our stockholders, we will be obligated to recognize approximately \$142.5 million of remaining compensation expense over the next three years with respect to the significantly underwater options that we expect to be eligible for the option exchange, even if these stock options are never exercised. Because we will be replacing surrendered stock options with RSUs that have a slightly lower fair value than the surrendered stock options, we believe that we can provide an incentive to retain and motivate our participating employees without materially increasing the compensation expense we already must recognize (other than increases in compensation expense that may result from decreases in our stock price after the option exchange commences, but before the exchange actually occurs). Based on the assumptions below, if our stock price does not fluctuate between the date the option exchange commences (and the exchange ratios are set) and the date the exchange actually occurs, then, as a result of the option exchange, we would expect to recognize an incremental non-cash accounting charge of approximately \$1 million to \$2 million over the vesting periods of the new RSUs. However, even if our stock price fluctuates between the date the option exchange commences and the date the exchange actually occurs, we would not expect to recognize any material non-cash accounting charges as a result of the option exchange.

The majority of the stock options eligible for the option exchange were granted under our guidelines as part of our periodic broad-based focal grants. The table below reflects information as of February 17, 2009 regarding the outstanding options that were granted as part of our periodic broad-based focal grants that would be eligible for the option exchange if the highest per share trading price of our common stock for the 52-week period immediately preceding the start of the option exchange was at or below \$27.01.

Focal Grant	Number of Shares Underlying Eligible Options as of February 17, 2009	Per Share Exercise Price	Weighted Average Remaining Life of Options
March 2004	7,187,685	\$ 34.62	4.76
March 2005	6,474,964	42.58	5.77
March 2006	9,357,813	39.90	3.96
September 2006	5,789,197	28.15	4.40
March 2007	7,515,741	31.93	4.85
Total Number of Shares Underlying Options Eligible for Exchange (from focal grants)	36,325,400	\$ 35.81(1)	4.70

- (1) Represents the weighted average per share exercise price of all eligible options under our periodic broad-based focal grants.

Table of Contents

In addition to our periodic broad-based focal grants, historically we have granted options under our guidelines at varying times and having a broad range of exercise prices generally to newly hired employees and employees who have been promoted outside our focal granting processes. Please see Compensation Discussion and Analysis Equity Compensation Grant Practices. We have also assumed options previously granted by other companies in connection with our acquisition of those companies; however, these options constitute a minimal portion of the options eligible for exchange under the option exchange. The table below reflects information as of February 17, 2009 regarding the options that were not granted as part of our periodic broad-based focal grants that would be eligible for the option exchange if the highest per share trading price of our common stock for the 52-week period immediately preceding the start of the option exchange was at or below \$27.01.

Exercise Price of Eligible Options Which Are Not Focal Grants	Number of Shares Underlying Options as of February 17, 2009	Weighted Average Exercise Price	Weighted Average Remaining Life of Options
\$27.01 to \$28.14	2,768,865	\$ 27.55	4.49
\$28.16 to \$30.99	3,086,026	29.92	4.84
\$31.00 to \$34.60	5,845,886	33.27	5.11
\$34.63 to \$36.99	1,681,554	35.57	5.05
\$37.00 to \$40.99	4,988,179	39.09	5.25
\$41.00 to \$44.99	3,530,832	43.15	5.63
\$45.00 to \$51.99	3,179,090	46.35	5.50
\$52.00 and above	1,128,390	55.47	5.59
Total Number of Shares Underlying Options Eligible for Exchange (other than focal grants)	26,208,822	\$ 37.40	5.18

In sum, as of February 17, 2009, assuming that the highest per share trading price of our common stock for the 52-week period immediately preceding the start of the option exchange was at or below \$27.01, the total number of shares underlying options that would be eligible for the option exchange was approximately 62.53 million.

If our stockholders do not approve the amendments to certain of our equity incentive plans to provide for the option exchange or if our stockholders do not approve Proposal 3 of this proxy statement to increase the number of shares available for issuance under the 2008 Plan, eligible options will remain outstanding in accordance with their existing terms. We will continue to recognize compensation expense for these eligible options, even though these options may have little or no retentive or incentive value.

Summary of Material Terms

The option exchange authorized by the amendments to certain of our existing equity incentive plans, if approved by our stockholders, would provide for the following:

The option exchange will be open to all eligible employees (except where we determine that it is infeasible or impractical to offer the option exchange under local regulations as described below) who are employed by us

or one of our majority-owned subsidiaries as of the start of the option exchange and remain employed by us or one of our majority-owned subsidiaries through the completion date of the option exchange. Eligible employees will be permitted to elect which of their eligible options they wish to exchange for new RSUs on a grant-by-grant basis.

Our named executive officers and members of our Board will not be eligible to participate in the option exchange.

Only stock options that have a per share exercise price greater than or equal to the highest per share trading price of our common stock for the 52-week period immediately preceding the start of the option exchange will be eligible for exchange.

Stock options granted within the 12-month period immediately prior to the commencement date of the option exchange will not be eligible for exchange.

Table of Contents

Stock options which have a remaining term of less than 12 months immediately following the completion of the option exchange (based on their terms as of their original grant date) will not be eligible for exchange.

The exchange ratios used to determine the number of new RSUs to be granted in exchange for the eligible options surrendered will be determined in a manner intended to result in the grant of new RSUs that have a fair value equal to approximately 90% of the fair value of the eligible options for which they are exchanged. The exchange ratios will be established shortly before the start of the option exchange and will depend on the then-current fair value of the eligible option (calculated using the Black-Scholes option pricing model with a computation of expected volatility based on a combination of historical and market-based implied volatility from traded options on our common stock), the fair market value of our common stock and the original exercise price of the eligible option. The option exchange will not be a one-for-one exchange. Instead, participating employees will receive a substantially smaller number of RSUs than the number of shares that are covered by the surrendered eligible options.

None of the new RSUs granted in exchange for eligible options will be vested on the date of grant. The new RSUs will vest, subject to the participant's continued employment, in equal installments on each anniversary of the date of grant of the new RSUs with the number of installments determined using the date the surrendered option would have otherwise become fully vested in relation to the date the new RSUs are granted (unless local regulations or restrictions require that the vesting occur later than the first anniversary of the date of grant). Additional details regarding the vesting of the new RSUs is provided under the heading "Details of the Stock Option Exchange Program - Vesting of New RSUs" below.

In certain instances, as described below, instead of granting RSUs, a small cash payment will be made or a lesser number of new options will be granted in exchange for surrendered eligible options. In these limited cases, the cash provided or the new options granted will have a fair value intended to equal approximately 90% of the fair value of the surrendered options.

If our stockholders approve Proposal 3 of this proxy statement and this proposal, and our Board, Compensation Committee or CEO determines to implement the option exchange, the option exchange would commence within 12 months of the date of the Annual Meeting. If the option exchange does not commence within 12 months of the date of the Annual Meeting, we would consider any future option exchange or similar program to require new stockholder approval before it can be implemented.

While the terms of the option exchange are expected to be materially similar to the terms described in this proposal, each of our Board, Compensation Committee and CEO will have the discretion to change the terms of the option exchange to take into account a change in circumstances or local regulations and to determine not to implement the option exchange even if stockholder approval of the amendment of the equity incentive plans is obtained.

Reasons for the Option Exchange

We believe that to be successful, our employees need to think like owners. Consistent with this philosophy, our equity program continues to be broad-based. This broad-based equity program provides us with a competitive advantage, particularly in our efforts to hire and retain top talent in technology-related fields.

Due to the significant decline of our stock price during the last year, many of our employees now hold stock options with exercise prices significantly higher than the current market price of our common stock. For example, the closing price of our common stock on the Nasdaq Global Select Market on March 3, 2009 was \$10.42, whereas the weighted

average exercise price of all outstanding options held by our employees on that date was \$28.77. As of February 17, 2009, assuming the per share trading price of our common stock was \$12.00, approximately 96% of outstanding stock options held by our employees were underwater. Although we continue to believe that equity awards are an important component of our employees' total incentive benefits and provide us with a competitive advantage, we also believe that many of our employees view their existing options as having little or no value due to the significant difference between the exercise prices and the current market price of our common stock. In addition, the market for key employees remains extremely competitive, notwithstanding the current economic turmoil. As a

Table of Contents

result, for many employees, we believe that those stock options that are significantly underwater are no longer effective at providing the incentives that our Board and Compensation Committee believe are necessary to motivate and retain our employees.

Alternatives Considered

When considering how best to continue to provide incentives to and reward our employees who hold options that are significantly underwater, we considered the following alternatives:

Increase cash compensation. To replace equity incentives, we considered whether we could substantially increase base and target bonus cash compensation. However, significant increases in cash compensation would substantially increase our cash compensation expenses and reduce our cash flow from operations, which could adversely affect our business and operating results. In addition, these increases would not reduce our overhang and would not necessarily best align the interests of our employees with those of our stockholders. Further, in some non-U.S. jurisdictions, cash compensation is treated as a different type of benefit than equity awards and often has less favorable tax treatment than equity awards, so the long-term incentive and retention value would be diminished.

Grant additional equity awards. We also considered special grants of additional stock options at current market prices or RSUs. However, these additional grants would substantially increase our overhang and dilute the interests of our stockholders.

Exchange options for cash. We also considered implementing a program to exchange significantly underwater options for cash payments. However, an exchange program where options are generally exchanged for cash would substantially increase our compensation expenses and reduce our cash flow from operations, which could adversely affect our business and operating results. In addition, we do not believe that such a program would have significant long-term retention value. However, in certain instances where we have determined that offering RSUs would provide minimal retentive value, would be overly burdensome to administer or would not provide a meaningful benefit to holders of eligible options, we will provide for a cash payment in exchange for their surrendered options. Based on the assumptions described under [Details of the Stock Option Exchange Program](#) [Cash Payments](#) below, the amount of cash that we expect would be paid under the proposed option exchange is approximately \$1.9 million.

Exchange options for options with lower exercise prices. We also considered implementing a program to exchange significantly underwater options for options having an exercise price equal to the market price of our common stock on the date of the exchange. We believe, however, that implementing an option-for-RSU exchange program would have two relative advantages versus an option-for-option exchange program with an equivalent accounting impact. First, an option-for-RSU exchange program would require the grant of substantially fewer RSUs than options in an option-for-option exchange program (i.e., fewer shares will be subject to the replacement RSU awards granted than replacement option awards). Second, our overhang and stockholder dilution would decrease more significantly in an option-for-RSU exchange program compared with an option-for-option exchange program. In addition, granting RSUs is consistent with our current grant practices and provides value to our employees even if current economic conditions continue and our stock price fails to increase further. However, in Canada, an option-for-RSU exchange is subject to taxation on the date the options are exchanged for new RSUs. In light of the potential adverse consequences of such taxation to eligible employees in Canada, we will grant a lesser number of options in exchange for options surrendered by our eligible employees resident in Canada to avoid the tax inefficiency associated with an option-for-RSU exchange in Canada. If we determine that similar adverse tax consequences may arise in other foreign jurisdictions, we may grant a lesser number of options in exchange for surrendered options in those

jurisdictions as well. We do not expect this to impact a material additional number of eligible optionees.

The Option Exchange

After weighing each of these alternatives, subject to the exceptions described in this proposal, we have decided to provide an option-for-RSU exchange. We have determined that a program under which our employees generally

Table of Contents

could exchange significantly underwater stock options for a substantially smaller number of RSUs was the most attractive alternative for a number of reasons, including the following:

The option exchange offers a reasonable, balanced and meaningful incentive for our eligible employees. Under the option exchange, participating employees would surrender eligible options (which are significantly underwater) for a substantially smaller number of RSUs that will vest at least 12 months later than the eligible options for which they are exchanged. New RSUs that are granted in exchange for eligible options that were fully vested when surrendered will vest on the first anniversary of the date of grant (unless local regulations or restrictions require that the vesting occur later than the first anniversary of the date of grant). We believe that the lower number of new RSUs to be granted, the requirement that any eligible option has a per share exercise price greater than or equal to the highest per share trading price of our common stock for the 52-week period immediately preceding the start of the option exchange, and a new 12 month or longer vesting requirement, represents a reasonable and balanced option exchange with the potential for a significant positive impact on employee retention, motivation and performance. Additionally, the value of the RSUs directly correlates with movements in the market price of our common stock over time, thereby aligning employee and stockholder interests.

The exchange ratio will be calculated to return value to our stockholders. We will calculate the exchange ratios in a manner intended to result in the new RSUs having a fair value, for accounting purposes, that will be approximately equal to 90% of the fair value of the eligible options that are exchanged, which we believe will have no significant adverse impact on our reported earnings.

The option exchange will reduce our equity award overhang. Not only do the underwater options have little or no retention value, they cannot be removed from our equity award overhang until they are exercised, expire, or the employee who holds them leaves our employment. The option exchange will reduce our overhang while eliminating the ineffective options that are currently outstanding. Because a lesser number of shares will be subject to awards granted in exchange for eligible options, the number of shares of stock subject to all outstanding equity awards will be reduced, thereby reducing our overhang. Based on the assumptions described under *Details of the Stock Option Exchange Program Exchange Ratios* below, if all eligible options are exchanged, options to purchase approximately 62.53 million shares would be surrendered and cancelled, while approximately 3.57 million new RSUs would be granted in exchange for eligible options, resulting in a net reduction in the equity award overhang by approximately 58.96 million shares. As of March 3, 2009, the total number of shares of our common stock outstanding was approximately 1.3 billion. All eligible options that are not exchanged will remain outstanding and in effect in accordance with their existing terms.

Our named executive officers and members of our Board will not be eligible to participate in the option exchange. Although our named executive officers and members of our Board also hold options that are significantly underwater, these individuals are not eligible to participate in the option exchange because we believe that their compensation should remain at greater risk based on our stock price.

DETAILS OF THE STOCK OPTION EXCHANGE PROGRAM

Implementing the Option Exchange

We have not commenced the option exchange and will not do so unless our stockholders approve this proposal to amend certain of our equity incentive plans to permit the option exchange and Proposal 3 to increase the number of shares of common stock reserved for issuance under the 2008 Plan. Our Board authorized the option exchange on March 4, 2009, subject to such stockholder approval. If this proposal is approved, and our Board, Compensation Committee or CEO determines to implement the option exchange, the option exchange would commence within

12 months of the date of the Annual Meeting.

Table of Contents

If stockholders approve this proposal to amend certain of our equity incentive plans and Proposal 3 and the Board, Compensation Committee or CEO determines to commence the option exchange, eligible employees will be offered the opportunity to participate in the option exchange pursuant to a written offer that will be distributed to all eligible employees. Eligible employees will be given at least 20 business days in which to accept the offer of the new RSUs in exchange for the surrender of their eligible options. The surrendered options will be cancelled on the first business day following this election period. The new RSUs will be granted under the 2008 Plan on the date of cancellation of the surrendered options. In those limited cases where new options will be granted or cash payments made in exchange for surrendered options, such grants or payments also will be made on the date of the cancellation of the surrendered options. The shares of our common stock subject to surrendered options will not be available for future issuance under our equity incentive plans once the surrendered options are cancelled.

Prior to commencement of the option exchange, we will file the offer to exchange with the SEC as part of a tender offer statement on Schedule TO. Eligible employees, as well as stockholders and members of the public, will be able to review the offer to exchange and other related documents filed by us with the SEC free of charge on the SEC's website at www.sec.gov.

Eligibility

If implemented, the option exchange will be open to all of our active employees, worldwide, including any employees of our majority-owned subsidiaries, who hold options with a per share exercise price greater than or equal to the highest per share trading price of our common stock for the 52-week period immediately preceding the start of the option exchange, except where we determine that it is infeasible or impractical to offer the option exchange under local regulations. Our named executive officers and members of the Board will not be eligible to participate in the option exchange. Based on the assumptions described below, as of February 17, 2009, we estimate that approximately 93% of our employees holding options would be eligible to participate in the option exchange. The program also will not be available to any former employees. An active employee who tenders his or her options for exchange must also remain an eligible employee through the date the new RSU grant is made following the completion of the option exchange in order to receive the new RSUs. Active employment does not include any period of garden leave or notice periods that may be provided for under local law. If an option holder is no longer an active employee with us or one of our majority-owned subsidiaries for any reason, including layoff, termination, voluntary resignation, death or disability, on the date that the option exchange is commenced, that option holder cannot participate in the option exchange. If an option holder is no longer an active employee with us or one of our majority-owned subsidiaries for any reason on the date that the new RSU grant is made following the completion of the offer, even if he or she had elected to participate and had tendered his or her options for exchange, such employee's tender will automatically be deemed withdrawn and he or she will not participate in the option exchange. He or she will retain his or her outstanding options in accordance with their original terms and conditions, and he or she may exercise them during a limited period of time following termination of employment in accordance with their terms and to the extent that they are vested. A vote by an employee in favor of this proposal at the Annual Meeting does not constitute an election to participate in the option exchange.

Based on the assumptions described under [Details of the Stock Option Exchange Program](#) [Exchange Ratios](#) below, of the outstanding options held by eligible employees as of February 17, 2009, the maximum number of shares of common stock underlying options which could be surrendered for exchange is 62.53 million, and the maximum number of shares of common stock which would be subject to RSUs granted under the proposed option exchange, using the estimated exchange ratios below, would be 3.57 million. The amount of cash that we expect would be paid under the proposed option exchange, using the estimated exchange ratios below, is approximately \$1.9 million.

Exchange Ratios

The exchange ratios set forth below for the option exchange (that is, how many options an employee must surrender in order to receive one RSU) will be determined using the Black-Scholes option pricing model with a computation of expected volatility based on a combination of historical and market-based implied volatility from traded options on our common stock. Volatility is calculated on the same basis as we use for calculating stock expense under FAS 123(R). We chose to use this model to enable us to implement the option exchange in a manner

Table of Contents

Outstanding options at March 31, 2006

1,723,697

\$

27.59

5.40

\$

51,209

Exercisable options at March 31,2006

1,718,697

\$

27.52

5.39

\$

The majority of our options are granted annually at the board meeting in May. Thus far in 2006, 5,000 options were granted with an exercise price of \$52.30 and a calculated fair value of \$16.66. We recognized \$4,000 of expense in the first three months of 2006 related to this grant. Total unrecognized compensation expense relating to this grant was \$72,000, which will be recognized over the remainder of the five-year vesting period. The fair market value of this grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: risk-free interest rate of 4.58 percent; expected dividend yield of 1.5 percent; expected life of eight years; and expected volatility of 23.0 percent. We are currently transitioning to a lattice-based model for valuing stock options. This model will be in place for valuing all future option grants.

As discussed previously, prior to the adoption of SFAS 123R, we followed the intrinsic value method in accordance with APB 25 to account for employee stock options and accordingly recognized no compensation expense for the stock option grants. In accordance with SFAS 123R, we adopted the provisions of the statement on January 1, 2006 using the modified prospective approach. Under this method, prior periods are not restated. Had compensation cost for the plan been determined consistent with SFAS 123, our net income and earnings per share would have been reduced to the following pro forma amounts:

(in thousands, except per share data)	For the Three-Month Period Ended March 31, 2005	
Net income, as reported	\$	29,307
Add: Stock-based employee compensation expense included in reported income, net of related tax effects		
Deduct: Total stock-based employee compensation expense determined under fair-value-based methods for all awards, net of related tax methods		(622)
Pro forma net income	\$	28,685
Earnings per share:		
Basic as reported	\$	1.15
Basic pro forma	\$	1.13
Diluted		
as reported	\$	1.12
pro forma	\$	1.09

Pro forma disclosures for the first three months of 2006 are not presented because the amounts are recognized in the Statement of Earnings.

Pension Plan: On December 31, 2003, our pension plan was amended to freeze benefit accruals as of March 1, 2004. Additionally, the plan was also closed to new participants after December 31, 2003. Participants' benefits would increase in the future based on changes in their final average earnings. Future pay increases were indexed to a maximum of 5% annually. Increases in excess of 5% would not be reflected in the determination of participants' final average earnings. Effective December 31, 2005, the plan was further amended such that all participants' benefits were frozen and future pay will not alter a participant's accrued benefit. In 2005, we also shortened the amortization period of the plan's unrecognized gain/loss, to fully amortize it over the next two years because we intend to terminate the plan in 2006. Given the necessary regulatory approval process, we expect the entire plan termination process, including final asset distribution, to be completed by the end of 2007.

The table below represents the various components of pension expense for the three month periods ended March 31, 2006 and 2005.

Pension Expense (in thousands)	2006	2005
Service Cost	\$	\$
Interest Cost	147	189
Expected Return on Assets	(121)	(193)
Prior Service Cost		
Recognition of Transition Asset		
Recognition of (Gains)/Losses	324	220
Net Periodic Cost	\$ 350	\$ 216

While the ERISA required minimum contribution for the fiscal year ending December 31, 2006 is \$0, we will likely contribute the amount necessary to terminate the plan in late 2006 and distribute benefits in 2007.

Intangible assets: In accordance with SFAS 142, Goodwill and Other Intangible Assets, the amortization of goodwill and indefinite-lived intangible assets is not permitted. Goodwill and indefinite-lived intangible assets remain on the balance sheet and are tested for impairment on an annual basis, or earlier if there is reason to suspect that their values may have been diminished or impaired. Goodwill and indefinite-lived intangible assets, which relate to our surety segment, are listed separately on the balance sheet and totaled \$26.2 million at March 31, 2006 and December 31, 2005. Impairment testing was performed during 2005, pursuant to the requirements of SFAS 142. Based upon this review, these assets do not appear to be impaired.

Intangible assets with definite lives continue to be amortized over their estimated useful lives. Definite-lived intangible assets that continue to be amortized under SFAS 142 relate to our purchase of customer-related and marketing-related intangibles. These intangibles have useful lives ranging from five to 10 years. Amortization of intangible assets was \$0.1 million for the first three months of 2006 and 2005. At March 31, 2006, net intangible assets totaled \$0.4 million, net of \$5.3 million of accumulated amortization, and are included in other assets.

2. INDUSTRY SEGMENT INFORMATION - Selected information by industry segment for the three-month periods ended March 31, 2006 and 2005 is presented below.

	For the Three-Month Periods Ended March 31,			
	EARNINGS		REVENUES	
	2006	2005	2006	2005
SEGMENT DATA (in thousands)				
Property	\$ 5,078	\$ 8,061	\$ 25,622	\$ 21,133
Casualty	8,886	17,654	87,266	90,607
Surety	1,946	684	14,499	12,300
Segment totals before income taxes	\$ 15,910	\$ 26,399	\$ 127,387	\$ 124,040
Net investment income	16,708	14,612	16,708	14,612
Realized gains	4,442	2,984	4,442	2,984
General corporate expense and interest on debt	(3,537)	(3,714)		
Equity in earnings of unconsolidated investee	2,740	1,259		
Total earnings before income taxes	\$ 36,263	\$ 41,540		
Income tax expense	10,607	12,233		
Total	\$ 25,656	\$ 29,307	\$ 148,537	\$ 141,636

The following table further summarizes revenues (net premiums earned) by major product type within each segment:

(in thousands)	For the Three-Month Period Ended March 31,	
	2006	2005
Property		
Commercial property	\$ 18,033	\$ 16,103
Construction	2,737	3,189
Other property	4,852	1,841
Total	\$ 25,622	\$ 21,133
Casualty		
General liability	\$ 44,907	\$ 44,353
Commercial and personal umbrella	15,696	14,545
Commercial transportation	12,514	13,879
Specialty program business	6,891	9,922
Executive products	3,060	2,596
Other	4,198	5,312
Total	\$ 87,266	\$ 90,607
Surety	\$ 14,499	\$ 12,300
Grand Total	\$ 127,387	\$ 124,040

A detailed discussion of earnings and results by segment is contained in management's discussion and analysis of financial condition and results of operations.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995: This discussion and analysis may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are not historical facts, and involve risks and uncertainties that could cause actual results to differ materially from those expected and projected. Various risk factors that could affect future results are listed in our filings with the Securities & Exchange Commission, including the Form 10-K for the year ended December 31, 2005.

OVERVIEW

We are a holding company that underwrites selected property and casualty insurance and surety coverage through insurance company subsidiaries collectively known as RLI Insurance Group, or the Group. The Group provides property and casualty insurance coverages primarily for commercial risks representing 86% of our consolidated revenue for the first three months of 2006 compared to 88% for the same period last year.

As a niche company, we offer specialty insurance products designed to meet specific insurance needs of targeted insured groups and underwrite particular types of coverage for certain markets that are underserved by the insurance industry, such as our commercial earthquake coverage and oil and gas surety bonds. As a niche company, we also provide types of insurance products not generally offered by other companies, such as our stand-alone personal umbrella policy. The excess and surplus insurance market, which unlike the standard admitted market is less regulated and more flexible in terms of policy forms and premium rates, provides an alternative market for customers with hard-to-place risks and risks that admitted insurers specifically refuse to write. When we underwrite within the surplus lines market, we are selective in the line of business and type of risks we choose to write. Using our non-admitted status in this market allows us to tailor terms and conditions to manage these exposures more effectively than our admitted counterparts. Often the development of these specialty insurance products is generated through proposals brought to us by an agent or broker seeking coverage for a specific group of clients. Once a proposal is submitted, underwriters determine whether a proposal would be a viable product in keeping with our business objectives.

Management measures the results of our insurance operations by monitoring certain measures of growth and profitability across three distinct business segments: property, casualty and surety. Growth is measured in terms of gross premiums written, while profitability is analyzed through GAAP (accounting principles generally accepted in the United States of America) combined ratios, which are further subdivided into their respective loss and expense components. The GAAP combined ratios represent the profit generated from our insurance operations.

The foundation of our overall business strategy is to underwrite for profit. This drives our ability to provide shareholder returns in three different ways: the underwriting profit itself, investment income from fixed-income portfolios, and long-term growth in our equity portfolio. Our investment strategy is based on preservation of capital as the first priority, with a secondary focus on generating total return.

The property and casualty insurance business is cyclical and influenced by many factors, including price competition, economic conditions, natural or man-made disasters (for example, earthquakes, hurricanes, and terrorism), interest rates, state regulations, court decisions and changes in the law. One of the unique and challenging features of the property and casualty insurance business is that products must be priced before costs have fully developed, because premiums are charged before claims are incurred. This requires that liabilities be estimated and recorded in recognition of future loss and settlement obligations. Due to the inherent uncertainty in estimating these liabilities, there can be no assurance that actual liabilities will not be more or less than recorded amounts; if actual liabilities differ from recorded amounts, there will be an adverse or favorable effect on net earnings. In evaluating the objective performance measures previously mentioned, it is important to consider the following individual characteristics of each major insurance segment.

Our property segment primarily underwrites commercial fire, earthquake, difference in conditions, marine, and in the state of Hawaii, select personal lines policies. Property insurance results are subject to the variability introduced by perils such as earthquakes, fires and hurricanes. Our major catastrophe exposure is to losses caused by earthquakes, primarily in the state of California. Our second largest catastrophe exposure is to losses caused by hurricanes to commercial properties throughout the Gulf and East Coasts, as well as to homes we insure in Hawaii. We limit our net aggregate exposure to a catastrophic event by purchasing reinsurance and through extensive use of computer-assisted modeling techniques. These techniques provide estimates of the concentration of risks exposed to catastrophic events.

The casualty portion of our business consists largely of general liability, transportation, multi-peril program business, commercial umbrella, personal umbrella, executive products and other specialty coverages. In addition, we provide employers indemnity and in-home business owners coverage. The casualty book of business is subject to the risk of accurately estimating losses and related loss reserves because the ultimate settlement of a casualty claim may take several years to fully develop. The casualty line may also be affected by evolving legislation and court decisions that define the extent of coverage and the amount of compensation due for injuries or losses.

The surety segment specializes in writing small to large commercial and small contract surety products, as well as those for the energy (plugging and abandonment), petrochemical and refining industries. Our surety products usually involve a statutory requirement for bonds, and these bonds have maintained a relatively low loss ratio. Losses may fluctuate, however, due to adverse economic conditions that may affect the financial viability of an insured. The contract surety marketplace guarantees the construction work of a commercial contractor for a specific project. Generally, losses occur due to adverse economic conditions, inclement weather conditions or the deterioration of a contractor's financial condition. As such, this line has historically produced marginally higher loss ratios than other surety lines.

The insurance marketplace has softened over the last two years, meaning that the marketplace became more competitive and prices were generally flat to falling, even as coverage terms became less restrictive. Recently, pricing in the property segment began to increase, driven by hurricane-related losses for the industry. Nevertheless, we believe that our business model is geared to create underwriting profits by focusing on sound underwriting discipline. Our primary focus will continue to be on underwriting profitability as opposed to premium growth or market share measurements.

GAAP and non-GAAP Financial Performance Metrics

Throughout this quarterly report, we present our operations in the way we believe will be most meaningful, useful and transparent to anyone using this financial information to evaluate our performance. In addition to the GAAP presentation of net earnings and certain statutory reporting information, we show certain non-GAAP financial measures that we believe are valuable in managing our business and drawing comparisons to our peers. These measures include gross revenues, gross written premiums, net written premiums and combined ratios.

Following is a list of non-GAAP measures found throughout this report with their definitions, relationships to GAAP measures, and explanations of their importance to our operations.

Gross revenues

This is an RLI-defined metric equaling the sum of gross premiums written, net investment income and net realized gains (losses). It is used by our management as an overall barometer of gross business volume across all operating segments.

Gross premiums written

While net premiums earned is the related GAAP measure used in the statement of earnings, gross premiums written is the component of net premiums earned that measures insurance business produced before the impact of ceding reinsurance premiums, but without respect to when those premiums will be recognized as actual revenue. We use this measure as an overall gauge of gross business volume in our insurance underwriting operations with some indication of profit potential subject to the levels of our retentions, expenses and loss costs.

Net premiums written

While net premiums earned is the related GAAP measure used in the statement of earnings, net premiums written is the component of net premiums earned that measures gross premiums written less the cost of ceding reinsurance premiums, but without respect to when those premiums will be recognized as actual revenue. We use this measure as an indication of retained or net business volume in our insurance underwriting operations. It is an indicator of future earnings potential subject to our expenses and loss costs.

Combined ratios

This ratio is a common insurance industry measure of profitability for any underwriting operation, and is calculated in two components. First, the expense ratio reflects the sum of policy acquisition costs and insurance operating expenses, divided by net premiums earned. The second component, the loss ratio, is losses and settlement expenses divided by net premiums earned. The sum of the loss and expense ratios is the combined ratio. The difference between the combined ratio and 100 reflects the per-dollar rate of underwriting profit or loss. For example, a combined ratio of 95 implies that for every \$100 of premium we earn, we record \$5 of underwriting profit.

Net Unpaid Loss and Settlement Expenses

Unpaid losses and settlement expenses, as shown in the liabilities section of our balance sheet, represents the total obligations to claimants for both estimates of known claims and estimates for incurred but not reported (IBNR) claims. The related asset item, reinsurance balances recoverable on unpaid losses and settlement expense, is the estimate of known claims and estimates of IBNR that we expect to recover from reinsurers. The net of these two items is generally referred to as net unpaid loss and settlement expenses and is commonly referred to in our disclosures regarding the process of establishing these various estimated amounts.

In preparing the condensed consolidated financial statements, our management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosures of contingent assets and liabilities as of the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses for the reporting period. Actual results could differ significantly from those estimates.

The most critical accounting policies involve significant estimates and include those used in determining the liability for unpaid losses and settlement expenses, investment valuation, recoverability of reinsurance balances and deferred policy acquisition costs.

Critical Accounting Policies

Unpaid Losses and Settlement Expenses

We accrue liabilities intended to represent the ultimate settlement cost of losses and loss expenses incurred but not yet settled as of the accounting date. This includes both claims whose loss circumstances have been reported to us and for which our claims personnel have established estimates of ultimate cost (case reserves), and claims which have occurred, but which have not yet been reported to us (incurred but not reported or IBNR reserves). The ultimate cost of both of these categories, and therefore the liability booked to represent their ultimate cost, involve estimates.

The estimates underlying the accrued liabilities are derived from generally accepted actuarial techniques, applied to our actual experience, and take into account insurance industry data to the extent judged relevant to our operations. These estimates all have a level of uncertainty attached to them that can be measured using generally accepted actuarial techniques. Once uncertainty has been determined, a range of outcomes can be calculated. To that end, we have separated our settlement cost liabilities into three categories: latent liability loss and allocated losses and settlement expenses (LAE), remaining loss and allocated LAE, and unallocated LAE. For each of these categories we use a separate generally accepted actuarial method to measure the uncertainty of the estimates within that category. These methods were selected based on the loss development characteristics of each of the categories.

Our loss experience in a given accounting period is affected by all those factors that influence the quality of the business written in competitive coverage marketplaces: the premiums for which the coverage can be sold, the frequency and severity of claims ultimately produced on that business, the terms at which we purchase reinsurance coverage, and our expense structure. In the estimation of ultimate loss and loss expense liabilities, the factors that most significantly affect the ultimate results are:

changes in claim frequency and severity, or, more generally, the underwriting quality of the business written;

changes in the coverage sold (limits of coverage, deductibles, exclusions and extensions of coverage, reinsurance terms); and

changes in the overall profitability of the competitive coverage marketplace.

One of the unique and challenging features of the property and casualty insurance business is that products must be priced before costs have fully developed, because premiums are charged before claims are incurred. This requires that liabilities be estimated and recorded in recognition of incurred losses and settlement obligations that have not been reported. Due to the inherent uncertainty in estimating these liabilities, there can be no assurance that actual liabilities will not exceed recorded amounts; if actual liabilities do exceed recorded amounts, there will be an adverse effect. Furthermore, we may determine that recorded reserves are more than adequate to cover expected losses as happened during 2005 and, to a lesser degree, so far in 2006, when favorable experience on casualty business led us to reduce our reserves. Further information on these reserve releases is contained in the discussion of results below.

Underwriting Quality of the Business Written

In general, competitive insurance marketplaces change over time. This is particularly true of the excess and surplus lines marketplace. The principal measure of those changes is the average profitability of business in a given segment, which is principally determined by the premium charged as well as the frequency and severity of claims produced. Because the quality of business changes continuously, the ultimate profitability of the business being written in the current accounting period must be estimated. As the quality of the business changes, the reliability of recent experience as a guide to the results of current business weakens.

We therefore monitor changes in the quality of business written by the number of claims per unit of exposure, the cost per claim, and the shifts in the distribution of business by geographic region and product segment. We incorporate our understanding of those changes into our estimates of the ultimate cost of current claims for which reserves have been established.

Changes in the Coverage Sold

The excess and surplus lines marketplace is characterized by somewhat greater regulatory latitude in coverage terms and pricing. As competitive marketplace conditions change, our underwriters respond by modifying our coverage terms and pricing. While this is an appropriate response to a changing competitive environment, it also weakens the reliability of past experience as a predictor of the ultimate cost of claims arising from current business. The admitted marketplaces in which we operate provide for more stable terms and pricing because of their regulated nature. However, this regulation limits our ability to quickly adapt terms and pricing in light of changing marketplace dynamics.

Reinsurance is also important to our operations. Reinsurance is purchased in a related, but distinct competitive marketplace which also changes over time. The changes in the relative cost of reinsurance affect the ultimate cost of net loss liabilities for which we accrue reserves. In general, as we grow and increase our financial capacity to absorb fluctuations in results, our need for, and purchase of, reinsurance may decrease incrementally.

Changes in Overall Profitability

During and immediately after the period in which coverage is provided and the corresponding premiums are earned, there may be little actual claim experience from which to estimate the ultimate cost of those claims. In particular, for longer-tailed liability lines such as excess coverage, the reporting, case reserving, and settlement of those claims may take considerable time.

We therefore use generally accepted actuarial techniques that use the premiums charged for coverage as a basis for estimating the ultimate cost of losses and loss expenses for relatively immature accident periods. While this is technically appropriate, it does introduce another variable into the reserve estimate: the changing profitability of premiums for a given coverage over time. Since the ultimate profitability of the business written in a given period depends upon all the factors mentioned above, highly accurate profitability estimates of the longer-tailed lines are difficult to achieve.

We have insignificant exposure to asbestos and environmental policy liabilities. We entered affected liability lines after the industry had already recognized them as a problem, and we therefore adopted appropriate coverage exclusions. What exposure does exist is through our commercial umbrella, general liability, and discontinued assumed reinsurance lines of business. The majority of that exposure is in the excess layers of our commercial umbrella and assumed reinsurance books of business. Although our asbestos and environmental exposure is limited, management cannot determine our ultimate liability with any reasonable degree of certainty. This ultimate liability is difficult to assess due to evolving legislation on such issues as joint and several liability, retroactive liability, and standards of cleanup and that our participation exists in the excess layers of coverage on these risks.

Investment Valuation

Throughout each year, our internal and external investment managers buy and sell securities to maximize overall investment returns in accordance with investment policies established and monitored by our board of directors and officers. This includes selling individual securities that have unrealized losses when the investment manager believes future performance can be improved by buying other securities deemed to offer superior long-term return potential.

We classify our investments in debt and equity securities with readily determinable fair values into one of three categories. Held-to-maturity securities are carried at amortized cost. Available-for-sale securities are carried at fair value with unrealized gains/losses recorded as a component of comprehensive earnings and shareholders' equity, net of deferred income taxes. Trading securities are carried at fair value with unrealized gains/losses included in earnings.

Management regularly evaluates our fixed maturity and equity securities portfolio to determine impairment losses for other-than-temporary declines in the fair value of the investments. Criteria considered during this process include, but are not limited to: the current fair value as compared to the cost (amortized, in certain cases) of the security, degree and duration of the security's fair value being below cost, credit ratings, current economic conditions, the anticipated speed of cost recovery, and our decisions to hold or divest a security. Impairment losses result in a reduction of the underlying investment's cost basis. Significant changes in these factors could result in a considerable charge for impairment losses as reported in the condensed consolidated financial statements.

Part of our evaluation of whether particular securities are other-than-temporarily impaired involves assessing whether we have both the intent and ability to continue to hold securities in an unrealized loss position. We have not sold any securities for the purpose of generating cash over the last several years to pay claims, dividends or any other expense or obligation. Accordingly, we believe that our sale activity does not undermine our ability to continue to hold securities in an unrealized loss position until our cost may be recovered.

Recoverability of Reinsurance Balances

Ceded unearned premiums and reinsurance balances recoverable on paid and unpaid losses and settlement expenses are reported separately as assets, rather than being netted with the related liabilities, since reinsurance does not relieve us of our liability to policyholders. Such balances are subject to the credit risk associated with the individual reinsurer. Additionally, the same uncertainties associated with estimating unpaid losses and settlement expenses impact the estimates for the ceded portion of such liabilities. We continually monitor the financial condition of our reinsurers. Our policy is to periodically charge to earnings an estimate of unrecoverable amounts from troubled or insolvent reinsurers. Further discussion of our reinsurers and relating reinsurance balances recoverable can be found in note 5 to the financial statements included in our 2005 Annual Report on Form 10-K.

Deferred Policy Acquisition Costs

We defer commissions, premium taxes and certain other costs related to the acquisition of insurance contracts. These costs are capitalized and charged to expense in proportion to premium revenue recognized. The method followed in computing deferred policy acquisition costs limits the amount of such deferred costs to their estimated realizable value. This would also give effect to the premiums to be earned and anticipated losses and settlement expenses, as well as certain other costs expected to be incurred as the premiums are earned. Judgments as to ultimate recoverability of such deferred costs are highly dependent upon estimates of future loss costs associated with the premiums written.

THREE MONTHS ENDED MARCH 31, 2006, COMPARED TO THREE MONTHS ENDED MARCH 31, 2005

Consolidated gross revenues, as displayed in the table that follows, totaled \$196.3 million for the first three months of 2006 compared to \$183.7 million for the same period in 2005.

	For the Three-Month Period Ended March 31,	
	2006	2005
Gross revenues (in thousands)		
Gross premiums written	\$ 175,153	\$ 166,135
Net investment income	16,708	14,612
Net realized investment gains	4,442	2,984
Total gross revenues	\$ 196,303	\$ 183,731

Gross premiums written for the Group advanced 5% from 2005 levels, as both property and surety posted strong growth. Net investment income improved 14% to \$16.7 million. This growth is attributable to continued positive operating cash flow, coupled with a higher interest rate environment. Additionally, the sale of certain securities during the first three months of 2006 resulted in the recognition of \$4.4 million in net realized gains.

Consolidated net revenue for the first three months of 2006 increased \$6.9 million, or 5%, from the same period in 2005. Net premium earned was up 3%, while net investment income advanced 14%.

Net after-tax earnings for the first three months of 2006 totaled \$25.7 million, \$0.97 per diluted share, compared to \$29.3 million, \$1.12 per diluted share, for the same period in 2005. While both periods reflect favorable development on prior year's loss reserves, the magnitude of this favorable development was considerably larger in 2005. During the first three months of 2005, positive development on prior accident year's casualty loss reserves resulted in additional pretax earnings of \$9.1 million (\$0.23 per diluted share). In 2006, positive development on prior accident year's casualty loss reserves resulted in additional pretax earnings of only \$2.3 million (\$0.06 per diluted share). Additionally in 2005, losses related to 2004's Florida hurricanes did not develop as expected, improving 2005's pretax earnings by \$3.8 million (affecting casualty by \$2.8 million and property by \$1.0 million), or \$0.10 per diluted share.

The amounts disclosed for favorable loss development are net of performance-related bonus impacts, which affected other insurance and general corporate expenses. Bonuses earned by executives, managers and associates are predominately influenced by corporate performance (operating earnings and return on capital).

During the first three months of 2006, equity in earnings of unconsolidated investees of \$2.7 million included \$1.9 million related to Maui Jim, Inc. and \$0.8 million from Taylor Bean & Whitaker Mortgage Corp. Results for 2005 showed \$1.3 million in income, which included \$1.0 million related to Maui Jim and \$0.3 million from Taylor Bean & Whitaker. Continued strong operating performance from both companies drove the growth in the current quarter versus the comparable period of 2005.

Results for the first three months of 2006 include pre-tax realized gains of \$4.4 million, \$0.11 per diluted share, compared to pre-tax gains of \$3.0 million, \$0.07 per diluted share, for the same period last year.

Comprehensive earnings, which include net earnings plus unrealized gains/losses net of tax, totaled \$22.1 million, \$0.84 per diluted share, for the first three months of 2006, compared to comprehensive earnings of \$11.8 million, \$0.45 per diluted share, for the same period in 2005. Unrealized losses, net of tax, for the first three months of 2006 were \$3.6 million, \$0.13 per diluted share, compared to unrealized losses of \$17.5 million, \$0.67 per diluted share, for the same period in 2005. Both periods were negatively impacted, to varying degrees, by volatility experienced in the bond and equity markets.

RLI INSURANCE GROUP

As indicated earlier, gross premiums written for the Group advanced to \$175.2 million for the first three months of 2006, as property and surety posted strong growth. Underwriting income for the Group declined \$10.5 million to a pre-tax profit of \$15.9 million for the first three months of 2006. Results for 2005 of \$26.4 million include \$12.9 million in favorable development on prior accident years' casualty and hurricane reserves. On a comparative basis, results for 2006 include only \$2.3 million in favorable development on prior accident years' casualty reserves. The GAAP combined ratio totaled 87.5 for the first three months of 2006, compared to 78.8 for the same period in 2005. The Group's loss ratio increased to 52.3 for 2006, compared to 45.6 for 2005, reflective of the reduction in prior accident years' reserve releases.

	For the Three-Month Period Ended March 31,	
	2006	2005
Gross premiums written (in thousands)		
Property	\$ 42,892	\$ 31,519
Casualty	115,156	120,844
Surety	17,105	13,772
Total	\$ 175,153	\$ 166,135
Underwriting income (in thousands)		
Property	\$ 5,078	\$ 8,061
Casualty	8,886	17,654
Surety	1,946	684
Total	\$ 15,910	\$ 26,399
Combined ratio		
Property	80.2	61.8
Casualty	89.8	80.5
Surety	86.5	94.5
Total	87.5	78.8

Property

Gross premiums written for the Group's property segment improved \$11.4 million, or (36%) from the same period last year. For the first three months of 2006, property's gross premiums totaled \$42.9 million. The addition of our marine division and a reversal of the trend of market softening, which drove rates down the last few years, helped bolster writings in 2006. Our domestic fire book posted a \$9.0 million (64%) increase in written premium, as rates for wind-exposed business have increased significantly. Growth was achieved primarily on the basis of increased rate, as overall exposure to wind perils remained relatively constant. Additionally, our marine division, which was launched during the second quarter of last year added over \$4.0 million in written premium. Offsetting these improvements, construction premium declined \$1.5 million (66%) due to the fourth quarter 2005 decision to discontinue our participation in this line. In addition, while rates for California earthquake business are up over 30% in the first quarter of 2006, premiums for this business were down \$0.7 million (6%), as we continued our strategy of reducing our exposure in this line. For the segment, net premiums written and net premiums earned advanced at a faster pace than gross production. This change is driven primarily by a shift in mix of business and a slight increase in retention. As our domestic fire and marine lines continue to represent a greater proportion of the segment's production, this trend will continue.

Underwriting income for the segment was \$5.1 million for the first three months of 2006, compared to \$8.1 million for the same period in 2005. Results for 2006 translate into a combined ratio of 80.2, compared to 61.8 for the same period last year. The segment's loss ratio advanced to 37.8 from 29.7 in 2005, primarily due to increased loss activity on our domestic fire book. Losses incurred from the Midwest tornados, coupled with a slight increase in loss frequency resulted in the increase in the segment's loss ratio.

From an expense standpoint, the segment's expense ratio increased to 42.4 from 32.1 in Q1 2005. The expense ratio for the first three months of 2005 was lower due to \$2.1 million in increased reinsurance profit commission recognition. The expense ratio in 2006 is more indicative of the trend for this segment.

Casualty

The casualty segment posted gross premiums written of \$115.2 million for the first three months of 2006, down 5% from the same period last year. Rates have continued to soften at a modest pace in the casualty segment. Despite this softening, margins remain good and we continue to find opportunities for profitable growth. Gross premium for executive products advanced \$3.8 million (42%) and umbrella was up \$2.9 million (13%). Despite a slight erosion in rates, general liability, our largest growth contributor over the past several years, posted writings in line with last year and continues to produce profitable results. Our specialty program business declined \$4.7 million (41%) due to increased competition and exiting certain unprofitable accounts. In addition, transportation writings declined \$4.7 million (26%) due to a reduction in rate on both public and trucking and increased competition which resulted in lost renewals. As the casualty market continues to soften, we will remain focused on growing areas that provide the best return, while maintaining strict adherence to underwriting discipline.

In total, the casualty segment posted underwriting income of \$8.9 million, compared to income of \$17.7 million for the same period last year. Results for 2005 include favorable experience on prior accident years (2002 through 2004) for general liability and transportation and specialty programs. Due to this positive emergence, we released reserves. These reserve releases improved the segment's underwriting results by \$9.1 million. Moreover, a re-evaluation of 2004 hurricane reserves resulted in the release of reserves, adding \$2.8 million of underwriting income in 2005. Hurricane reserves on specialty program business (package policies on service stations and hotels) developed favorably and expected demand surge did not materialize, resulting in this 2005 reserve release. From a comparative standpoint, results for 2006 include only \$2.3 million of favorable experience on prior accident years (2000 and 2003), primarily from executive products. Overall, the combined ratio for the casualty segment was 89.8 for 2006 compared to 80.5 in 2005. The segment's loss ratio was 61.5 in 2006 compared to 51.0 in 2005, primarily driven by the reduction in prior accident year's reserve releases.

Surety

The surety segment posted gross premiums written of \$17.1 million for the first three months of 2006, up 24% from the same period last year. Premium growth was experienced across all lines: miscellaneous, commercial, energy and contract. The segment posted underwriting income of \$1.9 million, compared to an income of \$0.7 million for the same period last year. The combined ratio for the surety segment totaled 86.5 in 2006, versus 94.5 for the same period in 2005. The segment's loss ratio was 22.8 for 2006, compared to 32.8 for 2005, as results for both contract and commercial improved considerably. The expense ratio increased to 63.7 but was in line with expectations.

We are in litigation regarding certain commercial surety bond claims arising out of a specific bond program. A detailed discussion of this litigation can be found in Item 3 Legal Proceedings and note 10 of our 2005 Annual Report on Form 10-K. There have no significant changes to this litigation since the filing of this Annual Report.

INVESTMENT INCOME AND REALIZED CAPITAL GAINS

During the first three months of 2006, net investment income increased by 14% over that reported for the same period in 2005. This improvement was due to an increased asset base, higher interest rates, and continued positive operating cash flow. On an after-tax basis, investment income increased by 13%. Operating cash flows were \$21.7 million in the first three months of 2006, down from \$31.0 million reported for the same period in 2005. Cash flows in excess of current needs were primarily used to purchase fixed-income securities, which continue to be comprised largely of high-grade, tax-exempt, corporate and U.S. government/agency issues. The average annual yields on our investments for the first three months of 2006 and 2005 were as follows.

Pretax Yield	1Q 2006	1Q 2005
Taxable	5.06%	4.92%
Tax-Exempt	3.96%	4.01%
After-tax yield		
Taxable	3.29%	3.20%
Tax-Exempt	3.75%	3.80%

During the first three months of 2006, the average after-tax yield of the fixed-income portfolio was relatively stable. The yield decreased slightly on tax-exempt bonds.

The fixed-income portfolio decreased by \$33.6 million during the first three months of 2006. This portfolio had a tax-adjusted total return on a mark-to-market basis of 0.0%. Our equity portfolio increased by \$12.0 million during the first three months of 2006, to \$333.1 million. The equity portfolio had a total return of 5.6% during the first three months of 2006.

We realized a total of \$4.4 million in capital gains in the first three months of 2006, compared to capital gains of \$3.0 million in the first three months of 2005. The increase in net realized gains is due in part to the timing of the sale of individual securities.

We regularly evaluate the quality of our investment portfolio. When we believe that a specific security has suffered an other-than-temporary decline in value, the investment's value is adjusted by reclassifying the decline from unrealized to realized losses. This has no impact on shareholders' equity. There have been no losses associated with the other-than-temporary impairment of securities since 2002.

The following table is used as part of our impairment analysis and illustrates, by certain industry-level categories, our equity portfolio as of March 31, 2006, including fair value, cost basis, and unrealized gains and losses.

Edgar Filing: EBAY INC - Form PRE 14A

(dollars in thousands)	Cost Basis	3/31/06 Fair Value	Gross Unrealized		Net	Unrealized Gain/Loss% (1)
			Gains	Losses		
Consumer Discretionary	\$ 12,697	\$ 15,573	\$ 2,899	\$ (23)	\$ 2,876	22.7%
Consumer Staples	17,792	33,133	15,721	(380)	15,341	86.2%
Energy	10,644	28,092	17,450	(3)	17,448	163.9%
Financials	31,564	62,942	31,447	(69)	31,378	99.4%
Healthcare	11,286	26,098	14,812	(0)	14,812	131.2%
Industrials	16,964	39,034	22,088	(17)	22,070	130.1%
Materials	5,181	9,355	4,185	(10)	4,174	80.6%
Information Technology	13,075	17,845	5,275	(506)	4,770	36.5%
Telecommunications	9,572	15,922	6,350		6,350	66.3%
Utilities	45,173	65,057	20,026	(141)	19,884	44.0%
Other	20,070	20,088	18		18	0.1%
Total	\$ 194,016	\$ 333,138	\$ 140,270	\$ (1,149)	\$ 139,121	71.7%

(1) Calculated as the percentage of net unrealized gain (loss) to cost basis.

The following table is also used as part of our impairment analysis and illustrates the total value of securities that were in an unrealized loss position as of March 31, 2006. It segregates the securities based on type, noting the fair value, cost (or amortized cost), and unrealized loss on each category of investment as well as in total. The table further classifies the securities based on the length of time they have been in an unrealized loss position.

**Investment Positions with Unrealized Losses
Segmented by Type and Period of Continuous
Unrealized Loss at March 31, 2006**

(dollars in thousands)	0-12 Mos.		> 12 Mos.		Total
U.S Government					
Fair value	\$	11,372	\$	\$	11,372
Cost or Amortized Cost		11,818			11,818
Unrealized Loss		(446)			(446)
U.S Agency					
Fair value	\$	401,133	\$	23,918	\$ 425,051
Cost or Amortized Cost		407,185		25,010	432,195
Unrealized Loss		(6,052)		(1,092)	(7,144)
Mtge/ABS/CMO					
Fair value	\$	83,785	\$	990	\$ 84,775
Cost or Amortized Cost		85,832		1,005	86,837
Unrealized Loss		(2,047)		(15)	(2,062)
Corporate					
Fair value	\$	169,322	\$	15,054	\$ 184,376
Cost or Amortized Cost		174,600		16,208	190,808
Unrealized Loss		(5,278)		(1,154)	(6,432)
States, political subdivisions & revenues					
Fair value	\$	270,984	\$	26,918	\$ 297,902
Cost or Amortized Cost		275,774		27,690	303,464
Unrealized Loss		(4,790)		(772)	(5,562)
Subtotal, debt securities					
Fair value	\$	936,596	\$	66,880	\$ 1,003,476
Cost or Amortized Cost		955,209		69,913	1,025,122
Unrealized Loss		(18,613)		(3,033)	(21,646)
Common Stock					
Fair value	\$	18,580	\$	\$	18,580
Cost or Amortized Cost		19,729			19,729
Unrealized Loss		(1,149)			(1,149)
Total					
Fair value	\$	955,176	\$	66,880	\$ 1,022,056
Cost or Amortized Cost		974,938		69,913	1,044,851
Unrealized Loss		(19,762)		(3,033)	(22,795)

Edgar Filing: EBAY INC - Form PRE 14A

The following table shows the composition of the fixed income securities in loss positions at March 31, 2006 by the National Association of Insurance Commissioners (NAIC) rating and the generally equivalent S&P and Moody's ratings. Not all of the securities are rated by S&P and/or Moody's.

		Equivalent		(dollars in thousands)				
NAIC	S&P	Moody's				Unrealized	Percent	
Rating	Rating	Rating	Book Value	Fair Value	Loss	to Total		
1	AAA/AA/A	Aaa/Aa/A	\$ 959,441	\$ 939,835	\$ (19,606)	90.6%		
2	BBB	Baa	65,681	63,641	(2,040)	9.4%		
3	BB	Ba	0	0	0	0%		
4	B	B	0	0	0	0%		
5	CCC or lower	Caa or Lower	0	0	0	0%		
6			0	0	0	0%		
		Total	\$ 1,025,122	\$ 1,003,476	\$ (21,646)	100%		

As of March 31, 2006, we held forty eight common stock positions that were in unrealized loss positions. Unrealized losses on these securities totaled \$1.1 million. All of these securities have been in an unrealized loss position for less than nine months.

The fixed income portfolio contained 496 unrealized loss positions as of March 31, 2006. The \$21.6 million in associated unrealized losses for these 496 securities is only 1.6% of the fixed income portfolio's cost basis. Of these 496 securities, 42 have been in an unrealized loss position for more than 12 consecutive months and these collectively represent \$3.0 million in unrealized losses (0.2% of total fixed income portfolio's cost basis). The fixed income unrealized losses can primarily be attributed to an increase in medium and long-term interest rates since the purchase of many of these fixed income securities. We continually monitor the credit quality of our fixed income investments to gauge our ability to be repaid principal and interest. We consider price declines of securities in our other-than-temporary-impairment analysis where such price declines provide evidence of declining credit quality, and we distinguish between price changes caused by credit deterioration, as opposed to rising interest rates.

INCOME TAXES

Our effective tax rate for the first three months of 2006 and 2005 was 29%. Effective rates are dependent upon components of pretax earnings and the related tax effects. Income tax expense attributable to income from operations differed from the amounts computed by applying the U.S. federal tax rate of 35% to pretax income for the first three months of 2006 and 2005 as a result of the following:

(in thousands)	2006		2005	
	Amount	%	Amount	%
Provision for income taxes at the Statutory rate of 35%	\$ 12,692	35%	\$ 14,539	35%
Increase (reduction) in taxes resulting from:				
Tax exempt interest income	(1,512)	(4)%	(1,446)	(4)%
Dividends received deduction	(458)	(1)%	(458)	(1)%
Dividends paid deduction	(116)	(1)%	(104)	
Other items, net	1		(298)	(1)%
Total tax expense	\$ 10,607	29%	\$ 12,233	29%

LIQUIDITY AND CAPITAL RESOURCES

We have three primary types of cash flows: (1) cash flows from operating activities, which consist mainly of cash generated by our underwriting operations and income earned on our investment portfolio, (2) cash flows from investing activities related to the purchase, sale and maturity of investments, and (3) cash flows from financing activities that impact our capital structure, such as changes in debt and shares outstanding.

Cash flows from operating activities decreased during the first three months of 2006 compared to last year, due to an increase in claim payments. The following table summarizes these cash flows for the three month periods ended March 31, 2006 and 2005.

(in thousands)	2006		2005	
Operating cash flows	\$ 21,709		\$ 31,015	
Investing cash flows	\$ (5,578)		\$ (27,028)	
Financing cash flows	\$ (16,131)		\$ (3,987)	
Total	\$		\$	

We have \$100.0 million in long-term debt outstanding. On December 12, 2003, we completed a public debt offering, issuing \$100.0 million in senior notes maturing January 15, 2014 (a 10-year maturity), and paying interest semi-annually at the rate of 5.95% per annum. The notes were issued at a discount resulting in proceeds, net of discount and commission, of \$98.9 million.

As of December 31, 2005 and March 31, 2006, we were party to three reverse repurchase agreements (short-term debt) totaling \$15.5 million and \$15.3 million, respectively.

We are not party to any off-balance sheet arrangements.

At March 31, 2006, we had short-term investments maturing within one year of approximately \$121.7 million and investments of \$429.3 million maturing within five years. We maintain revolving lines of credit with two financial institutions, each of which permits us to borrow up to an aggregate principal amount of \$10.0 million. Under certain conditions, each of the lines may be increased up to an aggregate principal amount of \$20.0 million. The facilities have three-year terms that expire on May 31, 2008. As of March 31, 2006, no amounts were outstanding on these facilities.

We believe that cash generated by operations, cash generated by investments and cash available from financing activities will provide sufficient sources of liquidity to meet our anticipated needs over the next 12 to 24 months.

We maintain a well-diversified investment portfolio representing policyholder funds that have not yet been paid out as claims, as well as the capital we hold for our shareholders. As of March 31, 2006, our investment portfolio had a book value of \$1.8 billion. Invested assets at March 31, 2006, increased by \$54.8 million, from December 31, 2005.

As of March 31, 2006, our fixed-income portfolio had the following rating distribution:

AAA	76.6%
AA	10.4%
A	7.6%
BBB	5.4%
Total	100.00%

As of March 31, 2006, the duration of the fixed income portfolio was 5.05 years. Our fixed-income portfolio remained well diversified, with 735 individual issues as of March 31, 2006. During the first three months of 2006, the total return on our bond portfolio on a tax-equivalent, mark-to-market basis was 0.0%.

In addition, at March 31, 2006, our equity portfolio had a value of \$333.1 million and is also a source of liquidity. The securities within the equity portfolio remain primarily invested in large-cap issues with strong dividend performance. Included within our equity portfolio are certain real estate investment trust (REIT) securities. Our investment strategy remains one of value investing, with security selection taking precedence over market timing. We use a buy-and-hold strategy, minimizing both transactional costs and taxes.

In the first quarter of 2006, we allocated investment funds to additional asset classes. An allocation was made to a high yield municipal bond mutual fund. In addition, funds were placed into an enhanced dividend equity strategy. These two investment vehicles have exhibited favorable historic risk/return profiles and low correlation to the existing investment portfolio.

As of March 31, 2006, our equity portfolio had a dividend yield of 2.8% compared to 1.8% for the S&P 500 index. Because of the corporate-dividend-received deduction applicable to our dividend income, we pay an effective tax rate of only 14.2% on dividends, compared to 35.0% on taxable interest and REIT income and 5.0% on municipal bond interest income. As with our bond portfolio, our group of 158 equity securities is well diversified. During the first three months of 2006, the total return on our equity portfolio on a mark-to-market basis was 5.6%.

Our capital structure is comprised of equity and debt outstanding. As of March 31, 2006, our capital structure consisted of \$100.0 million in 10-year maturity senior notes maturing in 2014 (long-term debt), \$15.3 million in reverse repurchase debt agreements with maturities from zero to six months (short-term debt), and \$700.0 million of shareholders' equity. Debt outstanding comprised 16.5% of total capital as of March 31, 2006.

Our 119th consecutive quarterly dividend payment was declared in the first quarter of 2006 and paid on April 14, 2006 in the amount of \$0.17 per share. Since the inception of cash dividends in 1976, we have increased our annual dividend every year. In its annual Handbook of Dividend Achievers, Mergent FIS (formerly a division of Moody's) ranked us 171st of more than 11,000 U.S. public companies in dividend growth over the last decade.

Dividend payments to us from our principal insurance subsidiary are restricted by state insurance laws as to the amount that may be paid without prior approval of the regulatory authority of Illinois. The maximum dividend distribution is limited by Illinois law to the greater of 10% of RLI Insurance Company's policyholder surplus as of December 31 of the preceding year, or its net income for the 12-month period ending December 31 of the preceding year. Therefore, the maximum dividend distribution that can be paid by RLI Insurance Company during 2006 without prior approval is \$69.1 million. In the first three months of 2006, a \$35.2 million dividend was received as an asset transfer from RLI Insurance Company relating to RLI Insurance Company's investment in Maui Jim, Inc. This leaves \$33.9 million in dividend capacity from insurance subsidiaries for the remainder of 2006. The total amount paid in all of 2005 was \$13 million.

Interest and fees on debt obligations totaled \$1.7 million for the first three months of 2006, up \$128,000 from the same period in 2005. Rising interest rates in the reverse repurchase markets have been offset by a reduction in the outstanding balance of these instruments. As of March 31, 2006, outstanding debt balances totaled \$115.3 million, compared to \$146.9 million at March 31, 2005. The March 31, 2006 debt balance is comprised of the \$100.0 million in senior notes and \$15.3 million in reverse repurchase agreements. The March 31, 2005 balance of \$146.9 million consisted of \$100.0 million in senior notes and \$46.9 million in reverse repurchase agreements. The Company has incurred interest expense on debt at the following average interest rates for the three month periods ended March 31, 2006 and 2005:

	1Q	1Q
	2006	2005
Line of Credit	NA	NA
Reverse repurchase agreements	4.55%	2.51%
Total short-term debt	4.82%	2.68%
Senior notes	6.02%	6.02%
Total Debt	5.86%	4.95%

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of economic losses due to adverse changes in the estimated fair value of a financial instrument as the result of changes in equity prices, interest rates, foreign exchange rates and commodity prices. Our consolidated balance sheets include assets and liabilities whose estimated fair values are subject to market risk. The primary market risks are equity price risk associated with investments in equity securities and interest rate risk associated with investments in fixed maturities. From time to time, equity prices and interest rates fluctuate causing an effect on our investment portfolio. We have no exposure to foreign exchange risk and no direct commodity risk.

Our market risk exposures at March 31, 2006, have not materially changed from those identified in our 2005 Annual Report on Form 10-K.

ITEM 4. Controls and Procedures

We maintain a system of controls and procedures designed to provide reasonable assurance as to the reliability of the financial statements and other disclosures included in this report, as well as to safeguard assets from unauthorized use or disposition. An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures was performed, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures are effective, as of the end of the period covered by this report.

In designing and evaluating our disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurances of achieving the desired control objective, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. We believe that our disclosure controls and procedures provide such reasonable assurance.

No changes were made to our internal control over financial reporting during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

- Item 1. Legal Proceedings** There were no material changes to report.
- Item 1A. Risk Factors** There were no material changes to report.
- Item 2. Unregistered Sales of Equity Securities and Use of Proceeds** Not Applicable
- Item 3. Defaults Upon Senior Securities** - Not Applicable
- Item 4. Submission of Matters to a Vote of Security Holders** Not Applicable
- Item 5. Other Information** - Not Applicable

Item 6. Exhibits

Exhibit 31.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

RLI Corp.

/s/Joseph E. Dondanville
Joseph E. Dondanville
Sr. Vice President, Chief Financial Officer
(Duly authorized and Principal
Financial and Accounting Officer)

Date: April 27, 2006