

GOING DUTCH: THE GOOGLE IPO

By Eugene Choo

The initial public offering (IPO) by Internet search giant Google was arguably the most talked about IPO of 2004. In April 2004, Google founders Larry Page and Sergey Brin announced their intention to take the company public. They surprised investors when they revealed that Google would use a Dutch auction¹ process for its IPO, rather than a traditional, investment bank-led offering. Bidding for shares closed on August 18, 2004, and trading commenced on August 19, 2004.

GOOG's debut at \$85 per share was accompanied by plenty of publicity and press coverage. The IPO price had dropped from an initial estimated range of \$108-\$135, yet Google still managed to raise \$1.67 billion. Of this amount, \$1.2 billion went to the company and \$473 million went to Google executives and investors selling their shares.² Page, Brin, CEO Eric Schmidt, senior Google managers and directors, and long-term Google employees gained potential millions through the value of their stock and stock options. Driven by market hype and strong investor interest, the stock price surged in the following weeks, and traded as high as \$210.86 on February 3, 2005.³

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1. Dutch auction IPOs are fairly uncommon. At the time of the Google IPO, only ten U.S. companies had gone public using a Dutch auction process. Dutch auction IPOs differ from traditional IPOs in that the initial share price is determined largely through a pre-IPO bidding process, instead of being pre-set by underwriting investment banks. *See, e.g., Completed Auctions*, WR Hambrecht + Co., at <http://www.wrhambrecht.com/ind/auctions/completed.html> (last visited Mar. 12, 2005); WR Hambrecht + Co., *Open IPO: How It Works*, at <http://www.openipo.com/ind/auctions/openipo/index.html> (last visited Mar. 10, 2005) [hereinafter *Open IPO*]; *see also* PAUL MILGROM, PUTTING AUCTION THEORY TO WORK 26, 241 (2004).

2. The IPO price adjustment resulted from several factors, among them a perception by market analysts that the initial price range overvalued the company. *See, e.g., Google IPO Priced at \$85 a Share*, CNN.COM, Aug. 19, 2004, at <http://edition.cnn.com/2004/BUSINESS/08/19/google.ip0>; Paul La Monica, *Google Goes Low: IPO Set at \$85 a Share*, CNN.COM, Aug. 19, 2004, at <http://money.cnn.com/2004/08/18/technology/googleipo>; Andrew Ross Sirkin & Gary Rivlin, *SEC Approves Google IPO, Company Cuts Share Price*, N.Y. TIMES, Aug. 18, 2004, available at <http://www.nytimes.com/2004/08/18/technology/18CND-GOOGLE.html?ex=1095998400&en=54af74a3266605c4&ei=5070>.

3. *See, e.g.,* Les Christie, *The ABCs of a Unique IPO: The Hottest Tech IPO in Years Will Be Run as a Dutch Auction*, CNN.COM, Apr. 29, 2004, at <http://money.cnn.com/2004/04/29/technology/googleauction>. For stock quotes and trends, *see, for exam-*

Google's IPO was very lucrative and generally successful, especially considering its unconventional Dutch auction process. Despite various criticisms by observers and initial missteps by the company, Google's modified Dutch auction set an appropriate price for the offering and satisfied the company's business and cultural goals. The Google example also shows that Dutch auction IPOs can work for larger companies. However, as is discussed below, Google's success may have been unique to the circumstances. Because most companies (especially smaller privately-held firms) will not enjoy the same advantages that Google had, a significant increase in Dutch auction IPOs is unlikely to occur in the near future. Instead, most IPOs will likely continue to take place under the traditional model.

This Note examines several questions brought up by the Google IPO: (1) Why did Google management opt to use a Dutch auction, and how successful was it? (2) How does the Google IPO compare with traditional IPOs and other Dutch auction IPOs? (3) Did Google's modified Dutch auction⁴ really make the offering more "democratic"—that is, more accessible to average investors and the general public? (4) Are Dutch auction IPOs a viable alternative to the traditional IPO model? (5) Can other companies successfully emulate Google's approach when going public? Part I includes a synopsis of Google's corporate history and an overview of IPOs in the technology age. Part II outlines Google's goals and its IPO process. Finally, Part III discusses and evaluates the Google IPO and its subsequent effects.

I. BACKGROUND: THE GOOGLE STORY AND IPOs IN THE TECHNOLOGY AGE

A. Google's History

Google founders Larry Page and Sergey Brin met in 1995, while they were computer science graduate students at Stanford University. In 1998, Page and Brin founded Google Inc., after securing \$100,000 from an "angel"⁵ investor. The company was incorporated and officially began opera-

ple, Bloomberg.com, at <http://www.bloomberg.com> (last visited Mar. 10, 2005); Yahoo! Finance, at <http://finance.yahoo.com> (last visited Mar. 10, 2005).

4. The distinction between a pure Dutch auction and Google's modified Dutch auction is explained *infra* Part III.

5. Angel investors provide the initial financing necessary for a startup company. "Angels are typically successful business people with a high net worth that invest in and often advise start-up companies." Richard Mann et al., *Starting From Scratch: A Lawyer's Guide to Representing a Start-up Company*, 56 ARK. L. REV. 773, 823 (2004).

tions on September 7, 1998, in Menlo Park, California. Google's search engine began in Beta status, but achieved full operation by 1999. The same year, Google secured \$25 million in first-round financing from premier venture capital firms Sequoia Capital and Kleiner Perkins Caufield & Byers.⁶

Page and Brin took pride in the fact that they were able to build a unique corporate culture based on collegiality and innovation.⁷ As of 2000, Google.com was handling more than 100 million search queries a day. Google also partnered with online portal Yahoo! to provide Yahoo! with search engine technology and services, although this partnership ended in early 2004.⁸ By 2002, Google had overtaken Yahoo! as the market leader in search technology and won several industry awards for its search engine. In the following two years, Google further solidified its status as the top search engine and became an established brand name on the Internet and beyond.⁹

In contrast to many Internet startups, Google was a financial success enjoying a steady revenue stream based on advertising, while simultaneously providing technologically-sound products.¹⁰ In 2004, Google also

6. See *Google History*, at <http://www.google.com/corporate/history.html> (last visited Feb. 18, 2005).

7. *Id.*

8. Jim Hu & Stephanie Olsen, *Yahoo Dumps Google Search Technology*, CNET NEWS.COM, Feb. 17, 2004, at http://news.zdnet.com/2100-3513_22-5160710.html. Yahoo! dropped Google after acquiring search engine companies Inktomi, Overture, Alta-vista, and Alltheweb in 2003. Yahoo! and Google quickly became fierce competitors, as evidenced by Yahoo!'s recent patent infringement lawsuit against Google. Prior to Google's IPO, Yahoo! agreed to drop the suit, in exchange for 2.7 million Google shares, worth up to \$300 million at the \$85/share IPO price. See *Google's IPO Rollercoaster*, ECONOMIST, Aug. 20, 2004, available at http://www.economist.com/agenda/displayStory.cfm?story_id=3103916; Deborah Lohse, *Google IPO to Offer More Shares*, SAN JOSE MERCURY NEWS, Aug. 9, 2004, available at http://www.mercurynews.com/ml/mercurynews/business/special_packages/google/9357106.htm.

9. Google currently receives over 200 million search requests a day. See, e.g., *The Amazing Shrinking Google IPO*, CBS MARKETWATCH, Aug. 18, 2004, at <http://www.cbsnews.com/stories/2004/08/18/tech/main636869.shtml> (Aug. 18, 2004). See generally Paul La Monica, *Google Sets \$2.7 Billion IPO*, CNN.COM, Apr. 30, 2004, at <http://money.cnn.com/2004/04/29/technology/google>. Google further strengthened its brand name when it won dismissal of a trademark infringement suit by Geico. Stefanie Olsen, *Google Wins in Trademark Suit with Geico*, CNET NEWS.COM, Dec. 15, 2004, at <http://www.wrhambrecht.com/ind/auctions/completed.html>.

10. In its first report as a public company, Google declared revenues of \$805.9 million for third quarter 2004, more than double the \$394 million figure for third quarter 2003. Google Investor Relations, *Google Announces Record Revenues for Third Quarter 2004*, at <http://investor.google.com/releases/2004Q3.html>. See generally Google Finan-

began beta-testing an advertising-based webmail product—Gmail. Other presently offered technologies include Google Toolbar, Google Desktop, Froogle (a comparison shopping search engine), and Newsgroups, Images, and News search engines.¹¹ By early 2004, Google had firmly positioned itself as the market leader in search engine technology. Page and Brin felt that the company was ready to go public, and in April 2004, they announced their decision to take that route.¹²

B. The Dot-Com Boom: Venture Capital and IPOs

The dot-com boom brought the rise of the startup funding model for nascent technology companies. Initially funded by angel investors, and further financed by subsequent rounds of venture capital, these companies—particularly in Silicon Valley—went public during the bull market of the mid-to-late 1990s. Companies such as Amazon.com, Yahoo!, and eBay raised millions through their IPOs, and are still viable today despite the dot-com crash following the turn of the millennium. Other companies, such as Pets.com, EToys, and Webvan, were not as successful.¹³ Although such companies raised millions at the IPO stage, their business plans were not sustainable in the long run. Still others, such as America Online, either merged with or were eventually acquired by traditional media companies.¹⁴

Technology companies helped fuel both the late 1990s boom and the downturn that followed. Stock indices soared as investors poured money into hot new stock issues, many of which were by high-tech or Internet startups. Overvaluation of companies, short-term stock speculation, and

cial Data, at http://investor.google.com/fin_data.html. For a discussion of Google's key revenue sources, see *Google's IPO Rollercoaster*, *supra* note 8.

11. Google also recently announced an ambitious plan to digitize the collections of five major libraries: Stanford University, University of Michigan, Harvard University, University of Oxford, and the New York Public Library. See Barbara Quint, *Google and Research Libraries Launch Massive Digitization Project*, INFO. TODAY, Dec. 20, 2004, at <http://www.infotoday.com/newsbreaks/nb041220-2.shtml>.

12. See *Google History*, *supra* note 6; see also *Google's IPO Rollercoaster*, *supra* note 8 (describing Google's key revenue sources).

13. See, e.g., Elizabeth Blakey, *Venture Capital's Biggest Losers*, ECOMMERCENEWS.COM, Apr. 26, 2001, at <http://www.ectnews.com/story/9180.html>.

14. America Online (now AOL Time Warner) acquired Netscape in 1998, and eventually merged with Time Warner. See, e.g., Sandeep Junnarkar & Tim Clark, *AOL Buys Netscape for \$4.2 Billion*, CNET NEWS.COM, Nov. 24, 1998, at <http://news.com.com/2100-1023-218360.html?legacy=cnet>.

post-IPO “pops” of 300% were not uncommon.¹⁵ The majority of emerging companies were backed by significant amounts of venture capital. Major venture capital firms such as Sequoia Capital, Kleiner Perkins Caufield & Byers, Accel Partners, and Hummer Winblad provided the funding necessary for hundreds of startups, as well as secondary financing for more established technology companies.¹⁶

1. *The Venture Financing Process*

The venture financing process generally involves three steps.¹⁷ First, the recipient company’s founders come up with an idea and a business plan, usually committing their own financial resources prior to seeking outside funding. The company principals then search for additional seed and startup capital, usually provided by an angel investor, in exchange for an equity interest in the company in the form of preferred stock. Seed capital provides funds necessary for research and market testing, while startup capital funds the purchase of equipment and infrastructure and the hiring of employees. Finally, for successive rounds of financing,¹⁸ venture capitalists provide funds in exchange for one or a combination of: preferred stock, convertible debt, warrants, and options.¹⁹

15. Software company VA Linux surged almost 700% on the first day of its IPO. See, e.g., Mark Gimein, *Dissecting the VA Linux IPO*, SALON.COM, Dec. 10, 1999, at http://archive.salon.com/tech/log/1999/12/10/va_linux (Dec. 10, 1999).

16. See, e.g., Joseph Bankman & Ronald Gilson, *Why Start-ups?*, 51 STAN. L. REV. 289, 289 (1999) (“The prototypical start-up involves an employee leaving her job with an idea and selling a portion of that idea to a venture capitalist.”). Some successful VC-backed companies include Amazon, AOL, Apple, Cisco, Sun, VeriSign, and Yahoo!. For a more detailed description of venture capital, fund formation, and financing, see OREN FUERST & URI GEIGER, *FROM CONCEPT TO WALL STREET* (2003); STEVE HARMON, *ZERO GRAVITY 2.0: LAUNCHING TECHNOLOGY COMPANIES IN A TOUGHER VENTURE CAPITAL WORLD* (2001); PRIVATE EQUITY AND VENTURE CAPITAL: A PRACTICAL GUIDE FOR INVESTORS AND PRACTICIONERS (Rick Lake & Ronald Lake eds., 2000); National Venture Capital Association, at <http://www.nvca.org> (last visited Feb. 18, 2005); *Venture Capital*, WIKIPEDIA: THE FREE ENCYCLOPEDIA, at http://en.wikipedia.org/wiki/Venture_capital (last visited Feb. 18, 2005).

17. Venture capital firms are usually formed as limited/limited-liability partnerships, with a pool of resources drawn from pension funds, university endowments, insurance companies, and other large institutional funds. See sources cited *supra* note 16. See generally, e.g., Kleiner Perkins Caufield & Byers, at <http://www.kpcb.com> (last visited Feb. 18, 2005); Sequoia Capital, at <http://www.sequoiacap.com> (last visited Feb. 18, 2005).

18. Successive financing rounds are referred to as “second-stage” and/or “mezzanine” financing. See sources cited *supra* note 16.

19. See sources cited *supra* note 16; see also Mann et al., *supra* note 5, at 824 (“VCs differ from angels in that they typically invest other investors’ capital in start-ups.”).

Because there is a substantial risk of venture failure, venture capital firms typically take measures to help offset that risk. This includes retaining an equity interest (preferred stock) in the company, as well as charging financing fees and/or securing convertible debt against the company. Other negotiable instruments include warrants and stock options.²⁰ Key company assets such as capital stock (buildings, equipment, and infrastructure) and intellectual property²¹ are often used as collateral when securing debt.

Venture capital firms structure investment agreements to create significant rights in recipient companies' governance.²² When negotiating a financing deal, both the venture capital firm and the recipient company must address several key terms, including level of control, offsetting risk, fees, technology/intellectual property, and harvesting/exit strategy. Most venture capital firms reserve the power to hire and fire certain managers, to buy out existing partners or owners, and to provide operational and technical guidance.²³

Venture capital firms will also negotiate either a harvesting agreement or an alternative exit strategy.²⁴ If the recipient company is successful, its venture backers expect to "harvest" their initial investment by selling their stock, warrants, options, convertibles, or other forms of equity in three to ten years. The harvesting process becomes more complicated if the company merges with or is acquired by another firm.²⁵ A venture capital

20. See *supra* notes 16-19 and accompanying text. For a definition of stock options, warrants, and other instruments, see, for example, *Stock Option*, WIKIPEDIA: THE FREE ENCYCLOPEDIA, at http://en.wikipedia.org/wiki/Stock_option (last visited Feb. 18, 2005) ("A stock option is a specific type of option with a stock as the underlying [security] . . . [I]t is a contract to buy . . . or sell . . . shares of stock, at a predetermined or calculable . . . price."); *Warrant (finance)*, WIKIPEDIA: THE FREE ENCYCLOPEDIA, at http://en.wikipedia.org/wiki/Warrant_%28finance%29 (last visited Feb. 18, 2005) ("A warrant is the right—but not the obligation—to buy or sell a certain quantity of an underlying instrument at an agreed-upon price").

21. Intellectual property is a valuable asset for technology companies. Mann et al., *supra* note 5, at 775-90.

22. *Id.* at 804.

23. See sources cited *supra* note 16; see also Ronald Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1082 (2003) (Venture capital firms have an "incentive to make the investment in monitoring necessary to evaluate the portfolio company's overall performance over the initial funding period."). See generally Mann et al., *supra* note 5, at 804-05.

24. A privately-held company may also eventually choose to go public. Harvesting agreements and alternative exit strategies—for example, merger/acquisition or IPO—allow venture capital firms to "cash out" at the end of their investment. See sources cited *supra* note 23 and accompanying text.

25. See Mann et al., *supra* note 5, at 839.

firm's exit strategy also "provides the means to give the entrepreneur an important performance incentive: a call option on control, the exercise of which is implemented by the venture capital fund's realization of its investment in the portfolio company by means of an IPO."²⁶

2. *Going Public: The Traditional Model*

Companies typically go public to raise substantial new capital for further growth; at the same time this creates liquidity for the company's private shareholders and venture backers.²⁷ An IPO also gives the company exposure to the market, thus facilitating future financing opportunities.²⁸ Prior to the IPO, company management must file a series of documents with the Securities and Exchange Commission (SEC), including a Form S-1 (initial registration statement).²⁹ The IPO is subject to the 1933/1934 Securities Acts and SEC rules, including Regulation FD and Rule 10b-5.³⁰

When going public, the majority of privately-held companies utilize the traditional book-building IPO model.³¹ In this model, investment banks serve as middlemen or gatekeepers between the company and the banks' "book of business"—large institutional investors, insurance and

26. Gilson, *supra* note 23, at 1091.

27. Gregory Lederman, Note, *Initial Public Offerings in the Age of the Internet*, 2 J. LEGAL ADVOC. & PRAC. 43, 44-45 (2000).

28. Mann et al, *supra* note 5, at 840. Significant benefits "of going public include the prestige, visibility, and credibility associated with public companies." *Id.* There are also significant costs, including the hiring of "underwriters, securities lawyers, accountants, and financial printers." *Id.* Nor does going public guarantee business success—investors may avoid IPOs when the economy is in a recession; public companies are also more vulnerable to hostile takeovers. Thus, private companies must carefully consider these benefits and costs before deciding to go public. *Id.* at 839-43.

29. The S-1 includes required disclosures and prospectus. Additional documents include the Form 10-Q (quarterly report). See *Form Types Used for Electronic Filing on EDGAR*, U.S. Securities and Exchange Commission, at <http://www.sec.gov/info/edgar/forms/edgform.htm> (last visited Mar. 10, 2005).

30. See Mann et al., *supra* note 5, at 829-33, 842-44; see also Andres Rueda, *The Hot IPO Phenomenon and the Great Internet Bust*, 7 FORDHAM J. CORP. & FIN. L. 21, 22-24 (2001). Regulation Fair Disclosure ("Regulation FD") addresses selective disclosure. Secs. & Exch. Comm'n, at <http://www.sec.gov/rules/final/33-7881.htm> (last visited Mar. 17, 2005). Rule 10b5 addresses insider trading liability, either on the basis of a trader's "'use' or 'knowing possession' of material nonpublic information" (Rule 10b5-1) or misappropriation resulting from a breach of a duty of trust or confidence. Secs. & Exch. Comm'n, at <http://www.sec.gov/rules/final/33-7881.htm> (last visited Mar. 17, 2005). It requires that "when an issuer intentionally discloses material information, it do so publicly and not selectively." Secs. & Exch. Comm'n, at <http://www.sec.gov/news/extra/seldsfct.htm> (last visited Mar. 17, 2005).

31. Mira Ganor, A Proposal to Restrict Manipulative Strategy in Auction IPOs 5-6 (2004), available at <http://ssrn.com/abstract=572243>.

pension funds, and wealthy individual clients. For most securities offerings, investment banks serve as underwriters.³² They synthesize financial statements, accounting reports, and market research about the company for potential investors. The company and its lead underwriter determine an initial share price and number of shares. The banks then generate interest by promoting the issue to their preferred clients.³³

In larger public offerings, the lead underwriter, along with company management, is responsible for coordinating publicity and market interest for the issue. This is usually accomplished by a road show, where representatives of the underwriters, along with key officers of the issuing company, solicit and advertise the company to potential investors.³⁴ The lead underwriter may adjust the initial share price after gauging market demand following the road show. Underwriters often reserve shares of "hot" issues for their preferred customers, before allowing the remaining shares to sell on the open market. Alternatively, they may agree to help a lukewarm issue by supporting the share price (by buying back shares on the open market) for a set period of time after the IPO.³⁵ Underwriters typically receive a fee of 5-10% of the aggregate value of the IPO.³⁶

Underwriters typically take pre-IPO orders only from their clients and other large investors, at a different (often discounted) price than post-IPO

32. See *id.* For large offerings, investment banks will pool together and form an underwriting syndicate, with one or more lead underwriters. Most securities offerings are coordinated by investment banks. See Rueda, *supra* note 30, at 29-30. Solicitation and marketing is sometimes conducted over the Internet. See Lisa Mondschein, *The Solicitation and Marketing of Securities Offerings through the Internet*, 65 BROOKLYN L. REV. 185 (1999). Other alternatives include direct public offerings (DPOs) and small-issue public offerings conducted via Internet. See generally Anita Indira Anand, *The Efficiency of Direct Public Offerings*, 7 J. SMALL & EMERGING BUS. L. 433 (2003); Jeffrey Hass, *Small Issue Public Offerings Conducted Over the Internet: Are They Suitable for the Individual Investor?*, 72 S. CAL. L. REV. 67 (1999); William Sjostrom Jr., *Going Public through an Internet Direct Public Offering: A Sensible Alternative for Small Companies?*, 53 FLA. L. REV. 539 (2001).

33. See Rueda, *supra* note 30, at 29-43. See generally Ganor, *supra* note 31, at 5-6.

34. See Rueda, *supra* note 30, at 29-43.

35. See *id.*, at 49 ("[T]he price for an under-subscribed IPO can easily collapse. In that case, the underwriter must either subscribe itself to the issue or sell the stock at a deflated price, incurring substantial per share losses."). For a more detailed description of IPO pricing and mechanics, see JASON DRAHO, *THE IPO DECISION: WHY AND HOW COMPANIES GO PUBLIC* (2004); ROSS GEDDES, *IPOS AND EQUITY OFFERINGS* (2003); TOM TAULLI, *INVESTING IN IPOS V2.0* (2001).

36. Mann et al., *supra* note 5, at 842. Investment bank Merrill Lynch typically charges a 7% commission. John Shinal, *Google IPO: No Merrill, Bank May Not Have Liked Fee Structure*, S.F. CHRON., Jun. 22, 2004, available at <http://www.sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2004/06/22/BUGRK79OT41.DTL&type=business>.

shares available on the open market. The lead underwriters are instrumental in negotiating and setting the initial share price and allocation. Prior to the IPO, the underwriters will have often negotiated sales with their preferred clients—typically institutional investors and high net-worth individuals—which ideally will generate sufficient market demand by the time of the offering. Average investors, on the other hand, are typically not able to purchase shares until after the stock officially goes public. If it is a “hot” IPO, the stock price will “pop”³⁷ on the first day, and individual investors often end up paying a premium for shares compared to the banks’ preferred clients.³⁸ Some economists and analysts argue that this is due to “underpricing”³⁹ of the issue prior to the IPO, which often creates an artificial “trader’s surplus”⁴⁰—an overvaluation of the stock—in the days or weeks following the IPO.

37. See Gimein, *supra* note 15. Underwriters often agree to “underprice” an issue pre-IPO, in order to increase the chances of a first-day pop. See Rueda, *supra* note 30, at 24-35 (“[An] investment bank will have a near-monopoly in aftermarket trades for the first few weeks following an IPO, a period during which the stock has not yet been disseminated widely enough to allow other banks to freely offer it to their customers. . . . [The] investment bank will rely on its analysts’ expertise . . . for due diligence . . . [and thus], the investment banker will usually have a good indication beforehand whether an IPO will be ‘hot.’”).

38. For some hot IPOs, the stock price might be quite volatile in the days following the IPO—the price surges as buyers rush in; later on, the price may drop considerably as investors “flip” (sell) in search of quick profits. See Rueda, *supra* note 30, at 26-27, 47.

39. See Rueda, *supra* note 30, at 24-35. Mira Ganor argues that auction IPOs, however, may also cause underpricing rather than a more efficient IPO pricing at the outset. See Ganor, *supra* note 31, at 11-19. Paul Murphy writes,

What’s interesting and applicable about this is the underlying theory. An acre of land is an acre of land; value that acre based on its real earnings potential and a cornfield in Iowa should be worth more than a lot in Manhattan.

In reality, however, that acre in Manhattan is worth more, not because it will grow more crops or make a nicer park, but because society as a whole has decided to build a city around it—and it’s this social decision that gives the land in Manhattan its value advantage. . . .

....

. . . Get the market buzz on-side from the start, and we’ll get that \$100 valuation for our \$10 share . . .

See Paul Murphy, *Pricing an Imaginary IPO*, LINUXINSIDER.COM, Dec. 12, 2004, at <http://www.linuxinsider.com/story/Pricing-an-Imaginary-IPO-38537.html>.

40. See Murphy, *supra* note 39 (“[T]he resulting distortions affect every major decision management makes . . . [including the exaggeration of] real earnings potential during upswings and [a] focus on very short term decision making . . . during downswings.”).

C. The Dutch Auction Model

Dutch auction IPOs differ from traditional IPOs in that the Dutch auction ostensibly allows the market to set the initial share price. All investors, individuals as well as institutions, have a chance to place bids on a stock issue. This transfers a significant amount of price-setting power and market influence away from the investment banks, which results in greater autonomy for corporate management and a more “democratic” offering. Instead of the traditional IPO, where shares generally are sold first to favored investors, a Dutch auction theoretically allows any investor to enter a bid.⁴¹

1. *Economic Theory: First-Price versus Second-Price Auctions*

A Dutch auction essentially reverses the mechanics of the traditional English auction. Economists refer to Dutch auctions as an open, first-price auction: the seller sets an opening price, and then units are sold beginning from the highest bidder downward, until the market clears. This is in contrast with the traditional (second-price, or English) auction, where units are sold when the last (highest) bid is made.⁴² A normal auction on Ebay or at a traditional auction house such as Lloyd’s illustrates the second-price auction: the seller may choose to set a reserve price (the lowest price at which she is willing to sell), then potential buyers place successively higher bids, until there are no more bidders. The unit sells at the last, highest bid.⁴³

Dutch auctions are less common but can in fact be found on popular Internet auction sites such as eBay and Amazon.com. In eBay Dutch auctions, current high bids are always displayed after the item description. The complete bidding history, including unsuccessful bids, is available as well.⁴⁴

41. See, e.g., Rueda, *supra* note 30, at 90 (“[I]POs could be distributed according to the Dutch auction system . . . [where] stock would go to the highest bidder, and not to the underwriter’s preferred customer.”); see also Ravi Bapna et al., *Insights and Analyses of Online Auctions*, 44 COMMUNICATIONS OF THE ACM 42 (2001). In practice, investors having a brokerage account or preexisting relationship with the “right” bank will have an advantage even in Dutch auctions. See generally *Completed Auctions*, *supra* note 1.

42. See MILGROM, *supra* note 1, at 26, 241; see also Paul Milgrom, *Auctions and Bidding: A Primer*, 3 J. ECON. PERSPECTIVES 3, 6-7 (1989).

43. See MILGROM, *supra* note 1, at 26, 241; see also Milgrom, *supra* note 42, at 6-7.

44. The Dutch auctions held on eBay are not true Dutch auctions, but the core concept is the same: multiple identical items may be sold in one auction. See Bapna et al., *supra* note 41, at 49-50 (“The so-called Dutch auction used by eBay is an ascending open uniform price auction that differs from the original version of Dutch auctions, which originated in Dutch Flower markets. . . . [It] can be most loosely identified with a multi-

2. Dutch Auction IPO Mechanics

Traditional IPOs are not properly auctions, since the bulk of the shares are privately sold at a price predetermined by the underwriters. In a Dutch auction IPO, on the other hand, the IPO price is determined by investor bids. Bidders submit the highest price that they are willing to pay and the number of shares desired at that price. The highest bidders (or the earliest, if investors submit bids at the same price) get first priority on the shares, which are then allocated in order from highest to lowest bid, until all the shares are sold. The final price is uniform, however: all bidders receive shares priced at the lowest accepted bid.⁴⁵

A Dutch auction IPO has several benefits. It reduces transaction costs by bypassing investment banks and thus allows the market to set the price. Investors receive shares more efficiently, based on what they are willing to pay rather than preexisting relationships between investment banks and their clients. Moreover, a Dutch auction “ensures that the company going public is [not] going to leave too much money on the table by going public

item extension of what is classically known as a Vickrey auction. . . . It should be noted that Vickrey’s original version of this auction was designed to be a sealed-bid auction, in contrast to eBay’s open and progressive version where all bids are posted and can be revised. . . . [T]his revised mechanism offers discriminating prices in contrast to the original mechanisms’ uniform pricing.”); Michael Giberson, *The Other Dutch Auction IPO*, KNOWLEDGE PROBLEM, Aug. 23, 2004, at <http://www.knowledgeproblem.com/archives/000906.html>.

45. James Surowiecki, *How to Do an IPO*, SLATE.COM, Dec. 9, 1999, at <http://slate.msn.com/id/1004150>; see also *Dutch Auction IPO*, Marginal Revolution, at http://www.marginalrevolution.com/marginalrevolution/2004/08/dutch_auction_i.html (quoting N.Y. TIMES, Aug. 21, 2004) (last visited Mar. 10, 2005). To illustrate further, consider the following example:

Imagine the Dutch auction of a 100 share offering. The auctioneer begins by calling out a prohibitively high price per share that he knows will attract no bids. He then calls out lower and lower prices until someone decides to buy a few shares (eight, for example). The auctioneer continues to lower the price until someone agrees to buy more shares (12, for example). So far, bidders have bought 20 shares, one-fifth of the total IPO, and they’ve bid different prices.

The auctioneer continues to lower the price until all 100 shares are spoken for. At auction’s end, bidders get the number of shares they agreed to buy, but at the price bid by the last bidder. If the first guy bid \$100 per share for the eight shares, and the second guy bid \$75 per share for the 12 shares, they only pay what the last guy bid—say, \$50 per share.

Bruce Gottlieb, *What Is a Dutch Auction IPO?*, SLATE.COM, May 6, 1999, at <http://slate.msn.com/id/1002736>.

at a lower price than the one the market was willing to pay.”⁴⁶ Furthermore, if the auction is conducted over the Internet, it gives the average investor “who lacks the resources to spend on brokerage fees and information finding, a chance to invest on even ground with richer investors.”⁴⁷

A Dutch auction IPO decreases the role of underwriters in the IPO process. The pricing is ostensibly more transparent, as the initial share price is determined according to the public’s bids.⁴⁸ Although the investment banks fill orders and sell shares, they have much less control over the price.⁴⁹ The end result for the offering company is a tradeoff: lower fees for the investment bank, but the risk of a lukewarm market for the stock issue. A small privately-held company without sufficient brand recognition, resources, and market share to generate sufficient interest on its own may find that it is in its best interest to hire underwriters to manage its IPO. Although the offering company gives up pricing control and must pay the investment banks a considerable fee, this helps insure against the risk of a cold issue.⁵⁰ The traditional model IPO allows a company to leverage the investment banks’ expertise in order to build interest and credibility for its stock issue, in exchange for giving up control over price and initial share allocation.⁵¹

46. Surowiecki, *supra* note 45.

47. Daniel Weisenfeld, Note, *IPOs on the Internet: The Need for the Next Step*, 22 HASTINGS COMM. & ENT. L.J. 529, 541 (2000).

48. Dutch auction IPOs do not necessarily eliminate underpricing, however. See Ganor, *supra* note 31, at 11-19. Ganor reasons that “some sophisticated investors can maximize their wealth by choosing to bid in a strategic way that causes underpricing. This outcome is contrary to the conventional wisdom that postulates that auction IPO[s] will always prevent underpricing.” *Id.* at 21.

49. See, e.g., Rueda *supra* note 30, at 90-91 (“For example, [WR] Hambrecht’s ‘OpenIPO’ system sells to . . . the highest bidders . . . at the price of the lowest bid accepted.”). Typical orders for IPO shares are usually made in blocks of 1,000 or more. See Shinal, *supra* note 36.

50. Compare this to the real estate market: A seller of property gains a higher potential profit if she chooses not to hire a realtor. But if the seller cannot, on her own, generate enough interest in the property, she risks a loss—either because she must sell at a discount or because she cannot sell the property at all. Hiring a realtor helps insure against this risk. This idea is attributed to Professor Peter Menell, University of California at Berkeley, School of Law (Boalt Hall) (Oct. 20, 2004).

51. See *supra* notes 31-35 and accompanying text. Companies often negotiate agreements with underwriters to keep an issue above the initial IPO price for a set period of time—banks will manage the supply of shares according to market demand.

Table 1: Differences between Traditional and Dutch Auction IPOs⁵²

	Traditional IPO	Dutch Auction IPO
Pricing Mechanism & Share Allocation	Coordinated by underwriting investment banks	Determined by market via investor bids
Role of Underwriters	Underwriters set the IPO price, market the IPO, and support the price in the event of an undersubscribed offering	Underwriters' price-setting power virtually eliminated; lower transaction costs; underwriters still market the IPO
Post-IPO Price Effect	Potential for a larger pop, because the stock is "under-priced" prior to the IPO	Less potential aftermarket pop, due to relatively more efficient pricing and share allocation

San Francisco's WR Hambrecht is the only major U.S. investment bank that offers Dutch auction IPOs. Its Open IPO product utilizes a "uniform price auction in which large and small investors are all subject to the same auction rules."⁵³ WR Hambrecht's website describes OpenIPO as "an innovative auction process for distributing stock to individuals and institutions through a more efficient and equitable process. The auction

52. See *supra* notes 31-35 and accompanying text. In addition, see *IPO Watch: Morningstar in Dutch*, RED HERRING, Jan. 10, 2005, at <http://www.redherring.com/Article.aspx?a=11128&hed=IPO+Watch%3A+Morningstar+in+Dutch>, which states:

The Dutch auction is just that—an auction with the merchandise going to the highest bidder. In the world of IPOs, it is as straightforward as this: "Here's the deal. What do you want to pay for it?" [¶] The Dutch auction IPO's offering price is the highest bid it takes to sell all of the shares. It is called the clearing price. [¶] In a true Dutch auction, all the higher bids are swallowed up into the clearing price. As a result, there are no aftermarket orders to drive the stock higher once the IPO starts trading. [¶] In a Dutch auction the investment banker acts as an auctioneer. [¶] In a traditional Wall Street underwriting, the investment bankers agree to buy all the shares from the issuer and re-offer them to the buyers. In the process, they negotiate the IPO's terms between the buyers and the issuer. If the deal is not a sell-out, then the investment bankers are stuck with the unsold shares. [¶] The investment bankers are underwriters. A Dutch auction IPO is, nevertheless, an auction. It has more in common with the goings-on at Sotheby's or Aunt Mabel's estate sale than it does with business as usual in the IPO market. [¶] A traditional Wall Street underwriting is a negotiated sale, with some similarities to real estate transactions.

53. MILGROM, *supra* note 1, at 26; see also *Open IPO*, *supra* note 1.

process allows shares of an initial public offering to be allocated in an equal and impartial way. All successful bidders pay the same price per share."⁵⁴

OpenIPOs take place on the Internet, and its claimed benefits include: equal access to shares, fair and impartial allocation (no preferences), flexibility (including multi-tiered bids at different amounts of interest for shares at different prices), and equal pricing.⁵⁵ WR Hambrecht typically charges a commission of 4% for its OpenIPO services.⁵⁶ As of December 2004, ten U.S. companies had gone public using a Dutch auction IPO. WR Hambrecht, through its OpenIPO product, underwrote all ten offerings.⁵⁷

II. THE GOOGLE IPO: COMPANY GOALS AND THE IPO PROCESS

Google management's decision to use a Dutch auction IPO represents a break from the pack in Silicon Valley and beyond. As the most popular Internet search engine,⁵⁸ Google possessed key advantages which helped make the Dutch auction work—namely, a strong, widely-known brand name and a broad user/customer base. This allowed the company to publicize its IPO to a broad range of potential investors. In interviews and SEC filings, Larry Page and Sergey Brin made clear their desire to open up the offering to the investing public. They asserted that the Dutch auction process made the IPO accessible to the average investor; all investors theoretically had the opportunity to enter bids prior to the IPO, which in principle placed individual investors on par with investment banks, mutual fund managers, and large institutional investors.⁵⁹

54. See *Open IPO*, *supra* note 1. Anyone with \$2000 and Internet access can open an account. *Id.*

55. *Id.*

56. See Shinal, *supra* note 36.

57. See *Open IPO*, *supra* note 1. The ten firms who used the OpenIPO are: Andover.net (acquired by VA Linux), Briazz, Genitope, New River Pharmaceuticals, Nogatech, Overstock.com, Peet's Coffee & Tea, Ravenswood Winery, Red Envelope, Salon.com. See *Completed Auctions*, *supra* note 1.

58. See, e.g., Evan Hansen & Jim Hu, *AskJeeves Denounces Paid Inclusion*, CNET NEWS.COM, Jan. 14, 2004, at http://news.com.com/Ask+Jeeves+denounces+paid+inclusion/2100-1024_3-5168805.html.

59. See Google Inc., *Letter from the Founders: "An Owner's Manual" for Google's Shareholders*, in Amendment No. 9 to Forms S-1 Registration Statement Under the Securities Act of 1933, at 27 (filed with the SEC on Aug. 18, 2004) [hereinafter Google Amended Form S-1], available at <http://www.sec.gov/Archives/edgar/data/1288776/000119312504142742/ds1a.htm>; see also Securities and Exchange Commission Form 10-Q for Google Inc. (Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Ex-

A. The Google Vision

Larry Page and Sergey Brin sought to make a statement with the Google IPO. They recognized that taking the company public presented a unique opportunity to use an unconventional open IPO model which followed their philosophy and appealed to their users, customers, and potential investors. Page and Brin described their vision in a letter to investors, contained in their Form S-1/prospectus:

Google is not a conventional company. We do not intend to become one. Throughout Google's evolution as a privately held company, we have managed Google differently. We have also emphasized an atmosphere of creativity and challenge, which has helped us provide unbiased, accurate and free access to information for those who rely on us around the world.⁶⁰

Page and Brin sought to institute a unique, dual-class corporate structure that would preserve managing control for its founders, but still in the long run maintain a stable company for its shareholders, employees, customers, and users. They saw the IPO as an ideal opportunity to extend their long-term goals:

If opportunities arise that might cause us to sacrifice short term results but are in the best long term interest of our shareholders, *we will take those opportunities. . . .*

. . . .

We will not shy away from high-risk, high-reward projects because of short term earnings pressure. . . .

. . . .

We are creating a corporate structure that is designed for stability over long time horizons. By investing in Google, you are placing an unusual long term bet on [our] team . . . and on our innovative approach.⁶¹

change Act of 1934 for the Quarterly Period Ending September 30, 2004) [hereinafter Google 10-Q], available at http://investor.google.com/pdf/20040930_10-Q.pdf.

60. Google Inc., *Letter from the Founders: "An Owner's Manual" for Google's Shareholders*, in Forms S-1 Registration Statement Under the Securities Act of 1933, at i (filed with the SEC on Apr. 29, 2004) [hereinafter Google S-1 Form], available at <http://www.sec.gov/Archives/edgar/data/1288776/000119312504073639/ds1.htm>.

61. *Id.* at i-iii. In addition, see Google Amended Form S-1, *supra* note 59, at 31:

It is important to us to have a fair process for our IPO that is inclusive of both small and large investors. It is also crucial that we achieve a good outcome for Google and its current shareholders. This has led us to pursue an auction-based IPO for our entire offering. Our goal is to

Page and Brin also wanted to minimize the speculation, small initial share float, and stock price volatility that plagued technology IPOs in the past. Their goal was to have both the IPO price and aftermarket price reflect an efficient market value set by “rational and informed buyers and sellers.”⁶² They also wanted to secure a relatively stable stock price in the days following the IPO by offering enough shares to meet investor demand at the time of and after the IPO.⁶³ There was no guarantee, however, that all interested investors would receive shares.⁶⁴

B. The Google IPO: Process and Metrics

Google’s auction and offering took place in five stages, and investors were required to order at least five shares:

- 1) Qualification: Investors obtained a Bidder ID on www.ipo.google.com, after reading and following the instructions in the prospectus.⁶⁵
- 2) Bidding: All qualified investors submitted their bids through one of the underwriters, including lead underwriters Morgan Stanley and Credit Suisse First Boston, as well as WR Hambrecht and a syndicate of other investment banks. Investors were required to identify the number of shares they wished to purchase and price per share they were willing to pay.⁶⁶
- 3) Auction closing: Google reserved the right to close the auction at any time, but investors were allowed to modify, withdraw, and re-enter their bids until they were accepted.⁶⁷
- 4) Pricing: The bidding process generated a clearing price for the shares of Class A common stock offered in the auction. The clearing price was the highest price at which all of the shares offered could be sold to potential investors, based on bids in the master or-

have a share price that reflects an efficient market valuation of Google that moves rationally based on changes in our business and the stock market.

62. Google Amended Form S-1, *supra* note 59, at 31.

63. *Id.* Whether the actual IPO price, and aftermarket price, was indeed more stable is somewhat contested. See *infra* Part III.A for further discussion.

64. Google Amended Form S-1, *supra* note 59, at 31. In fact, Google was unable to fill 100% of its pre-IPO orders. See *infra* Part III.B for a discussion on how this affected the outcome of the IPO.

65. Google Amended Form S-1, *supra* note 59, at 34-35.

66. *Id.* at 35-37.

67. *Id.* at 38.

der book that had not been withdrawn or rejected at the time the auction closed.⁶⁸

- 5) Allocation: Once the IPO price was determined, all investors who submitted successful bids received an allocation of shares at the IPO price. The allocation process did not give any preference to successful bids based on bid price. Google and its underwriters also set a maximum share allocation.⁶⁹

Bidding closed on August 18, 2004, and the offering commenced the next day.

Table 2: Google IPO Metrics⁷⁰

IPO Date:	August 19, 2004
Price:	\$85.00
Method:	Modified Dutch Auction ⁷¹
Lead Underwriters:	Morgan Stanley, Credit Suisse First Boston
Stock Symbol:	GOOG
Exchange:	NASDAQ
Number of Shares Offered:	19,605,052
Value of Offering:	\$1.67 billion
Initial Market Cap:	\$23.1 billion
Total Initial Shares Outstanding:	271.2 million
	(33.6 million class A, 237.6 million class B)
Allocation Percentage:	74.2% of bid shares
Initial SEC Filings:	Form S-1 Prospectus (amended 9/30/04) Form 10-Q Quarterly Report (amended 8/18)

68. *Id.* at 38-40.

69. *Id.* at 40-41.

70. Table and data modified from *Initial Public Offering Details*, GOOGLE IPO CENTRAL, at <http://www.google-ipo.com> (last visited Feb. 18, 2005).

71. Google's IPO was a modified Dutch auction: not all 100% of the shares were allocated through the bidding process, and Google retained the ability to adjust the initial share price (in a true Dutch auction, the market would set the price). Some shares were reserved for the Yahoo! Settlement, *see supra* note 8, and another portion was allocated to the underwriters; only about 75% of the shares were offered directly to the investing public. Google agreed to give Yahoo! 2.7 million shares—worth up to \$300 million. Yahoo! sold more than 1 million shares, adding to the 24.6 million shares initially offered. *See Google's IPO Rollercoaster*, *supra* note 8; Lohse, *supra* note 8. In its IPO prospectus, Google also reserved the right to change the auction from a pure to modified Dutch auction. *See* Google Form S-1, *supra* note 60.

III. DISCUSSION: THE GOOGLE IPO WAS AN OVERALL SUCCESS

Google's IPO was very lucrative and generally successful, especially considering its unconventional Dutch auction process. Despite various criticisms by observers and initial missteps by the company, Google's modified Dutch auction set a relatively accurate and appropriate price for the offering and satisfied the company's business and cultural goals. The Google IPO also showed that Dutch auction IPOs can work on a large scale. However, Google's success may have been somewhat unique to the circumstances. Thus, most IPOs will likely continue under the traditional model, and a significant rise in Dutch auction IPOs is not expected to occur any time in the near future.

The Google IPO was not without its share of problems, however. The company and its management encountered several hurdles in the weeks leading up to the auction. Among them were allegations of SEC disclosure violations, a re-accounting of and offer to buy back employee stock options (nearly 23 million⁷²), and the downward adjustment of its final IPO price estimate (from \$108-\$135 to \$85-\$95).⁷³ Pressure from investment banks and market analysts, along with settlement of a pending patent infringement suit by rival Yahoo!, led Google management to switch to a hybrid, or *modified Dutch auction*. It changed the number of shares offered, and lowered the IPO price to \$85 a share. This last-minute price change generated the most controversy in the weeks leading up to the issue.⁷⁴

... Google initially scared individual investors with a price range topping out at \$135. "The goal was to get a different mix of shareholders that wouldn't flip the IPO. . . . Instead, it scared

72. Google began repurchasing 23.4 million shares of common stock on November 30, 2004, along with additional options that it may have issued improperly between September 2001 and July 2004. Google also offered to buy back unexercised options on about 5.22 million common shares. Associated Press, *Google to Start Buyback of Shares*, SAN JOSE MERCURY NEWS, Nov. 30, 2004, available at http://www.mercurynews.com/mld/mercurynews/news/local/states/california/northern_california/10306197.htm.

73. See *Google's IPO Rollercoaster*, *supra* note 8. Google's initial market capitalization of \$23.1 billion (at \$85/share) amounted to less than top rival Yahoo!'s valuation of \$39 billion at the time. See *Google IPO Priced at \$85 a Share*, *supra* note 2. Alleged (but unsubstantiated) disclosure violations included the controversy stemming from a Playboy magazine interview with founders Page and Brin. See, e.g., Associated Press, *Play Boys: Google IPO a Go Anyway*, WIRED NEWS, Aug. 14, 2004, available at http://www.wired.com/news/business/0,1367,64588,00.html?tw=wn_story_top5.

74. See *supra* note 73 and accompanying text; see also Hu & Olsen, *supra* note 8 (discussing settlement of Yahoo! lawsuit).

off retail investors and got mostly institutional buyers on the first day [of bidding]. Most individual investors couldn't afford 100 shares." To compound matters, institutional buyers didn't go for the auction system. Scare off retail investors with a high price tag and annoy Wall Street, and you get an auction below your initial price range.⁷⁵

These apparent missteps in the public eye may reflect a level of inexperience with the Dutch auction IPO model, not only on the part of Google management, but also by the investment banks. Moreover, the price adjustments prior to the IPO may reflect uncertainty with respect to pricing: a shift in pricing risk when moving from the traditional IPO model (path dependence) to the Dutch auction (setting an independent price). Market pressure to ensure a first-day "pop" is another plausible explanation.⁷⁶ However, the IPO was generally deemed a success by the investing and business communities. Within a month of the IPO, Google's stock price had risen to \$117 (on September 21, 2004); at the six-month mark, Google shares traded at \$198 (as of February 18, 2005).⁷⁷

A. Pre-IPO Pricing and Post-IPO Trend

Google's modified Dutch auction generated a relatively accurate but flexible initial share price. Many critics argued that Google's hybrid auction was flawed⁷⁸ because the company reset the initial price range and allocation of shares after the auction began:

75. *Lessons from Google's IPO*, KNOWLEDGE@WHARTON, Oct. 20, 2004 (quoting Professor Raffi Amit), at <http://knowledge.wharton.upenn.edu/index.cfm?fa=viewArticle&id=1036>.

76. See, e.g., Dan Gillmor, *Naysayers Are Wrong: Google IPO Was A Success*, Siliconvalley.com, Aug. 20, 2005, at <http://www.siliconvalley.com/mld/siliconvalley/9449507.htm>. See generally *The Buzz on Google's IPO*, KNOWLEDGE@WHARTON, May, 19, 2004 ("Especially for companies where nobody knows what their shares are worth and where different investors might have vastly different opinions of what shares should trade at, a Dutch auction allows companies to raise more money for a given amount of shares because the people [willing to bid the most] for these shares end up getting them the first day. . . . People who buy the Google IPO thinking there will be a first-day pop [in the stock price] will be really disappointed and they might even lose money in the first week or two as speculation gets taken out of [the price of the shares].") (quoting Professor David Croson), at <http://knowledge.wharton.upenn.edu/index.cfm?fa=viewArticle&id=981>.

77. For stock quotes and trends, see, for example, Bloomberg.com, *supra* note 3; Yahoo! Finance, *supra* note 3.

78. See Giberson, *supra* note 44 ("Strictly speaking, I wouldn't call the Google process a Dutch auction . . . Google . . . collected information about investor demands and then picked the price at which they wanted to sell at. The price eventually chosen was lower than the price at which quantity demanded would have equaled quantity sup-

Google substantially reduced the amount of shares offered after the auction had already started. Dutch auctions are supposed to have fixed inventories. Fixing the inventory assures investors that the issuer won't be able to manipulate the clearing price by simply reducing inventory. This is of course exactly what Google did. They . . . cut the size of the offering by 24%.⁷⁹

This flexibility, however, was an advantage of Google's *modified* Dutch auction process, not a weakness. Rather than binding Google to a set offering price as in a traditional IPO, the hybrid auction allowed Google to:

set a price such that supply equaled . . . investor demand as revealed through the bidding process.

If a Dutch auction allows firms to set a market clearing price, why did the Google price pop from \$85 per share to \$100.34 per share on the first day of trading on the Nasdaq? . . . [T]he Dutch auction gave Google the ability to set a market clearing price for its shares, [but] the modified Dutch auction as described in the prospectus did not require Google to do so. Google chose to go public at a price with unsatisfied demand.⁸⁰

Google's first-day increase of 18% reflects this unsatisfied demand. However, this increase was not "so great as to encourage and reward 'flipping'

plied, with the resulting run up in price on the first day. . . . I can see why the company would prefer this approach to a strict Dutch auction, the company is in a better position to maximize the IPO's value to the firm. But would consumers tend to bid lower in a price-discriminator's auction (Google's approach) than they would bid in a strict Dutch auction?"

79. Bill Burnham, *Dutch Auctions and Democracy: Two Things That Don't Make Sense For IPOs*, Sep. 15, 2004, at http://billburnham.blogs.com/burnhamsbeat/2004/09/dutch_auctions_.html.

80. Laurie Simon Hodrick, *Google's IPO: A Dutch Auction Works, If You Let It* (Fall 2004), at http://www-1.gsb.columbia.edu/hermes/fall2004/article_google.cfm.

in which the stock is sold for a quick profit.”⁸¹ The modest increase indicates a lack of volatility in the immediate (first-day) aftermarket.⁸²

Google’s post-IPO trend, however, suggests a somewhat more volatile stock. Google’s stock price increased to \$149 on October 21, 2004, when the company announced its third quarter earnings report. Revenues of \$503.9 million for Q3 2004 exceeded analyst expectations by 11%.⁸³ On November 16, Google’s second “lockup” period expired,⁸⁴ allowing the sale of 38.5 million shares owned by employees and early investors—almost double the 19.6 million shares offered in the IPO. The price subsequently dropped that day by almost 7%—to \$172.55, with a trading volume of 21 million shares—considerably higher than the previous daily average of 9 million shares.⁸⁵

81. Ed Zwirn, *Did Google IPO Invalidate Dutch Auctions?*, CFO.COM, Aug. 23, 2004 (“If in the beginning there were irrational expectations about Google’s pricing, that does not reflect adversely on the Dutch-auction process. . . . Despite a bad market, the Google IPO was well priced and the shares were distributed fairly. The Google IPO shows that the market is smarter than any individual investment banker. . . . It appropriately discounted the stock because of risk; there were no hidden balls. Compare the Google offering to so many of the technology IPOs of the late ‘90s, when in hours or days after its IPO a stock would rocket up to huge multiples of its initial price, or would open at an enormously inflated price only to collapse.”) (quoting Bruce Mann), *at* http://www.cfo.com/article.cfm/3122873/c_3122901?f=home_todayinfinance

82. *Id.*

83. “We’re very pleased with our performance,” noted CEO Eric Schmidt. Michael Liedtke, *Google’s Third-Quarter Profit More Than Doubles*, S.F. CHRON., Oct. 21, 2004, available at http://sfgate.com/cgi-bin/article.cgi?file=/news/archive/2004/10/21/financial_1658EDT0341.DTL; see also Paul La Monica, *Gaga for Google*, CNN.COM, Oct. 22, 2004, *at* <http://money.cnn.com/2004/10/21/technology/google>; Sarah Lacy, *For Google, A White-Knuckle Ride*, BUSINESSWEEK, Nov. 17, 2004, *at* http://www.businessweek.com/bwdaily/dnflash/nov2004/nf20041117_6651_db016.htm.

84. Lockup periods prevent private shareholders (for example, company principals, executives, venture backers) from cashing out immediately after the IPO. Most IPOs have a single lockup period which expires 180 days after the IPO. See Rueda, *supra* note 30, at 30 (“During the lock-up period, certain investors are prohibited from selling their stock in the open market in order to prevent a potential run on the stock and a destabilization of its price.”). Google, however, had five staggered lockups. Its first, which expired on Sept. 2, 2004, had little impact—only 4.7 million shares were released; GOOG was up 1.26%, at \$101.51. The third, which released 24.9 million shares, expired on Dec. 16, 2004; GOOG was down only 48 cents. The fourth, also 24.9 million shares, took place on Jan. 15, 2005; GOOG actually rose by \$3.93 the next trading day. The last, and largest lockup, expired on Feb. 14, 2005, releasing 176.8 million shares. Lacy, *supra* note 83; see also Bloomberg.com, *supra* note 3 (for stock quotes and trends); Yahoo! Finance, *supra* note 3 (same).

85. Bloomberg.com, *supra* note 3; Yahoo! Finance, *supra* note 3 (same)

Table 3: Post-IPO Price Trend⁸⁶

	Aug. 19	Sept. 21	Oct. 21	Nov. 16	Dec. 16	Jan. 18	Feb. 3	Feb. 18
Price	\$85	\$117	\$149	\$172	\$176	\$203	\$210	\$197

Although these figures indicate a general upward trend, as a whole, Google's day-to-day price fluctuations have been greater than recent IPOs.⁸⁷ Analysts predicted that Google's last lockup expiration, on February 14, 2005, would lead to further volatility and possible downward pressure on its stock price as more shares would be available on the open market.⁸⁸ In the ten trading days prior to the lockup expiration, Google's daily average trading volume rose to 16.3 million shares, which was 65 percent higher than the previous daily average.⁸⁹ Indeed, on the morning of February 14, Google shares initially fell by 3.5 percent to \$181 when the market opened for trading. The stock rebounded by that afternoon, however. Google stock closed at \$192.99—an increase of \$5.59 from the previous trading day, with a volume of 38.5 million shares, about 3.6 times its new

86. Table indicates prices at the close of trading. For stock quotes and trends, see, for example, Bloomberg.com, *supra* note 3; Yahoo! Finance, *supra* note 3.

87. Lacy, *supra* note 83 (“[T]he average IPO in 2003 was up 16.9% from its initial price to the lockup expiration. Google’s price: up a whopping 103%. The typical IPO traded down 1.8% on its lockup expiration from its price a month earlier . . . [but] Google shares were up 20%. The typical IPO traded down 2.4% on its lockup expiration from its price two weeks earlier, while Google has traded down 11%. . . . In early after-hours trading on Nov. 16, it was already trading back up by 0.38%.”).

88. *Id.*; see also Reuters, *Investors Focus on Last Google Lockup Expiry*, CNET NEWS.COM, Feb. 11, 2005 (“‘It has been a pretty volatile stock,’ said Barry Randall, portfolio manager of the \$100 million First American Technology Fund, which has a small Google stake. ‘I don’t feel like the unlocking of shares on Monday adds materially to the risks.’”), available at http://news.com.com/Investors+focus+on+last+Google+lockup+expiry/2100-1030_3-5573351.html.

89. Mark Schwanhauser, *Google Insiders Facing Option: Sell Stock Now or Bide Time*, SAN JOSE MERCURY NEWS, Feb. 13, 2005, at <http://www.mercurynews.com/mld/mercurynews/news/10890006.htm?1c>.

daily average of 10.8 million.⁹⁰ By the end of that week, Google's price had risen further to \$197.95.⁹¹

Despite any indications of stock volatility, Google's auction process arguably gave a more accurate or appropriate IPO price, as compared to a traditional IPO. Many investment bankers and analysts initially declared the auction a failure, due to the last minute price range adjustment to \$85 per share. However,

Google founders Larry Page and Sergey Brin were more concerned about conducting an offering that was fair to small investors than with getting the highest possible price for the company's shares. "[T]he intent was to find the fairest price, not the highest price [. . .] where everyone, including their very loyal customers, had the right to compete for shares on an equal footing."⁹²

By opening up the pricing mechanism to investor bids, the initial share price was more reflective of market demand. Underwriters had less influence in determining the final price outcome. On the demand side, more bidders arguably resulted in a more efficient distribution of Google shares, both at the time of the IPO and in the days immediately following. The lack of volatility in the immediate aftermarket also validates the Dutch auction process as a pricing system.⁹³

B. A Democratic IPO, But Not Entirely

There is considerable debate as to whether Google's Dutch auction was truly open to the public. First, Google was unable to satisfy all bids for its shares. Google indeed switched from a pure Dutch auction to a modified version, where successful bidders received only 75% of their re-

90. See Associated Press, *Update 1: Google Shares Rebound After Lockup Expires*, Feb. 14, 2005, available at <http://www.forbes.com/technology/personaltech/feeds/ap/2005/02/14/ap1825586.html>; Eric Hellweg, *Google's St. Valentine's Day Massacre?*, CNN.COM, Feb. 18, 2005, at <http://money.cnn.com/2005/02/07/technology/techinvestor/hellweg/?cnn=yes>; Reuters, *Google Rises Despite Lockup Expiry*, CNN.COM, Feb. 14, 2005, available at <http://money.cnn.com/2005/02/14/technology/google.reut>.

91. \$92 was GOOG's closing price on February 18, 2005, with a trading volume of about 8.5 million shares.

92. John Shinal, *Lifting the Google Lid: Leaders of WR Hambrecht Can Finally Talk About IPO*, S.F. CHRON., Sep. 15, 2004 (quoting investment banker Bill Hambrecht), available at <http://www.sfgate.com/cgi-bin/article.cgi?file=/chronicle/archive/2004/09/15/BUG0F8OUAL1.DTL&type=business>.

93. Zwirn, *supra* note 81 (citing Richard Mann).

quested shares.⁹⁴ Thus, many skeptics assert that Google's hybrid auction failed to fully democratize the IPO process.⁹⁵ The critics blame the complexity of the Dutch auction process for inhibiting access to the average individual investor. However, others disagree and also point to limitations typically placed on small investors by underwriters in traditional IPOs:

[M]any investors that historically had been precluded from participating in hot IPOs did have the possibility of buying into the Google IPO. While the offer was not accessible to everyone, the limitation on small-investor participation arose at the underwriter level and was based on the underwriters' interpretation of SEC restrictions that protect small investors from making unsuitable investments. The barrier to entry was not the auction's complexity: small investors who were provided with access typically did not find the bidding complicated. Further, the fact that many of the trades on the first day were small lots contradicts the assertion that all small investors were denied access.⁹⁶

Despite criticism of Google's hybrid auction, the fact that "[e]veryone who bid \$85 or higher got the shares is a remarkable achievement in a world where hot issues are doled out in a favored way."⁹⁷ Instead of catering exclusively to institutional investors, Google management abided strictly by SEC rules, refusing to share any proprietary financial information with fund managers during its road show presentations.⁹⁸ Post-IPO interviews suggested that institutional investors were nevertheless satisfied with the results: "We got shares, the shares went up, we're happy,"⁹⁹ said one fund manager. Another fund manager was "pleasantly surprised. The investors benefited through this IPO process, even though there was negative sentiment. A lot of that culminated in what the deal was: a fair-market

94. This suggests that Google used a pro rata percentage allocation method, one of two models disclosed in the IPO prospectus—to be used in the event of a modified rather than pure Dutch auction—whereby investors would receive as many requested shares as possible, should they meet the clearing price. See Dawn Kawamoto & Stefanie Olsen, *Google Storms onto Wall Street*, CNET NEWS.COM, Aug. 20, 2004, at <http://news.zdnet.co.uk/business/0,39020645,39164220,00.htm>.

95. See Hodrick, *supra* note 80.

96. *Id.*

97. Shinal, *supra* note 92 (quoting Bill Hambrecht).

98. *Id.* ("If they wanted a higher price, they would have treated the big investors with kid gloves. . . . [In an auction], the allocation of shares doesn't depend on what kind of commissions [are generated] for the investment bankers.") (quoting Professor Jay Ritter, University of Florida).

99. Kawamoto & Olsen, *supra* note 94. The fund manager also added that had Google used a pure Dutch auction, its shares would have traded flat after their opening.

price . . . [but] . . . looking back, Google's management and early investors probably think it's less of a success."¹⁰⁰

On balance, Google's modified Dutch auction was "a compromise between the interests of the bankers and the interests of the company."¹⁰¹ The hybrid auction allocated as many shares as reasonably possible to the investing public, while also satisfying demand from institutional investors. Because of the size and structure of Google's offering, and the large number of underwriters, Google was able to negotiate a fee of only 2.8%.¹⁰² Had Google used a traditional IPO, lead underwriters Morgan Stanley and Credit Suisse First Boston would have received the largest portion of banking fees—around 7% of the IPO's value.¹⁰³

C. A Financial Success?

The Google IPO is generally regarded as financially successful, at least on the surface.¹⁰⁴ Google raised \$1.67 billion through the offering, and its stock price has more than doubled since. Furthermore, despite Google management's highly publicized pre-IPO miscues, the IPO took place without any major problems and received generally favorable press afterwards.¹⁰⁵ Post-IPO reports indicate that the majority of Google insiders and investors were pleased with the results.¹⁰⁶ And partly due to the

100. *Id.*

101. Shinal, *supra* note 92 ("It wasn't an IPO auction in the purest sense, [but] I think it worked almost in spite of itself.") (quoting Bill Hambrecht); *see also* John Shinal, *Google IPO Achieved Its Major Goal: It's All about Raising Cash for the Company and Rewarding Employees, Early Investors*, S.F. CHRON., Aug. 22, 2004 [hereinafter Shinal, *Google IPO Achieved Its Major Goal*] ("[I]t was really a hybrid auction that was managed in a very intelligent way.") (quoting venture capitalist Richard Kramlich), available at <http://sfgate.com/cgi-bin/article.cgi?file=/c/a/2004/08/22/BUGCL8BS201.DTL>.

102. Gary Rivlin, *After Months of Hoopla, Google Debut Fills the Norm*, N.Y. TIMES, Aug. 20, 2004, available at <http://nytimes.com/gst/abstract.html?res=F20E12F7345B0C738EDDA10894DC404482&incamp=archive:search>.

103. *See* Shinal, *supra* note 36; Rivlin, *supra* note 102.

104. *See, e.g.*, Shinal, *Google IPO Achieved Its Major Goal*, *supra* note 101.

105. Page and Brin's pre-IPO interview in *Playboy* magazine occurred during the initial post-S-1 quiet period—a potential violation of SEC disclosure rules. The SEC restarted the clock on the quiet period, and then allowed the auction (and issue) to proceed. Management's misaccounting of employee stock options resulted in Google buying back almost 23 million options, and then amending its S-1 to reflect the changes. *See Google's IPO Rollercoaster*, *supra* note 8; *see also supra* note 9 and accompanying text.

106. In a December 1, 2004 interview, Google CEO Eric Schmidt stated that the company was "very proud" of the IPO. He also indicated that despite initial "grumbling about the process, investors were well served. 'In every case, these are the happiest people on the planet.'" Reuters, *Google CEO Proud of Auction-Style IPO*, CNET

IPO's strong performance, Google earned record revenues of \$805.9 million for the third quarter of 2004 (up 105% from Q3 2003), and \$1.032 billion for the fourth quarter (up 101% from Q4 2003).¹⁰⁷ Google's revenue growth rate is currently outpacing that of Yahoo!, its primary rival.¹⁰⁸ Some industry experts, however, assert that it might be too early to conclude that the Google IPO is an unambiguous success.¹⁰⁹

NEWS.COM, Dec. 1 2004, available at http://news.com.com/Google+CEO+proud+of+auction-style+IPO/2100-1030_3_5473724.html.

107. Financial Release, Google Inc., Google Announces Record Revenues for Fourth Quarter and Fiscal Year 2004 (Feb. 1, 2005), at <http://investor.google.com/releases/20050201.html>. The publicity generated by the IPO arguably contributed to strong traffic and advertising growth in both Q3 and Q4 2004. *Id.* ("Google had an exceptional quarter. Revenues and profits increased significantly, our execution was solid across the company and most importantly, our relationship with our users, partners and advertisers became even stronger. . . . All of this happened while we continued to innovate, expand around the world and make strategic, long-term investments.") (quoting Google CEO Eric Schmidt); see also Financial Release, Google Inc., Google Announces Record Revenues for Third Quarter 2004 (Oct. 21, 2004), at <http://investor.google.com/releases/2004Q3.html>; Ben Elgin, *Google's First Report Is a Goodie*, BUSINESSWEEK, Oct. 22, 2004, available at http://www.businessweek.com/technology/content/oct2004/tc20041022_05-19_tc119.htm. See generally Google Press Center, at <http://www.google.com/press/index.html>.

108. Michael Liedtke, *Google Surges to Sevenfold Improvement in Fourth-Quarter Profit*, Associated Press, Feb. 1, 2005, available at <http://sfgate.com/cgi-bin/article.cgi?f=/news/archive/2005/02/01/financial1630EST0268.DTL>. Liedtke writes:

Google's lofty opinion of itself looks reasonable now, said . . . analyst John Tinker. "Everybody thought they would take the eye off the ball after the IPO, but what they are showing is that they are just getting stronger." . . . [¶] "The model that we have built over the years is working very, very well right now," Google CEO Eric Schmidt. . . . [¶] [Google's] fourth-quarter revenue rose 28 percent from the third quarter, an unusually robust growth rate for a company its size. [¶] . . . Yahoo's fourth-quarter revenue increased 19 percent from the third quarter. [¶] For all of 2004, Google earned \$399.1 million, or \$1.46 per share, on revenue of \$3.19 billion. In 2003, the company earned \$105.6 million, or 41 cents per share, on revenue of \$1.47 billion.

Id.

109. See *Lessons from Google's IPO*, KNOWLEDGE@WHARTON, Oct. 20, 2004, at <http://knowledge.wharton.upenn.edu/index.cfm?fa=viewArticle&id=1036>, which states:

The jury is still out on whether the IPO is a success or not," says . . . professor Raffi Amit. "The fact that Google did a Dutch auction is a good thing. The company managed to float an offering when 10 deals were cancelled in the two weeks before. Google managed an IPO in a soft tech market."

Professor Peter Fader agrees, to a point. He says the way individual investors chased Google like lovelorn puppies the first day of trading is a sign that some folks will never learn. But if they can't remem-

1. Comparing Google with Recent Dutch Auction IPOs

Comparing the Google IPO to recent (but smaller) Dutch auction IPOs shows that Google outperformed other companies that chose the Dutch auction route, both in terms of capital raised and first-day pop. These companies include Salon.com (1999), Overstock.com (2002), and New River Pharmaceuticals (August 2004), all of whom used WR Hambrecht's OpenIPO to go public.¹¹⁰ Table 4 summarizes the figures for the four companies.

Table 4: Google vs. 3 OpenIPOs¹¹¹

	Salon.com ¹¹² (1999)	Over- stock.com ¹¹³ (2002)	New River ¹¹⁴ (8/2004)	Google ¹¹⁵ (8/2004)
IPO Price Per Share	\$10.50	\$13.00	\$8	\$85

ber lessons from the dot-com boom, maybe they can pick up a few in the aftermath.

See also Hodrick, *supra* note 80.

110. See *Open IPO*, *supra* note 1.

111. Andover.net (1999) also used a Dutch auction IPO. Andover.net experienced a first-day pop of 252%. First-day increases of this magnitude are extremely rare for Dutch auction IPOs. See Dawn Kawamoto, *Andover.net Success Boosts OpenIPO Concept*, CNET NEWS.COM, Dec. 13, 1999, at <http://news.com.com/2100-1040-234289.html?legacy=cnet>. See also *IPO Watch: Morningstar in Dutch*, *supra* note 52, which states:

Since April 1999, there have been 11 IPO Dutch auctions held in the United States With the exception of two deals, the rest have racked up an average opening-day loss . . . of 0.25 percent. [¶] The two exceptions were: The Google IPO of August 2004 [which] closed its opening day up \$15 per share from its initial offering price [and the] Andover.net IPO of December 1999 [which] closed its opening day up 252.1 percent from its initial offering price. [¶] The successful Google bidders at \$85 per share got about 75 percent of the stock they bid for For this to have happened, the deal had to have been priced below its clearing price That left "orders on the table" and resulted in a big opening-day pop [¶] There were no reports concerning the allocation of the 1999 Andover.net offering. However, judging from its screaming opening-day pop, the deal had to have been priced below its clearing price.

112. James Surowiecki, *Salon.com Breaks IPO Ground*, SLATE.COM, Jun. 23, 1999, at <http://slate.msn.com/id/1003073>.

113. Clay Corbus, *Changing Behavior: Finding Investors, Not Traders*, WR Hambrecht + Co., July 17, 2002, at <http://www.wrhambrecht.com/comp/equity/corbus>.

114. *IPO Watch: Hanging On*, RedHerring.com, Aug. 10, 2004, at <http://redherring.com/article.aspx?a=10789&hed=IPO%2BWatch:%2BHanging%2Bon>.

115. See, e.g., *Initial Public Offering Details*, *supra* note 70.

Value of Offering	\$25M	\$39M	\$33.6M	\$1.67M
First-day Close	\$10.00	\$13.03	\$7.50	\$100
Net Change	-4.8%	+0.2%	-6.25%	+18%

These data indicate that Google performed quite well in the immediate (first day) aftermarket. The negligible or negative first-day pops for Salon.com, Overstock.com, and New River Pharmaceuticals suggest that Dutch auctions can indeed reveal more accurate IPO prices.¹¹⁶ Google's modified, rather than pure, Dutch auction likely explains the modest 18% first-day increase.¹¹⁷ Google's stock also performed very well in the extended aftermarket, as shown by a near-doubling within three months. New River's stock, however, "flopped" in the aftermarket.¹¹⁸ Its IPO took place on August 5, 2004—two weeks before Google—and New River stock ended its first week down 11.8% from its opening price.¹¹⁹

2. Comparing Google with Yahoo! and AskJeeves

Google's Dutch auction IPO achieved a very modest first day pop when compared to the IPOs of two of its competitors—Yahoo! (1996)¹²⁰

116. The lack of a "pop" implies a relatively accurate opening price. Corbus, *supra* note 113 ("We believe the data demonstrate two things: OpenIPO finds the right price and finds the right buyers The OpenIPO . . . is designed to find the highest price at which all shares can be sold. This does not necessarily mean that an OpenIPO offering will always get more money for the company, but it will deliver a fair price . . ."). Andover.net's 252% pop is likely an aberration, as it was only the third company to use WR Hambrecht's OpenIPO.

117. See Giberson, *supra* note 44.

118. *IPO Watch: Hanging On*, *supra* note 114. New River Pharmaceuticals is a specialty pharmaceutical company developing safer and better versions of widely prescribed drugs.

119. Jerry Knight, *Google Not the First to Go Dutch*, WASH. POST, Aug. 23, 2004 ("Like Google, New River did not get the price it was seeking in the Dutch auction, taking \$8 a share rather than the \$10 to \$12 it was seeking New River completed its offering during a week in which 17 IPOs were scheduled and only three were completed. 'But it got done, in a really bad market,' said Bruce Mann . . . one of the creators of the Dutch auction IPO Mann argues that New River's success in selling stock when other deals were being delayed shows that the Dutch auction process can succeed where conventional IPOs fail."), at E01, available at <http://www.washingtonpost.com/ac2/wp-dyn/A25070-2004Aug22?language=printer>.

120. See Rosé Aguilar, *Yahoo IPO Closes at \$33 After \$43 Peak*, CNET NEWS.COM, Apr. 12, 1996, at <http://news.com.com/2100-1033-209413.html?legacy=cnet>; see also *Yahoo Set to Go Public at \$13*, CNET NEWS.COM, Apr. 11, 1996, at <http://news.com.com/2100-1033-206991.html?legacy=cnet>.

and AskJeeves (1999)¹²¹—although Google's IPO raised a significantly larger amount of capital. Both Yahoo! and AskJeeves, however, went public utilizing the traditional IPO model, relying on investment banks to publicize and price the stock issue.

Table 5: Yahoo!, AskJeeves, and Google¹²²

	Yahoo! (1996)	AskJeeves (1999)	Google (2004)
Type	Traditional IPO	Traditional IPO	Modified Dutch Auction
IPO Price	\$13	\$14	\$85
Value of Offering	\$33.8 million (2,600,000 shares @ \$13/share)	\$42 million (3,000,000 shares @ \$14/share)	\$1.67 billion (19,605,052 shares @ \$85/share)
First-day Pop	\$13 to \$33 = \$20 +154%	\$14 to \$65 = \$51 +364%	\$85 to \$100 = \$15 +18%

The key statistic in Table 5 is the first-day pop. These data reflect two trends: (1) Using a Dutch auction generated less of a pop in the immediate aftermarket, and (2) Google went public in a slower market, which helps explain the smaller increase; but due to its established presence and pre-IPO publicity, it garnered enough interest to offer over 19 million shares worth more than \$1.6 billion¹²³—a much higher figure than Yahoo! and AskJeeves.

In Google's IPO, individual investors who were able to secure shares at the \$85 IPO price did not pay a substantial premium—trader surplus, or alternatively, underwriter payoff. Had Google used a traditional IPO, these investors would have had to wait to purchase shares, by which time the price would have increased, presumably as high as \$100. Critics of

121. Tim Richardson, *IPO Bags AskJeeves A Tidy Sum*, REGISTER, Jul. 2, 1999, at http://www.theregister.co.uk/1999/07/02/ipo_bags_askjeeves_a_tidy.

122. See sources cited *supra* note 121. See also Dawn Kawamoto & Stefanie Olsen, *Google Gets to Wall Street and Lives*, CNET NEWS.COM, Aug. 19, 2004, at http://news.com.com/Google+gets+to+Wall+Street--and+lives/2100-1038_3-5317091.html.

123. See, e.g., Steve Gelsi, *Google Delivers Pop Despite Auction*, CBS.MARKETWATCH.COM, Aug. 19, 2004, at <http://cbs.marketwatch.com/news/story.asp?guid=%7B00D4FA7B-543F-4BD7-B433-97E4779AF61%7D&siteid=google&dist=google>.

Google's modified auction argue that Google could have raised more money had they not lowered the initial share price to \$85. This implies that Google left "money on the table" and failed to realize the full potential value of the IPO.¹²⁴

All successful bidders benefited from the first day increase of 18%, however. Google management may well have intentionally lowered the IPO price in order to generate more post-IPO upside for investors while also alleviating underwriter concerns about an overpriced issue.¹²⁵ Investment banks usually become nervous when an IPO issue trades down on its first day, because "investors sometimes take that as a sign that the stock is 'broken.'"¹²⁶ Alternatively, this may indicate that the stock was initially overpriced. Thus, "[a]ny time a stock trades up from the offering on the day of the IPO . . . it's a success So, if I wear my investment-banking hat, [the Google IPO] was perfectly executed at the end, despite the other wiggles and waggles If I wear my investor's hat, time will tell if it was successful."¹²⁷

3. *Upside for Google and Its Insiders*

On a purely financial level, Google insiders and venture backers gained the most from the IPO. Founders Page and Brin became billionaires, long-term employees possessing stock and options became millionaires, and venture capital firms Kleiner Perkins Caufield & Byers and Sequoia Capital were in a position to realize a significant return on their initial investments. At the time of the offering, Page and Brin sold nearly 500,000 shares each, and CEO Eric Schmidt sold 369,000 shares; Kleiner Perkins and Sequoia sold none.¹²⁸ When the second (90-day) lockup period expired on November 16, 2004,¹²⁹ Sequoia and Kleiner Perkins had

124. Scott Reeves, *Google's Flub, Flop, and Bomb*, FORBES.COM, Sep. 17, 2004, at http://www.forbes.com/home/strategies/2004/09/17/cx_sr_0917ipooutlook.html. Had Google opened at \$105, it would have raised an additional \$390 million (\$20 x 19.6 million shares offered).

125. See generally Associated Press, *Wait-and-See Outweighs Hype Over Google IPO*, Siliconvalley.com, Jul. 29, 2004, available at <http://www.siliconvalley.com/mld/siliconvalley/news/9274644.htm?template=contentModules/printstory.jsp>.

126. Kawamoto & Olsen, *supra* note 122 (quoting fund manager Bruce Lupatkin).

127. *Id.* Lupatkin also noted that during the late 1990s, traditional IPOs were [under] priced to accommodate a potential 10-15% first-day pop. *Id.*

128. Initial SEC filings had the figures at approximately 500,000 each for Page and Brin, 738,000 for Schmidt, and 2 million each for Kleiner Perkins and Sequoia. *The Amazing Shrinking Google IPO*, CBSMARKETWATCH.COM, Aug. 18, 2004, at <http://www.cbsnews.com/stories/2004/08/18/tech/main636869.shtml>.

129. See Lacy, *supra* note 83.

the opportunity to sell shares.¹³⁰ By November 26, several Google officers had either sold or announced their plans to sell additional shares.¹³¹ By February 11, 2005—one trading day before Google's last (February 14) lockup expiration—both Sequoia and Kleiner Perkins had “taken steps to enable their investors to cash in more than \$5 billion worth of Google stock.”¹³²

Google as a whole also benefited from the IPO. The IPO generated considerable publicity and additional interest in the company. For example, an investment bank with no underwriting links to Google began research coverage of the company just one day after the IPO. “Typically, underwriters are the first out of the gate with coverage.”¹³³ More importantly, Google's founders and management were able to retain voting control. They accomplished this by restricting the type of shares offered in the IPO: only Class B shares were offered; Class A shares, retained by Google insiders, held all the voting power.¹³⁴ This issue structure reflects Page and Brin's stated goals: to preserve Google's corporate culture and long-term prospects for shareholders, employees,¹³⁵ customers, and users. Finally, Google management realized the need for continuing innovation in order

130. As of November 16, Sequoia Capital owned 8.7% of Google, worth \$4.42 billion. Kleiner Perkins Caufield & Byers owned 7.7%, worth \$3.89 billion. *Google May Decline as Restrictions End on Selling Shares*, Bloomberg.com, Nov. 16, 2004, at <http://bloomberg.com/apps/news?pid=10000103&sid=abhgtZm8TUXM&refer=us>.

131. These trades were subject to SEC Rule 10b5-1, which regulates insider trading. Associated Press, *Three Google Executives Sell Shares*, S.F. CHRON., Nov. 26, 2004 (“[T]hree officials, including CFO George Reyes, sold more than 300,000 Class A shares . . . for \$162.68 to \$168.78 each . . . Company founders Sergey Brin and Larry Page intend to each sell 7.2 million shares, or about 19 percent of their holdings, under Rule 10b5-1 trading plans. CEO Eric Schmidt plans to sell about 2.2 million shares, about 15 percent of his stake in the company.”), at <http://sfgate.com/cgi-bin/article.cgi?f=/news/archive/2004/11/26/financial1139EST0071.DTL>.

132. Schwanhausser, *supra* note 89.

133. *Lessons from Google's IPO*, *supra* note 109. Analyst Youssef Squali estimated Google's worth at \$115/share. *Id.*

134. *Id.* The prospectus explains Google's Class A and Class B share structure. “[Google's prospectus] was extremely complicated. . . . [It is] clear that the owners didn't want to lose control.” *Id.* (quoting Professor Raffi Amit). This was a source of controversy among some investors.

135. *Id.* (“We provide many unusual benefits for our employees, including meals free of charge, doctors and washing machines. We are careful to consider the long-term advantages to the company of these benefits.”) (quoting Google prospectus). See generally Google Form S-1, *supra* note 60.

to remain the market leader, ahead of Yahoo! and MSN. The IPO raised substantial financial resources to help pursue this objective.¹³⁶

D. Learning From The Google Experience

The Google IPO provides three key insights: (1) Dutch auctions work “if you let them,”¹³⁷ but they are not the solution to underpriced IPOs and underwriter payoffs; (2) even successful IPOs can have their share of problems; (3) a significant rise in Dutch auction IPOs is unlikely to occur any time in the near future.

1. Dutch Auctions Can Work, If Executed Properly

If executed properly, Dutch auction IPOs provide an economically efficient pricing and allocation mechanism where share price equals demand.¹³⁸ In theory, a true Dutch auction sets a fair market price and allows the issuing company to raise more capital. However, Google’s first-day pop of \$15 indicates that the auction did not close at the actual market-clearing price. In addition, only 75% of the shares were allocated through the bidding process, and the company retained the ability to adjust the initial share price. In a true Dutch auction, there would have been little or no first-day increase, and the issuer does not change the offering price; only the market does. When compared to many of the technology IPOs of the late 1990s—where the common pattern was either a huge opening pop, or a freefall resulting from an overly inflated opening price—the Google IPO

136. See *Google’s IPO Rollercoaster*, *supra* note 8. Google’s current strength is its network of sponsored websites, which bring in traffic and advertising revenue. Google generates most of its income from sponsored links on web searches. Gathering more information about users and making them more loyal to Google’s services will help keep Google ahead of Yahoo!. Fending off MSN, however:

[requires] that . . . Google turn its technology into a new operating system that will run over the Internet rather than on a desktop, making Windows irrelevant. As a first step, Google unveiled Gmail . . . offering huge online storage capacity. The idea is to make money from sending out carefully targeted ads, based on information found in emails. But the service is controversial: privacy advocates have accused Google of Big Brother-style snooping . . . [¶] [T]he prospect of a battle with Microsoft is not enticing. [Microsoft] has long been adept at copying technologies and then crushing the companies that first developed them. It is also awash with cash. The \$1.7 billion that Google has raised from selling a slice of itself on the stock market is small change compared with Microsoft’s war chest.

Id.

137. Hodrick, *supra* note 80.

138. *Id.*; see also Zwirn, *supra* note 81 (quoting Mann: “[T]he Google IPO was well priced and the shares were distributed fairly”).

was much more stable. Those who called Google's auction a failure were usually parties with a vested interest in the traditional system—bankers and high-value investors.¹³⁹

2. *Even Successful IPOs Can Have Problems*

On balance, Google's IPO strengthened its name recognition and company prestige.¹⁴⁰ After the IPO, however, Google's overall image also experienced some negative effects. Many managers and employees became paper millionaires,¹⁴¹ and a number of Google insiders have since realized a significant profit on their initial investments.¹⁴² Cashing out by insiders and employees could also affect the company's maverick image: "Do-gooders can't get any better by going public. . . . Whenever there's an IPO, people wonder if you are selling out. You can't escape that perception."¹⁴³

Going public also opened up Google's business processes to closer public scrutiny. Management's pre-IPO miscues—the Playboy interview, the announcement of a share/option buyback, and the last minute IPO price adjustment—raised questions about its handling of the IPO.¹⁴⁴ Its

139. See Hodrick, *supra* note 80.

140. See *Lessons from Google's IPO*, *supra* note 109 ("The Google brand needs no introduction The name, which has become a verb, represents the top destination for searching online, and one of the top destinations on the Web overall.") (quoting analyst Youssef Squali).

141. *Id.* Or billionaires, in Page and Brin's cases. Many Google insiders became "real [millionaires] since they [were] allowed to cash out shortly after the IPO—the company's image took a hit." *Id.* (quoting Professor Peter Fader). Google's lockup provisions allowed the sale of 4.6 million shares 15 days after the IPO, an additional 39.1 million after 90 days, and a total of 260 million after 180 days. *Id.*; see also Lacy, *supra* note 83.

142. See Schwanhausser, *supra* note 89. During the week of February 7-11, 2005, John Doerr, a Google director and managing partner at Kleiner Perkins, sold 150,000 shares worth about \$30 million. *Id.* To purchase their stock options, Google insiders "paid an average of 30 cents in 2000 and \$3.67 as recently as 2003." *Id.*; see also Reuters, *supra* note 88 ("Google co-founder Sergey Brin and director Ram Shriram, an early investor, also have sold shares under a previously announced executive selling plan."); Hui-yong Yu, *Sequoia Rolls With Google*, BLOOMBERG NEWS, Feb. 12, 2005 ("Sequoia Capital investors are expecting to receive about \$3 billion of shares in Google Inc. from the U.S. venture capital firm, the profit from a \$12 million investment in the Internet search company six years ago."), available at http://www.insidebayarea.com/businessnews/ci_2566063.

143. See *Lessons from Google's IPO*, *supra* note 109 ("Usually, such profits wouldn't be a big deal. But Google claims to be different. In the letter in its prospectus, one of Google's chief tenets is to 'Do no evil.'"); see also Google's Form S-1, *supra* note 60.

144. See *Lessons from Google's IPO*, *supra* note 109 ("Google executives [came] off as 'a little naïve.'") (quoting Professor Raffi Amit). Google did not provide institutional

refusal to share proprietary financial information during road show presentations did not help perceptions about the company among bankers and institutional investors. To counter these critiques, and to maintain its reputation, Google management must continue to be innovative, proactive, and assertive: "Ultimately success or failure resides with management [and the founders] . . . You have to put a great deal of faith in their ability to create and execute."¹⁴⁵ This is especially important considering the intense competition from Google rivals Yahoo! and MSN.¹⁴⁶

3. *A Viable Model for Future IPOs?*

Some market observers believe that Google's IPO sets a new precedent for future U.S. IPOs.¹⁴⁷ For example, Morningstar recently decided to change its IPO from a traditional offering to a Dutch auction.¹⁴⁸ However, Morningstar and Google are different in several key respects, which suggests that there is no guarantee that Morningstar's IPO will be as successful as Google's:

Although Morningstar is well known in the world's financial circles, it is hardly a household name. [¶] Over the last three years, Morningstar has shown steady revenue growth. That is always a plus. But its business model has not been profitable. That can be a minus. . . . Google [on the other hand] is a household name. Period. [¶] Over the last three years, Google has recorded explo-

investors with an adequate estimate of future growth and earnings. This lack of financial guidance exposes Google stock to potential volatility. *Id.*; see also Shinal, *Google IPO Achieved Its Major Goal*, *supra* note 101.

145. See *Lessons from Google's IPO*, *supra* note 109 (quoting Professor Peter Fader).

146. See *id.* ("Although Google enjoys faster growth and higher profitability, we see several risks to its valuation, which may mean the stock ultimately trades at a discount to its peers.") (quoting analyst Marianne Wolk).

147. Associated Press, *Google Sets Possible Precedent for IPOs*, Aug. 20, 2004, ("No matter where they stood on the success or failure of Google's IPO, most experts and insiders agreed that other companies would attempt IPO auctions in the future, and would try to involve the public to one degree or another. And Wall Street would continue to be, at best, ambivalent about the concept."), available at http://abcnews.go.com/wire/Business/ap20040820_1863.html; see also Joanna Glasner, *Google IPO Sets Odd Precedent*, WIRED NEWS, Aug. 11, 2004, at http://www.wired.com/news/business/0,1367,64508,00.html?tw=wn_story_top5.

148. See *IPO Watch: Morningstar in Dutch*, *supra* note 52. On January 7, 2005, Morningstar announced that it switched underwriters from Morgan Stanley to WR Hambrecht, more than six months after the company initially announced its intent to go public. *Id.*; see also Kristen French, *Morningstar Readies Itself for Surprise IPO*, May 6, 2004, <http://www.financial-planning.com/pubs/fpi/20040506104.html>.

sive growth in revenues. That is always a plus. And the company's business model has been profitable. That's also a plus.¹⁴⁹

Thus, although the Google IPO proves that auction IPOs can work for larger companies, most IPOs will likely continue under the traditional model—at least for the time being.¹⁵⁰

Google's hybrid auction worked because a large number of potential investors knew the company, its strong brand, and sound products. Google's long-term vision, business strategy, and strong corporate culture afforded the company sufficient credibility among the investing public. In addition, the company's strong financials and unique market position provided sufficient negotiating leverage against underwriters and institutional investors. Most companies do not have the resources or leverage to induce investment banks (other than WR Hambrecht) to conduct a Dutch auction IPO. And smaller, lesser-known companies such as New River Pharmaceuticals do not have the name recognition, marketability, or financial resources to garner as much market interest as Google did.¹⁵¹

Mass adoption of Dutch auction IPOs is unlikely for another key reason: investment banks would be extremely averse to relinquishing their influence and discretion in offerings, along with associated commissions and transaction fees.¹⁵² Moreover, while Dutch auctions maximize initial share pricing, they do not guarantee "a strong syndicate of stable, long-term shareholders which should be one of the primary goals, if not the primary goal, of any IPO."¹⁵³ Yet this does not preclude the future viability of Dutch auction IPOs:

149. *IPO Watch: Morningstar in Dutch*, *supra* note 52.

150. *See Lessons from Google's IPO*, *supra* note 109 ("I do feel the Dutch auction is the way to go because it's more transparent . . . but I don't see it emerging as a popular method. . . . I'm skeptical about the IPO process in general . . . The IPO process brings out the worst in the stock buying. It's gambling. No matter what the ultimate number Google trades at, it has nothing to do with the value of the firm.") (quoting Professor Peter Fader).

151. Justin Hibbard, *Q&A with Bill Hambrecht: Not Too Many Googles Going On*, *BUSINESSWEEK*, Sep. 16, 2004, at http://www.businessweek.com/bwdaily/dnflash/sep2004/nf20040916_2332_db049.htm. Even Google CEO Eric Schmidt is unsure whether "Google had changed the way IPOs work—responding to an often-asked question in venture capital circles." Reuters, *supra* note 106.

152. Investment banks will very likely maintain their central role in securities offerings, at least until finance, technology, and information-sharing progress to the point where new models (such as the Internet direct public offering) become more common and viable.

153. Burnham, *supra* note 79.

Had the Google IPO been viewed as an unambiguous success, there is no doubt that it would have been followed by a flood of additional Dutch auction IPOs. Given the controversy now surrounding its outcome, what can we expect in the future? [We] expect to see noteworthy Dutch auction IPOs executed in the future, though at a slower rate of adoption than if the outcome had been an indisputable triumph. . . . [T]he future use of the Dutch auction for IPOs was never predicated on the success of this particular deal.¹⁵⁴

A potential alternative is to use the Dutch auction model as a non-binding way to improve the IPO pricing process. Instead of only taking share orders, underwriters could ask investors directly regarding their willingness to pay for particular IPO issues, and then make the data available to issuing companies. This is essentially the pricing process that lead underwriters Morgan Stanley and Credit Suisse employed for the Google IPO.¹⁵⁵ This intermediate Dutch auction alternative may also serve “to better educate [issuing companies] about their rights and responsibilities when it comes to determining the issue price and allocating shares.”¹⁵⁶ This would require issuers to closely monitor share orders and also determine “which investors they [would] really like to have at their annual meetings.”¹⁵⁷

IV. CONCLUSION

The Google IPO is generally regarded as a success, as it raised nearly \$1.7 billion, despite contentions that Google could possibly have made more. The IPO also generated more publicity for Google, strengthening its brand recognition and company prestige. The decision to use a modified Dutch auction complemented Google’s vision and long-term strategy: to be innovative and creative, while providing value for its investors, employees, and customers. Private companies considering Dutch auction IPOs should approach them with caution. Companies with strong brand recognition, a sound long-term business plan, and the resources available

154. Hodrick, *supra* note 80. Google’s successful IPO does not necessarily indicate a return of the technology IPO boom. Professor Andrew Metrick reasons that “there are no signs indicating that technology [stocks] will see a renaissance like five years ago, which was clearly an investment bubble.” *Tug of War over Tech Stocks: Are They Heading Up, or Down?*, KNOWLEDGE@WHARTON, Nov. 17, 2004, at <http://knowledge.wharton.upenn.edu/index.cfm?fa=viewArticle&id=1070>.

155. Burnham, *supra* note 79.

156. *Id.*

157. *Id.*

to negotiate favorable terms from underwriters and financiers will be in a better position when deciding whether to use a Dutch auction to go public.

