What Google Can't Teach Us About IPO Auctions (and What It Can)

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WHAT GOOGLE CAN'T TELL US ABOUT INTERNET AUCTIONS (AND WHAT IT CAN)

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I. INTRODUCTION

No initial public offering (IPO) in the history of the United States capital markets has been discussed as intensely as the August 2004 offering of Class A Common Stock of Google, Inc.1 From the announcement of the IPO itself, to the details of its innovative Internet auction, to the post-IPO share price, the investing world has been continuously discussing Google for over a year.2 One aspect of Google’s IPO that received much attention before the offering was the fact that Google chose an online auction process as the mechanism to distribute its original IPO shares.3 In keeping with Google’s nonconformist image, its founders chose an IPO mechanism that had been used only once or twice a year in the United States.4 Many detractors of the traditional bookbuilding mechanism declared that the Google auction foreshadowed an upheaval in the cliquish investment banking industry.5 However, after the offering had taken place and the share price was on the rise, public attention gradually turned to Google’s future, ending general debate on discussions of the auction process. Although some industry insiders had predicted that Google’s auction would be the beginning of a trend,6 critics blamed the auction process for low investor demand in the weeks leading up to the offering and for a last-minute slash in the price range.7 In addition, in the year after the Google auction, only two other issuers launched an online IPO.8

Observers of the intersection of the Internet and the securities markets are left to wonder whether the Google auction was a harbinger of change, a meaningless

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3. See Fleischer, supra note 2, at 17.
5. Lohse, supra note 4 (discussing how investment bankers and Silicon Valley financiers were “stunned” at Google’s move and noting that stock sales are “entering a new era”).
6. See id.
7. See Fleischer, supra note 2, at 19-20.
8. FRIEDMAN, supra note 1, at 5-10 (citing Morningstar IPO Shares at $18.50, CHI. TRIB., May 3, 2005, at C1; Dutch Auction IPOs Could Lure More Takers: Attraction Grows as Google Hits $300 a Share, INVESTMENT DEALERS DIGEST, July 11, 2005).
This article analyzes this historic IPO and explores its influence on future online IPO auctions. Unfortunately, its offering cannot be used to herald an immediate change in the bookbuilding IPO market because Google was a unique issuer in many positive and negative respects. However, Google's auction will assist other issuers in negotiating with underwriters for alternative offering mechanisms.

II. BACKGROUND

A. The Initial Public Offering Machine

During the first day of trading in an initial public offering, most IPO shares experience a price increase from the offering price to the closing price for the day. From 1980–2001, the average IPO share price increased during the first day by 18.8%. This first-day "pop" will also be pronounced during "hot" IPO markets, such as the market that existed during the technology boom, specifically in 1999 and the first half of 2000 (the "1999-2000 Boom"). During this period, the average first-day increase was 77%. Technology issuers had even more dramatic first-day share price increases, with one-third of those issuers seeing the share price double in the first day. However, after the bursting of the technology bubble in 2001, the average first-day increase declined to 14%, marking the beginning of a cold IPO market. Even in lethargic market environments, the investment bank that determines an offering price seems to fix that price at a substantial discount from the price the market will bear.

The issuing company sells all its shares at the offering price, so the issuer does not profit from any share price increase, although insiders who sell shares in the aftermarket may be able to sell at the higher price. Primarily, persons that are able to buy IPO shares at the original offering price will capitalize on the spread between the offering price and the market price. In almost all IPOs conducted in the United States, the vast majority, almost 80%, of original IPO shares are pre-allocated by the underwriters of the offering. The recipients of those shares are usually institutional
investors known to the underwriters and regular customers of the underwriters. In fact, institutional investors receive approximately 75% of original IPO shares in the average offering. In addition, a much smaller number of original IPO shares are distributed by the issuers to employees, relatives, friends, and business partners as part of "friends and family" programs. As a consequence of the institutional investor and friends and family allocations, no more than 20% of an offering will be available for sale at the opening of trading. Those retail investors interested in investing in a new issuer must buy shares from original recipients at a higher price in the aftermarket. Generally, institutional investors are the recipients of IPO shares at the offering price, and later sell their shares to retail investors at a higher price, pocketing the difference.

1. Bookbuilding Method

The bookbuilding method gives the lead underwriter full control of the IPO offering. The underwriter controls how the offering is marketed, how the offering is priced, who receives the IPO shares, and when share recipients may sell their shares in the secondary market. Additionally, the underwriter solicits "indications of interest" from investors during road shows that take place after the company has filed its registration statement, but before the Securities Exchange Commission (SEC) has declared the statement "effective." Not surprisingly, the only investors invited to road shows are large, institutional investors and extremely wealthy individuals. Based on the indications of interest received at the road shows, the underwriter sets the price for the original IPO shares, determines which road show attendee will receive shares at the original IPO price, and determines the number of shares each attendee will receive. As noted previously, the underwriter allocates almost all of the IPO shares available for purchase before the shares are sold on the open market. Additionally, the underwriters employ certain tactics to encourage original recipients to hold on to their shares and not to sell their shares within the

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IPO shares in the sample were allocated before the IPO by the underwriter).


26. Id.
first few days ("flip"). 27 Therefore, the number of shares available for purchase in the first few days is very small. The small number of shares available and any hype surrounding the offering often create a situation in which demand exceeds the very small supply. 28 This situation ensures that when retail investors do begin buying shares from original allocatees the first few days of the offering, the price will increase, producing highly publicized first-day pops. 29

The bookbuilding process, complete with the underpricing and pre-allocation of shares, does not run afoul of any state or federal laws, including securities laws and National Association of Securities Dealers (NASD) rules. 30 However, recent scandals have shown that this process is inherently flawed and is open to abuse. 31 During the 1999-2000 Boom, underwriters used the ability to price IPO shares below the "indications of interest" to then "spin" these shares to potential clients or valued customers. 32 These shares contained a built-in gain that could be realized by selling the shares in the first few days at a higher market price. 33 This ability to allocate profit became very powerful and led many investment banks to abuse that ability. 34 The most extreme abuses occurred when investment banks, even the ones with household names, allocated shares to investors in return for excessive


29. Id.


32. Hurt, supra note 30.

33. Ritter & Welch, supra note 11, at 1797.

brokerage fees. Subsequently, many brokerage firms have been investigated and penalized for charging excessive brokerage fees in violation of NASD rules.

In addition, investment bankers abuse the bookbuilding process by allocating shares to officers of corporations in return for promises of future lucrative investment banking business. Since the 1999-2000 Boom, the NASD has proposed Rule 2712, which would prohibit investment bankers from allocating IPO shares to executives in a quid pro quo transaction. This type of allocation abuse, unlike allocations matched with the generation of excessive fees, is much harder to prove without evidence that an office of a corporation would not have chosen a particular investment bank for an offering had a broker at that investment bank not allowed that officer to participate in a lucrative IPO months before or after. Unfortunately, proposed Rule 2712 has been open for comment for almost four years, indicating that the Rule is unlikely to be accepted.

35. The NASD announced in May 2004 that it had fined Bear Stearns & Co., Inc., Morgan Stanley & Co., and others for churning excessive fees on the day of the IPO for the accounts of allocatees. See NASD, News Release, Charges Invemed Associates with Sharing in Customers’ Profits from Hot IPOs (Apr. 15, 2003), available at http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_002942. For example, a customer may be granted an opportunity to buy hot IPO shares on a certain day, but during that day, the broker will buy and sell a liquid security for the same customer and charge a fee of $100,000 instead of a $3000 fee.

36. See id. (describing how customers who received allocations of original IPO shares in hot issues would then enter into a wash trade in a different liquid security, paying the brokerage firm commissions up to six times the normal fee); NASD News Release, Thomas Weisel Partners to Pay $1.75 Million to Settle NASD Charges of IPO, E-Mail Retention Violations (Mar. 30, 2005), available at http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_013698 (determining that Thomas Weisel Partners received excessively high commissions ($1 per share compared to the normal six cents per share) on highly liquid trades within 24 hours of allocating hot IPO shares to the same customers during 1999-2000). Cf NASD, News Release, Morgan Stanley to Pay $2.7 Million for IPO Lock-Up Violations (June 9, 2000), available at http://www.nasd.com/web/idcplg?IdcService=SS_GET_PAGE&ssDocName=NASDW_014346 (fining Morgan Stanley for accepting IPO shares as fees, then violating NASD rules by selling shares for a profit before the expiration of one year, resulting in an “excessive fee”).

37. Probably one of the more famous examples publicized during Credit Suisse’s Frank Quattrone’s trial was Quattrone’s spinning of Corvis IPO shares to Michael Dell of Dell, Inc. in an effort to gain investment banking business from that company. During trial, email correspondence was entered into evidence in which Mr. Dell asked for IPO shares: “We would like 250[000] shares of Corvis. I know there have been efforts on both sides to build the relationship [between Dell Inc. and CSFB] and an offering like this would certainly help.” John Paczkowski, Get Yer Stinking Robotic Paws Off Me, You Damn Dirty Robo-Ape, SiliconValley.com (Oct. 13, 2000), http://www.siliconvalley.com/ml/d/siliconvalley/business/columnists/gmsv/7004186.htm.


39. Self-Regulatory Organizations: Notice of Filing of Proposed Rule Changes by the New York Stock Exchange, Inc. and the National Association of Securities Dealers Relating to the Prohibition of Certain Abuses in the Allocation and Distribution of Shares in Initial Public Offerings (IPOs), Exchange Act Release No. 50,896, 69 Fed. Reg. 77,804, 77,805 (Dec. 28, 2004) (giving the text of the second amendment to the proposed rule, which would prohibit allocating IPO shares to officers or directors of companies that (1) have been investment banking customers in the past 12 months; (2) may reasonably be investment banking customers within the next six months; or (3) in consideration of an express or implied promise to be an investment banking customer).
For most founders of start-up companies, letting investment banks and institutional investors skim off the top of the total IPO pie is part of a very lucrative deal for them. Many founders become amazingly wealthy in their IPOs, so they are content to forego some portion of operating capital for the issuer. However, savvy officers of seasoned companies are becoming disillusioned with the bookbuilding process. Companies that eventually went bankrupt after going public during the 1999-2000 Boom are now in litigation with investment banks, alleging that underpricing lost them much needed capital. But even with the excessively high transaction costs of going public, few issuers have a viable alternative to the bookbuilding system or the market power to forego Wall Street.

2. Bookbuilding v. Auctions

Although bookbuilding is the most prevalent IPO mechanism, other countries have used alternative methods. In Singapore, Finland, and the United Kingdom, mechanisms can be used whereby underwriters announce an offering price and investors submit demands for shares at that fixed price. Next, shares are allocated to the bidders in a random fashion. This fixed price method alleviates the discriminatory allocation problem inherent in bookbuilding; however, it does not address the ability of the underwriter to underprice the shares. Without the ability to parcel out underpriced shares to chosen recipients, underwriters might have less incentive to underprice the shares.

Alternatively, IPO shares can be distributed through an open auction process similar to processes used in Israel and France. In an Internet auction, bidders place orders based on the number of shares that they would purchase at given prices. The highest price at which all shares would be purchased becomes the offering price. Successful bidders are allocated shares based on the offering price, and if the offering is oversubscribed at the offering price, then bidders receive a pro rata

40. John C. Coffee, Jr., The IPO Allocation Probe: Who is the Victim?, N.Y.L.J., Jan. 18, 2001, at 5 (noting that underwriting typically is a “cost imposed on capital formation, which accrues to financial intermediaries”).
41. See Shawn Tully, Betrayal on Wall Street, FORTUNE, May 14, 2001, at 84 (describing billionaire H. Ross Perot as being “outraged” when institutional investors flipped shares of Perot Systems after its 1999 offering for a $180 million profit). See also Coffee, supra note 40 (describing as dysfunctional an IPO system that sees up to 75% of the market value of the IPO shares going to either underwriters or institutional investors and not the issuer).
43. Derrien & Womack, supra note 12, at 32 (stating that bookbuilding has dominated keeping alternatives for IPOs from being tried).
45. Id. at 12.
46. Id. at 10.
allocation of shares. No shares would be pre-allocated to either individuals or institutions.

The underwriter will have no discretion or very little discretion in determining the price of the IPO shares or the recipients of the distribution in the purest form of an online auction. The highest bidders will be the recipients of the original IPO shares, with some exceptions. Because the resulting offering price should reflect the full demand for the IPO shares, the online auction process should lead to less underpricing and theoretically a stable share price on the first day.

Understandably, in the United States underwriters have not embraced online IPOs. To do so would mean the end of a system that grants underwriters a monopoly on IPO shares that are used to reward and entice selected recipients. Generally, issuers choose an underwriter early in the IPO decision-making process, and unless that underwriter is the one firm in the United States that offers online IPOs, that underwriter is unlikely to counsel the issuer to investigate the pros and cons of online IPOs. If American underwriters recommended online IPOs, they would not only be giving up some control of the underwriting process to another underwriter, but they also would be giving up control of the allocation process, a lucrative opportunity to use other people's capital to curry favor with other Wall Street players. In addition, American underwriters may be loath to implement their own online auction mechanisms and thereby eliminate an allocation system that allows them to reward and entice their regular customers.

Attitudes of issuers may also create a stumbling block to change. Most new issuers have few choices when negotiating with investment banks to underwrite their IPOs. Although issuers may lose capital because of underpricing, the founders may be satisfied with the profits realized by the new ability to sell their shares in the secondary markets. In addition, the founders of the IPO company may not want to forego the potential upside of reserved directed shares for friends and family and

50. See David Nicklaus, Google Auction May Ripple into the Future, ST. LOUIS POST-DISPATCH, Aug. 20, 2004, at B1 (discussing that outcome of auction-style IPO was to end “Wall Street placing shares with friends and favored customers”).
53. See generally John Gapper, Wall Street Is Wrong About Google, FIN. TIMES (London), Aug. 12, 2004, at 17 (describing common complaints about Google’s decision and implementation of an online auction IPO).
55. See Nicklaus, supra note 50. See also Cornelli & Goldreich, supra note 23, at 2343-44 (describing allocation process in traditional bookbuilding as not following “an explicit rule”).
the ability to build in gain for themselves and their strategic partners. Further, founders often rely on venture capital firms (VCs) to choose investment banks, and VCs also may be hesitant to forego instant profits. Most frustratingly, founders also find themselves recruited into this scheme whereby they allow their investment bank to underprice shares of their company in return for the opportunity to receive allocations in future hot IPOs from that bank.

The other major Wall Street player involved in the IPO process, the institutional investor, has also been spoiled by huge short-term gains, as have arbitrageurs and day traders, and so will not be attracted to the online auction process. Ironically, because the auction process may entail "winner’s curse" problems, the share price may actually decline the first day. Because the IPO process creates profitable short-term opportunities for the professional investor, institutional investors will use their consumer power to maintain the bookbuilding status quo. Unfortunately, the main Wall Street players who profit from the American bookbuilding system are also the persons who have the power to choose the IPO format, which will hamper the growth of online IPOs.

Industry resistance aside, the availability of online IPO auction mechanisms promises a more democratic IPO process whereby the larger public has the opportunity to participate. Theoretically, the enhanced transparency of pricing and participation of investors should create a more efficient market for IPOs because the offering price will more accurately reflect the value investors place on the IPO shares. Abolishing the bookbuilding method would transform the IPO process and eliminate abusive profit allocations and other unfair practices such as spinning and laddering. Although the SEC and the NASD refuse to prohibit these practices, these practices would effectively disappear should online auctions proliferate and flourish.

57. Many start-ups during the 1999-2000 Boom engaged in a fragile house of cards in which the start-up would promise IPO allocations to executives of strategic partners in exchange for the strategic partners entering into lucrative contracts with the start-up. These lucrative contracts were the basis for the business plan on which the IPO was launched. See Hurt, supra note 30, at 745-48 (describing one scenario involving Sycamore Networks and Williams Communications).


59. For example, eBay used Goldman Sachs as its lead underwriter in its 1998 IPO, and seven directors of eBay accepted IPO allocations from Goldman in over 200 offerings between 1998 and 2001 that were worth millions of dollars to those directors. See In re eBay, Inc. S’holders Litig., No. C.A. 19988-NC, 2004 WL 253521, at *1 (Del. Ch. Jan. 23, 2004) (detailing claims of shareholders that the directors receiving IPO shares breached their fiduciary duty of loyalty to eBay shareholders by usurping a corporate opportunity).

60. David A. Vise, Google Launches Auction: Playboy Interview Won’t Delay IPO, WASH. POST, Aug. 14, 2004, at E1 (“Google has warned that there may be a ‘winner’s curse’ as a result of the auction process—meaning that the share price could fall on the first day of trading if the blind auction succeeds in maximizing the initial price, leaving successful bidders with a paper loss on day one.”).

61. See generally Gapper, supra note 53 (recognizing the advantages to professionals of the current bookbuilding system).

62. See Nicklaus, supra note 50; Cornelli & Goldreich, supra note 23, at 2343-44.

63. Although the SEC and the NASD refuse to prohibit these practices, these practices would effectively disappear should online auctions proliferate and flourish.
B. The SEC and Online Auctions

Technically, a true IPO online auction would violate federal securities laws. SEC rules prohibit both selling and offering to sell securities before the issuer’s registration statement for those securities becomes effective. The registration statement for a security cannot become effective until the final price is indicated by the issuer. In an online auction, bidders make binding offers to buy shares, and the seller accepts these offers at the highest price at which all shares will be sold. This process sets the final price. Therefore, in a pure online auction, the final price cannot be determined before buyers must make unconditional bids for the securities and those bids are unconditionally accepted by the seller. Beginning in 1999, investment banks have asked the SEC to issue no-action letters confirming that online auctions would not run afoul of SEC offerings rules.

The SEC issued its first no-action letter to Wit Capital Corporation, the first online investment bank, in July 1999. The letter stated that Wit Capital could sell shares in an online initial public offering; however, bids from prospective buyers would be considered mere “indications of interest” and bids would remain open until 48 hours before the registration statement would become effective. At that time, Wit Capital would send emails to all bidders to reconfirm their bids, at which time the bids would become offers. Wit Capital would then determine the winning price of IPO shares and submit a price amendment to the SEC. Next, after the registration statement became effective, Wit Capital would then accept the highest offers. The process described in the Wit Capital letter was an amalgam of a pure online auction and the bookbuilding process. For example, Wit Capital disclosed that it would reserve the right to set aside directed shares that could then be allocated to “employees or customers of the issuer or other persons with an affinity relationship with the issuer.” Also, Wit Capital indicated that it would allocate no more than 100 shares to any bidder until all winning bidders had been allocated 100 shares. Other innovative investment banks, which had emerged during the technology boom, followed suit.

65. FRIEDMAN, supra note 1, at 5-7.
66. See id. (citing Wit Capital Corp., SEC No-Action Letter, 2000 WL 1013585, at *1 (July 20, 2000)).
69. Id. at *23.
70. Id. at *8-10 (discussing generally how the confirmation process will work through email).
71. Id. at *6, *17.
72. Id. at *7.
In 2000, Wit Capital requested a second no-action letter to extend its auction mechanism to include follow-on and secondary offerings that would be priced and distributed in a Dutch auction format. However, Wit Capital failed to specify whether the revised format would also be used in connection with IPOs. In the proposed Dutch offering, bidders would bid for shares between a given maximum bid price and a minimum bid price. The offering price would then be set at the clearing price, the highest price for which all shares would be sold up to the maximum bid price. If the offering was oversubscribed at the offering price, then the issuer would allocate the shares to the bidders based strictly on the highest bids and the time of each bid. Thus, the online auction would be truly transparent, allowing any Internet user to view the aggregate demand in the auction at any price point. Additionally, each bidder would have the ability to change or cancel bids prior to the termination of the auction. Although the bids would be anonymous, the issuer and the underwriter could agree to adjust the allocation to ensure that either small bidders or large bidders, or both, would receive at least 25% of the allocation.

Although several investment firms created infrastructure to offer equity securities and debt securities in an online auction process, most, including Wit Capital, abandoned the practice after the end of the 1999-2000 Boom. Ironically, the firms most likely to want to go public via an online auction, technology firms and web-based businesses, were the very firms hit hardest by bursting of the technology bubble and the least likely to go public in large numbers for some time. Although only one of the companies at the forefront of online IPOs remains active in that industry, pioneers such as Wit Capital helped create a regulatory atmosphere permitting IPO auctions.

C. W.R. Hambrecht + Co.

Most traditional brokerage firms accept electronic orders for IPO shares from individuals. However, few brokerage firms have developed a system whereby all original IPO shares can be distributed via an Internet auction. Furthermore, of the firms that developed online auction systems during the 1999-2000 Boom, only W.R. Hambrecht + Co. currently maintains an online IPO auction platform. After 40 years in traditional investment banking at his own firm, Hambrecht & Quist, W.R. Hambrecht spoke publicly about the abuses of the IPO process and thereafter started a new investment banking firm, W.R. Hambrecht + Co. (hereinafter Hambrecht).

75. See id.
76. See id. at *3.
77. See id. at *3-4.
78. See id. at *4.
79. See id. at *3.
80. See id. at *4.
82. See generally Frontline, Interview: Bill Hambrecht, available at
Prior to the Google auction, Hambrecht launched ten companies, including Red Envelope and Peet’s Coffee & Tea, over five years using an online IPO auction process called OpenIPO. In 2004, the year that Google went public, only one other firm, New River Pharmaceuticals, Inc., used the OpenIPO platform for its IPO. Two firms, Genitope Corp. and Red Envelope, Inc., used the online auction format for their 2002 IPOs, and Overstocks.com used OpenIPO when it went public in 2001. As these numbers suggest, very few companies had launched online IPOs prior to Google’s IPO, barely one or two a year. Many of these companies are creatures of the Internet, like Red Envelope and Overstocks.com, or companies with a reputation for nonconformity, like Peet’s Coffee & Tea.

D. IPO Advisory Committee and the NASD

On August 22, 2002, Harvey Pitt, the now former SEC Chairman, asked Dick Grasso, then New York Stock Exchange Chairman, and Robert R. Glauber, then NASD Chairman, to convene a committee of leaders in both the business and academic communities to assess problems in the IPO process. Pitt and Grasso formed the NYSE/NASD IPO Advisory Committee (“Committee”) to focus on why IPO prices would increase dramatically at the beginning of an offering and how this phenomenon contributed to aggressive, possibly illegal, underwriting practices. In May 2003, the NYSE/NASD IPO Advisory Committee released a document entitled “Report and Recommendations,” detailing the Committee’s recommendations on how to restore integrity to the IPO process.

Although the Committee’s report does not denounce the bookbuilding process, the Committee recognized that investors had lost confidence in the IPO market due to the “widespread perception that IPOs are parceled out disproportionately to a few, favored investors, be they large institutions, powerful individuals or ‘friends and family’ of the issuer.” However, although the report supports alternatives to...
bookbuilding, such as Dutch auctions, the report clearly states that the Committee did not believe that bookbuilding was "inherently flawed" or that regulations should eliminate or even disfavor the traditional bookbuilding method.\textsuperscript{90} Instead, the Committee recommended that the market should determine the dominant method of IPO distribution.\textsuperscript{91}

III. THE GOOGLE AUCTION

At a time when most industry-watchers had forgotten about online IPOs, Google announced that it intended to launch its highly anticipated IPO in an online auction format.

A. Google, the Company

In some ways, Google Inc. is a typical dot.com company that emerged during the 1990s technology boom as one of the many start-ups created by two smart kids with a great idea. By 1998, Larry Page and Sergey Brin, who met while students at Stanford, raised $1 million in angel investor money to launch their own search engine to compete with Yahoo, Lycos, and Altavista.\textsuperscript{92} This search engine, known as Google, markets itself as the search engine that retrieves the most relevant webpages based on user’s search terms.\textsuperscript{93} By design or sheer luck, Google did not go public during the 1999-2000 Boom, although many technology companies with little or no record of earnings did choose to go public during that time, only to eventually fail. In fact, several search engine companies failed during this time or underwent massive restructuring.\textsuperscript{94} However, Google remained private and continued to prosper and is now both the pre-eminent search engine website and the fifth most popular website in the world.\textsuperscript{95}

Internet users can harness the power of Google’s search engine at no cost, so Google depends on advertising for revenue.\textsuperscript{96} Google’s AdWords program generates sidebar ads for vendors based on a user’s search terms on the Google

\textsuperscript{90} Id. at 1 n.1, 9.
\textsuperscript{91} Id. at 9.
\textsuperscript{93} For a thorough examination of Internet word search providers, see generally Eric Goldman, Deregulating Relevancy in Internet Trademark Law, 54 E.MORY L.J. 507, 511 (2005).
\textsuperscript{94} Lycos was sold twice, once in 2000 to Terra Networks, S.A., and again in 2004 to Daum Communications Corporation. Jung-A Song, Saturation Drives Daum to Buy Lycos: Acquisition Underlines Ambitions of South Korean Internet Companies, FIN. TIMES (London), Aug. 3, 2004, at 23. Altavista’s parent was bought by Compaq, which spun off Altavista stock in 1999. CMGI Files to Spin Off Altavista, TIMES OF INDIA, Dec. 19, 1999. Altavista was eventually bought by Overture Services, Inc., which was then bought by Yahoo in 2004. Michael Bazeley, How Yahoo Boosted its Revenue, SAN JOSE MERCURY NEWS, May 11, 2005.
\textsuperscript{95} Google, Quick Profile, at http://www.google.com/corporate/facts.html (last visited Sept. 7, 2005).
website. A portion of Google’s ad revenue is based on the number of users who click on the sidebar ads. Google also maintains a network of “thousands of third-party websites” that use Google’s AdSense program to generate ads on their own websites. Altogether, 95% of Google’s revenue is derived in some way from advertising.

B. Waiting for Google: Anticipating the Auction

In 2004, nothing captured the imagination of Wall Street like the announcement by Larry Page and Sergey Brin that not only would Google finally participate in a public offering but also that the public offering would be executed via an online auction. The founders explained that this auction would embody both the innovative mindset and democratic spirit of Google.

1. Google’s Registration Statement

In Google’s April 29, 2004 registration statement, the founders departed from the traditional S-1 format to write a letter to investors explaining that Google would be different from other public companies. First, the founders explained that they chose an online IPO auction format because they felt that the inefficiencies inherent in the traditional IPO process were damaging to both the issuer and the long-term investor. Similarly, the founders warned potential investors that the company was not interested in hitting short term financial benchmarks at the expense of long-term productivity. Thus, short-term investors would be disappointed with the auction process, which might result in no share price increase the first day of trading. Ultimately, the founders urged only long-term investment in their company.

Despite Google’s efforts to use its auction to demonstrate how the company was different from other technology companies, critics were quick to point out that Google’s auction process was not a true Dutch auction. In a true Dutch auction, anyone may bid, and the clearing price determines the offering price. At first blush, Google’s auction did not seem democratic. First, Google chose two
traditional underwriters for its auction, Morgan Stanley and Credit Suisse First Boston.108 These investment banks were not known for IPO innovation and had never offered an online IPO auction before. All other IPO auctions in the United States had been handled through W.R. Hambrecht + Co.109 Second, to participate in the auction, prospective investors were required to open an account with one of these two firms.110 To ensure that only serious bidders participated in the auction, these firms required prospective investors to maintain extremely high minimum balances in their accounts and to be adjudged “accredited investors.”111 The rumors flew that to create a qualifying account at one of these firms would require a balance of $1 million.112

2. First Amendment to the Registration Statement

In response to the criticism surrounding Morgan Stanley and Credit Suisse, the first amendment to the registration statement filed on May 21, 2004 (hereinafter first amendment), added twenty-nine additional banks as underwriters, including smaller banks and online banks, such as E*Trade.113 The twenty-nine additional underwriters included traditional Wall Street firms such as Merrill Lynch and Goldman Sachs, who were in the uncommon position of being part of a large syndicate without being named as co-lead underwriters.114 The addition of these firms seemed to open up the bidding to a larger number of investors as many of the smaller banks required only a $2000 minimum account balance. However, as the registration process continued, several larger banks dropped out and were omitted in subsequent registration statement amendments.115 For example, Merrill Lynch reportedly dropped out after estimating that it would lose money on the effort.116

The first amendment to the registration statement also contained five pages that detailed the risks inherent in the auction process.117 In any auction, a winner may be said to experience the “winner’s curse” because an auction winner by definition

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108. Form S-1, supra note 103, at 96.
110. Form S-1, supra note 103, at 25.
111. Id. at 26 (noting that “due to each underwriter’s requirements . . . you may not be able to open an account”).
114. Id. at 94 (noting that “due to each underwriter’s requirements . . . you may not be able to open an account”).
115. See, e.g., Google, Inc., Amendment No. 4 to Registration Statement (Form S-1) (July 26, 2004) [hereinafter Amendment No. 4], available at http://www.sec.gov/Archives/edgar/data/1288776/000119312504124025/ds1a.htm (showing a total number of underwriters had reduced to 28).
116. See Bill Deener, Google IPO May Not Live Up to Its Hype, DALLAS MORNING NEWS, Aug. 8, 2004, at 1D (hypothesizing that Google’s demand to reduce underwriting fees from seven percent to three percent drove Merrill Lynch out of the underwriting syndicate).
117. Amendment No. 1, supra note 113, at 18-22.
values the product at an amount higher than anyone else. In an IPO auction, because the auction price will be the highest price that anyone has offered to pay, the price may indeed decline over the offering's first few days in the secondary market. To an unsophisticated investor, the first-day pop may reflect the increasing value of a company. Therefore, if now-defunct issuers, such as Webvan, could see their share prices double in the first day of an offering, then the share price of a seasoned company like Google should double, or even triple. However, because the online auction format is designed to capture the demand buzz in the auction price, not in the first day closing price, that pop should not happen. Knowing that some investors would want to participate in the Google IPO in order to experience a big, first-day "pop," Google management tried to inoculate the market from that disappointment.

The first amendment identified another risk in an attempt to ward off post-auction backlash: the risk that the auction process might actually hurt Google's brand instead of enhance it. Therefore, Google warned that "[s]hould either the auction structure fail or users get frustrated with the process, then that negative public reception could reflect badly on Google products."

3. Second Amendment to the Registration Statement

Although the first amendment warned investors about the risk of share prices deflating due to a "lower level of participation by professional long-term investors and a higher level of participation by retail investors," the second amendment to the registration statement (hereinafter second amendment) more explicitly warned investors about the winner's curse phenomenon and the possibility that unsophisticated bidders might artificially drive the offering price. The second amendment added a new risk factor that addressed the possibility that "less price sensitive investors" would drive the auction clearing price beyond the true market value of the shares. Google warned prospective investors that a large number of unsophisticated investors with brand awareness of Google but lack of access to extensive research and analysis could drive the price above the fundamental value of a Google share. Not only might the share price not increase dramatically

120. Webvan, an online grocery delivery service, went public in November 1999, and its shares climbed 73% in its first day of trading. However, such euphoria was short-lived as Webvan declared bankruptcy on July 13, 2001. *See* Jenny Strasburg, *Five Years After the Bubble Popped; NASDAQ up 85% since Nadir in 2002*, S.F. CHRON., Mar. 10, 2005, at C1.
121. Amendment No. 1, *supra* note 113, at 18 ("Therefore, buyers hoping to capture profits shortly after our Class A common stock begins trading may be disappointed.").
122. *Id.* at 19 ("The systems and procedures used to implement our auction and the results of our auction could harm our business and our brand.").
123. *Id.* at 18-19.
125. *Id.*
during the first day, but it also might decrease. The second amendment warned that "the offering price of our shares may have little or no relationship to the price that would be established using traditional indicators of value.... As a result, [the] initial public offering price may not be sustainable." 126

The second amendment also discussed the topic of the selling of insider shares. Google management emphasized that Page and Brin were the only Google insiders contractually obligated to hold their shares once the offering was underway. 127 In other words, the high volume of shares held by other Google insiders were not subject to the usual lock-up agreement required by most underwriters. In most IPOs, the underwriter requires insiders to hold their shares for a certain number of days, typically 90 or 180 days. 128 Because the sale of a large amount of shares on a given day can drive the share price down, the underwriter uses lock-up agreements to maintain a high share price for as long as possible. The underwriter can waive the lock-up requirement at any time and regularly does so if the share price remains high. 129 Conversely, if the share price plummets, the underwriter may ask insiders to extend lock-up terms to stave off a price decrease. 130 Arguably, this type of underwriter price management is manipulative and inefficient; therefore, Google stressed that an unrestricted system would make the system more transparent. 131 However, Page and Brin themselves "entered into contractual lock-up agreements with our officers and directors and certain of our employees and other security holders." 132

Allowing the other insiders to sell their large numbers of pre-IPO shares at their discretion roused criticism. 133 Many critics thought that Google management, in a role similar to an underwriter, could then manage the stock price through pressuring employees and relatives to hold or sell. 134

4. Fourth Amendment to the Registration Statement

By the fourth amendment (hereinafter fourth amendment), Google management had compromised on the issue of lock-up agreements and described the details of an agreement between Google and holders of restricted securities that would gradually allow more insider shares to become available for sale after 15, 90, 120,

126. Id. at 20.
127. Id. at 107.
129. Fisch & Sale, supra note 58, at 1050-51 (explaining that the realistic length of a lockup agreement is entirely within the discretion of the underwriter, who can unilaterally waive the lockup agreement).
130. See Marshall, supra note 128, at 387.
132. Amendment No. 2, supra note 124, at 120.
134. Deborah Lohse & Michael Bazeley, Google Debut Losing Luster, SAN JOSE MERCURY NEWS, Aug. 8, 2004, at A1 (noting that pre-IPO, three times as many shares were held by Google insiders than in an average IPO).
150, and 180 days. Even after this disclosure, Google admitted that the short duration of the selling restriction agreements between us and our stockholders will allow significantly more shares to become freely tradeable soon after completion of the offering than is typical of initial public offerings. Accordingly, analysts were unimpressed with the details of this agreement, noting that according to Thomson Financial, no IPO in the last two years was launched without insiders agreeing to a lock-up period of at least 180 days. The head of one Wall Street firm complained that allowing insiders to sell their shares so quickly was inconsistent with Google management’s expressed focus on long-term investing. Further, analysts feared that the large amount of outstanding pre-IPO stock available for sale would eventually dilute the share price. However, because this risk was outlined in the Google disclosure documents, other analysts noted that the information on the lock-up restrictions would discount the share price, so that the eventual sale of insider stock should not affect the share price. This confidence in the market’s efficiency was not good news to Google management, however, who would not want the market to discount its IPO shares when bidding during the auction.

The fourth amendment's biggest surprise was the estimated price range for the original IPO shares. The company estimated that the offering price would be between $108 and $135 per share. U.S. auctions generally do list a range of prices, but this range seemed extremely high to many analysts. Obviously, the share price is irrelevant without taking into account the number of shares outstanding, but most IPOs in the United States are priced much lower to increase liquidity, usually no more than $20 or $30 per share. If Google priced in this estimated range, it would be ranked as the second highest IPO offering share price of all time. Analysts speculated that the high price range was designed to keep out the rabble. Google and the underwriters were concerned about the volume of interest, particularly unsophisticated interest, that might destroy the integrity of the auction process. If the offering price were sufficiently high and brokers required the purchase of a minimum number of shares, then only serious bidders would participate in the offering. Of course, the price could also have reflected the issuer’s

135. Amendment No. 4, supra note 115, at 110-11.
136. Id. at 23.
138. Id.
141. Amendment No. 4, supra note 115, at 1.
143. See Russ Wiles, IPO for Google Not Democratic on 2nd Viewing, ARIZ. REPUBLIC (Phoenix), Aug. 18, 2004, at D5 (stating that out of 160 IPOs in the twelve months prior to the Google IPO, only 4 IPOs opened with an offering price over $25, and none of those prices were above $30).
144. See id. (noting that no IPO in recent memory opened with a three-digit price).
145. Kevin J. Delaney & Ruth Simon, Deals & Deal Makers: Google's IPO Draws Lukewarm Interest From Small Investors, WALL ST. J., Aug. 9, 2004, at C1 (“Google may have set a high share price estimate to dampen interest among individuals.”).
146. Id.
sense of the market demand for shares at that time. If Google management believed that the price would rise to this level in the first few days of the offering, a common occurrence during the 1999-2000 Boom, then setting the range this high would ensure that the market demand would be captured by the issuer, not the resellers. 147

The fourth amendment also detailed that Google planned on selling 24,636,659 total shares, of which 10,494,524 would be shares currently issued and owned by Google stockholders. 148 Specifically, given the $105-135 per share range, Google stood to net as much as $1.6 billion from the sale if the shares priced at the midpoint. 149 If the high price range truly reflected the high demand for Google shares, then both Google and Google’s insiders would capture that demand. Specifically, Brin, who was planning on selling 962,226 shares, and Page, who planned to sell 964,830 shares, would pocket roughly $130 million each at the $135 offering price. 150 Notably, these shares constituted less than 3% of either Brin’s or Page’s holdings in the company. 151 Pricea at this range, the underwriters would share more than $90 million in fees at the unprecedented discount rate that Google had negotiated: 3%, compared with the industry-wide 7%.

5. The August Slump

In August 2004, critics speculated that demand for Google shares was waning. The high price range of $108-135 seemed destined for a fall as the registration process continued. 152 Institutional investors grew lukewarm on the offering as they found themselves in the unfamiliar and unenviable role of having to bid against retail investors in an auction that likely would not produce any short-term gains. 153 Because institutional investors were accustomed to receiving pre-allocated IPO shares and then selling them in the next few days at a profit, the Google IPO was not attractive to many institutional investors. 154 In addition, these institutional investors had a vested interest in seeing this auction experiment fail, and with it, any challenge to the status quo of bookbuilding offerings. 155

Faced early on with the specter of irrational retail investors crowding out institutional investors, Google may have attempted to dampen individual investor demand by setting the share price high and by issuing doomsday-like warnings in

148. Amendment No. 4, supra note 115, at 1.
149. Id. at 43.
150. Id. at 99.
151. Id.
153. See Lucchetti et al., supra note 147 (describing how a hedge fund manager felt some concern at being forced to “fly blind like everybody else” instead of being able to “bully underwriters overseeing the deals into giving them a healthy cut of shares before they start trading”).
154. Id. Investment guru James Cramer advised investors that the Google offering would suffer an initial slump because “[i]nstitutions, mutual funds and hedge funds are boycotting the deal.” Cramer advised buying shares during the post-IPO slump. Id.
its registration statement. These tactics appeared to work too well as retail investors seemed wary of the Google auction and the high share price range. Further, the description of the auction process may have been daunting to retail investors, who would have to register with both Google and a participating brokerage firm. This two-step process, discussed in section III.C., infra, may have frightened away as many retail investors as did the high price range.

Other factors added to the Google auction backlash in addition to the labyrinthine auction process and lofty price range. Some commentators opined that Google was losing its competitive edge over Yahoo, with its share of the search market destined to fall. Relatedly, Google had settled a patent infringement suit brought by Yahoo in August for $300 million worth of stock. Even Google's new email product, Gmail, was being criticized for raising privacy concerns. At the same time, computer giant Microsoft was also developing its own search product, which would challenge Google's market dominance. With that announcement, Wall Street speculated that growth in the Internet-search sector was slowing. In fact, the NASDAQ, the listing choice for many technology companies, was down 15% from January 2004. Furthermore, August, typically a vacation month, is traditionally a slow month for stocks and for IPOs. Perhaps because of this trend, in the two weeks leading up to Google's offering, ten other IPOs were cancelled.

The registration process also hit some marketing snags in August 2004. First, Google's road show was getting negative reviews. Besides receiving very little financial information, investors were put off by the dual classes of stock, which gave

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156. See Delaney & Simon, supra note 145 (citing an example of a first-time stock investor who had declined to buy Google shares after the $108-135 range was announced).
157. Id. (citing an example of a first-time stock investor who had declined to buy Google shares after the $108-135 range was announced).
158. See Lucchetti et al., supra note 147 (quoting an individual investor who ultimately decided not to invest because of the cumbersome bidding process as saying, "It seemed like every day there was something new we had to do. I didn't feel like I had the time.").
159. See Google's IPO Rollercoaster, supra note 155; Dutch Treat, supra note 101 (remarking on the threat of competition from Yahoo and Microsoft).
160. See Google's IPO Rollercoaster, supra note 155.
161. See id.
162. Pete Barlas, Google Bidders Grapple with its Valuation, INVESTOR'S BUS. DAILY, Aug. 2, 2004, at A4 (quoting an analyst as saying if "Microsoft is spending a boatload of money on search," then "the valuation [of Google] goes down").
164. NASDAQ was the world's first electronic stock market and is now the largest in the United States. It was originally an acronym for the National Association of Securities Dealers Automated Quotations. NASDAQ, http://en.wikipedia.org/wiki/Nasdaq (last visited Sept. 2, 2005).
165. See Google's IPO Rollercoaster, supra note 155.
166. See Lucchetti et al., supra note 147 (quoting a mutual fund manager who never believed that the IPO would take place because "in August everyone has gone to Nantucket or the Hamptons").
B class holders, Google insiders, ten votes per share. Second, some retail investors were frustrated by certain underwriters' restrictions on bids and rejection of accounts due to suitability concerns.

6. Seventh Amendment to the Registration Statement

Amid negative press focusing on everything from the auction to Google's business plan to the tech industry as a whole, the bidding process was scheduled to begin on August 13th. Unfortunately, one more shoe would drop before the auction opened, and it would drop in a plain brown wrapper. On August 12th, a new issue of Playboy magazine hit newsstands, complete with a seven-page interview with Page and Brin. Although Page and Brin gave the interview before the filing of the registration statement in April, investors became concerned that the release of the Playboy interview during the quiet period could cause regulatory problems. During the quiet period, an issuer cannot speak publicly about the offering, yet in the Playboy article, the spokesmen for the issuer were definitely talking. On August 13th, after management discussed the Playboy risk with the SEC, Google filed its seventh amendment to the registration statement (hereinafter seventh amendment), in which management disclosed as a risk the fact that the Playboy interview could create liability for Google for violating the SEC quiet period.

7. Friday the 13th—Bidding Begins

All of these negative factors together assured that bidding would not open with a bang. In fact, the bidding opened slowly on Friday, August 13th. Google's prospectus detailed the auction process and described its five stages: (1) qualification, (2) bidding, (3) auction closing, (4) pricing, and (5) allocation. The first step, the qualification of prospective bidders, ended on August 12th. Prior to the start of the bidding process, any investor who wished to bid on Google's IPO shares was required to complete the registration process. Registration included not only applying for a bidder identification number at a Google website, www.ipo.google.com, but also opening a qualifying account at a participating...
investment firm. The beginning of the second step, bidding, began August 13th.

C. Google on the Auction Block: The Auction Arrives

Once the bidding process started, bidders could submit bids to any of the twenty-eight underwriters listed in the seventh amendment via Internet, telephone, fax, or hand delivery. When bidders submitted their bids, they agreed to accept electronic delivery of all notices concerning the auction process. Bidders were able to change or withdraw bids during the bidding process, but management reserved the right to change the amount of shares sold and the price range throughout the bidding process. The prospectus specifically warned that “[i]t is very likely that the number of shares offered will increase if the price range increases.” Additionally, the prospectus explained that in the event of a change in the price range or the number of shares offered, Google would post a notice on its website, issue a press release, and send an electronic notice to all bidders without requiring bidders to reconfirm their bids. The prospectus also cautioned that once bidding began, the auction could be closed at any time. However, bidders did have the right to withdraw bids after the closing of the auction, if the bids had not been accepted. Bidders would be notified both when Google requested that the SEC declare the registration statement effective and when the effectiveness was declared.

Once the registration statement was declared effective, the pricing process would begin. The prospectus stated that the issuer retained the right to reject bids that could potentially be manipulative, and the issuers did reject some low-ball bids, but not others. All bids not rejected were then used to determine the “clearing price,” the highest price at which all of the shares offered would be sold. In a true Dutch auction, the clearing price is also the offering price. In the Google offering, the issuers stated their intention to use the clearing price as the “principal factor” in setting the IPO price, but retained the right to set the offering price below the

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177. Amendment No. 4, supra note 115, at 41.
179. Amendment No. 7, supra note 173, at 35-36.
180. Id. at 36.
181. Id. at 37.
182. Id.
183. Id. at 38.
184. Id.
185. Id. at 36 ("We, in consultation with our underwriters, will have the ability to reject bids that have the potential to manipulate or disrupt the bidding process. These bids include bids that we, in consultation with our underwriters, believe in our sole discretion do not reflect the number of shares that you actually intend to purchase, or a series of bids that we, in consultation with our underwriters, consider disruptive to the auction process.").
186. A Wall Street researcher bid $2 a share, which prompted a phone call from one of the underwriters asking him to confirm the price. That bid was ultimately rejected, but bids for $5 and $10 from the same bidder were accepted. Kevin J. Delaney, Gregory Zuckerman & Robin Sidel, Google Is Allowed to Continue Along Its Bumpy Road to IPO by Issuing Revised SEC Filing, WALL ST. J., Aug. 16, 2004, at C1.
187. Amendment No. 7, supra note 173, at 38.
auction clearing price. The stated reason for this reservation was to create a broader distribution of shares and "to potentially reduce the downward price volatility in the trading price of our shares in the period shortly following our offering." In other words, Google reserved the right to underprice below market demand, which could be beneficial if a winner's curse phenomenon occurred. 

After the offering price was determined, then Google would accept successful bids by sending electronic notices to those bidders. If the offering price was below the price range or more than 20% above the price range, Google would send an electronic notice to bidders, who would then have one hour to withdraw bids before acceptance.

1. Eighth Amendment to the Registration Statement

While registered bidders were making bids and adjusting them, yet another management misstep was revealed. Google filed its eighth amendment (hereinafter eighth amendment) on August 16, 2004. The eighth amendment disclosed for the first time that Google was being investigated by the SEC and state regulators for large numbers of unregistered shares and options for shares that the company granted to service providers in the preceding three years. Prior to the eighth amendment, the prospectus merely referenced the risk that the company would have to rescind those shares at a cost of $25.9 million. However, the eighth amendment added the statement "[w]e also understand that the Securities and Exchange Commission has initiated an informal inquiry into this matter and certain state regulators, including California, have requested additional information.

After Google released the eighth amendment, investors speculated that the offering would be postponed. However, on August 17th, Google announced to investors on its website and by electronic notices that it had formally asked the SEC to close the auction at 4 p.m. If the SEC agreed to do so, Google would then announce the final share price by 5 p.m. This announcement led some investors to speculate that demand must have been sufficiently high to convince Google to ask for the auction to close. Furthermore, commentators speculated that for Google to request final approval in the wake of the last filing, the bids received had to be in the suggested price range of $108-135. Consequently, investors rushed to place

188. Id.
189. Of course, the ability to underprice could also be abused.
192. Amendment No. 7, supra note 173, at 19.
193. Amendment No. 8, supra note 191, at 19.
194. Sorkin, supra note 191.
195. Google's IPO Rollercoaster, supra note 155; Sorkin, supra note 191 (quoting David Menlow, president of IPO Financial Network, who stated: "I'm conclusion-jumping here, but it appears on the surface they have enough bids to where they feel good about pricing the deal.").
bids before the auction ended. However, the SEC delayed effectiveness until the next day.196

2. Ninth Amendment to the Registration Statement

Early on August 18, any buzz created the night before was killed by Google’s ninth amendment to the registration statement (hereinafter ninth amendment), which lowered the estimated price range from $108-135 to $85-95.197 Consequently, some investors slashed their overpriced bids, others switched to a low-bid strategy, and others withdrew their bids altogether. Google also reduced the overall number of shares sold, from 25.7 million to 19,605,052.198 Google stated that the large reduction of shares would be achieved by selling fewer insider shares in the offering.

Wall Street analysts and journalists seized on Google’s lower price range as a huge sign of weakness. One columnist took this opportunity to attack Google management for criticizing the bookbuilding process and choosing to have an online auction:

The “go it alone” method that Google used was a total fiasco, just ridiculous. The arrogance, the incompetence was beyond belief. Their own missteps and misbehavior have brought much lower prices than they ever would have gotten for the deal. Institutions, mutual funds and hedge funds all are boycotting the deal. So the price will be artificially low. These guys will have totally messed it up for themselves.199

3. Registration Statement Declared Effective

Later in the evening on August 18th, Google’s registration statement was declared effective, and the auction closed. Google priced the shares at $85 per share, the bottom of the price range; all bidders who bid $85 per share or higher would receive shares.200 Any bids below $85 would be rejected, and those bidders would not receive any shares. Because Google reserved the right to deviate from the clearing price, no one outside the process could know if the clearing price was in fact $85 or if the clearing price was above or below that amount.201

The final step in the process, the allocation process, was even more opaque than the pricing step. Google had reserved the right to allocate its shares either in a pro rata allocation or in a “maximum share allocation” based on an algorithm that seemed to indicate that smaller bids would be wholly accepted while larger bids

196. Sorkin, supra note 191.
198. Id. at 2.
201. Form S-1, supra note 103, at 18 (describing how Google may set an initial public offering price that “is near or equal to the clearing price”).
would receive a reduced number of shares.\textsuperscript{202} Although Google did not make the bids public, most critics believe that winning bidders received a 75\% allocation.\textsuperscript{203} In other words, if a bidder bid $86 for 100 shares, the bidder only received 75 shares at $85 per share.\textsuperscript{204}

4. \textit{First Day of Trading}

Online IPO auctions are designed to capture investor demand and reduce first-day share price increases; in fact, Google's S-1 had warned that during the first day of trading, the share price could even decrease. However, during the first day of trading, Google shares rose in price 18\% from the offering price.\textsuperscript{205} Coincidentally and ironically, the average first-day share price increase for bookbuilding IPOs in the United States is 18.8\%.\textsuperscript{206} After the third day of trading, the Google stock price was up 29\%.\textsuperscript{207}

This difference between the auction clearing price and the secondary trading price could reflect several scenarios. First, the clearing price may have been over $85, but Google management underpriced the shares. Second, the online auction platform may have caused nervous investors to postpone buying until after the auction, creating two demand curves, one representing auction share demand and the other representing post-auction share demand. Third, the post-auction increase in share demand reflected buying strategies of the professional investors who boycotted the auction and waited to buy in the aftermarket. The true explanation is probably some combination of these three scenarios.

D. Google Aftermath or Google Honeymoon?

The first-day 18\% jump was only the beginning of an almost continuous rise in the share price.\textsuperscript{208} From September 1 to November 1, 2004, the price rose steadily to $196 per share, reflecting a 130\% profit over less than three months.\textsuperscript{209} Investor demand was so high in the first month that not even the expiration of the first lockup period, seen pre-IPO by analysts as impermissibly short, could affect the rising stock price. The additional 4.7 million shares injected into the market on September 2 were quickly snatched up by investors,\textsuperscript{210} and any momentary dip in share price was regained within a day or two.\textsuperscript{211}

\textsuperscript{202} Id. at 29.
\textsuperscript{204} See id. (discussing Thornburg's Core Growth Fund grant of "roughly 75 percent of two share groups it bid for a value of more than $85").
\textsuperscript{205} See FRIEDMAN, supra note 1, at 5-9.
\textsuperscript{206} Ritter & Welch, supra note 11, at 1.
\textsuperscript{208} See FRIEDMAN, supra note 1, at 5-9 to 5-10.
\textsuperscript{210} Id.
\textsuperscript{211} Gregory Zuckerman & Kevin J. Delaney, Google's Stock Rise Nears 50\%, WALL ST. J., Sept.
Similarly, the share price declined slightly after the next two lockup expiration dates on November 16 and December 16, but the stock rose steadily again from $180 on December 17 to $216.80 on February 2, 2005. The last lockup agreement expired on February 14, flooding the market with 90 million additional shares, almost doubling the public float. Although the dilution caused the share price to temporarily decrease, the share price closed on March 28, 2005 at $181.42, an amazing 112% increase over seven months. Beginning May 2005, Google's stock price began to climb again and peaked close to $300 before closing at $286.70 on June 20, 2005.

After the 40-day waiting period, analysts employed by Google's underwriters covered its stock and were overwhelmingly positive in their “buy” recommendations, compared to investment banks that were not participants in the IPO. Over time, analysts' buy recommendations and high price targets combined with Google's favorable earnings reports, have supported the meteoric rise of the share price.

In addition, although some institutional investors chose not to participate in the online auction, these important market movers jumped on the after-market bandwagon. For example, Fidelity Investments bought 15% of Google's Class A shares in the first month of trading. Growing institutional investor demand both supported and followed the share price, and by December 2004, 89% of Google's float was held by institutional investors.

The rapid price increase over the first ten months of trading casts some doubt on the pricing of the Google IPO and on the online auction process. Some analysts have attributed the rise in share price to a natural increase in Google's fundamental value. They argue that the $85 initial price was suppressed due to the confusing online auction process and the unflattering disclosures made close to the offering date. Therefore, the combined uncertainty surrounding both the substance and the


215. Zuckerman & Delaney, supra note 211 (reporting that CSFB, JPMorgan, Morgan Stanley, Thomas Weisel Partners, and Hambrecht gave price targets as high as $150).

216. Id. (reporting that in the preceding few weeks, CSFB had targeted Google stock at $225; Goldman Sachs at $215; and American Technology Research at $210).


process of the IPO reduced demand.\textsuperscript{219} Others attribute the volatility in pricing to the small public float of Google shares.\textsuperscript{220} Because only a small number of shares were available for sale during the first few months, demand exceeded supply, causing the price to rise. Google sold approximately 30 million shares to the public in the offering, then lockup expirations slowly released another 93 million shares over five months, with another 177 million shares being released at the final lockup expiration on February 14, 2005. However, not all of those shares have been sold into the market; as of March 28, 2005, the \textit{Wall Street Journal} reported that the Google public float entailed 128 million shares, compared to 273 million shares outstanding.\textsuperscript{221} As of June 23, the public float was only 180 million shares, following huge sell-offs by Page, Brin, and CEO Eric Schmidt. The current public float, at 191 million,\textsuperscript{222} is relatively small compared with Yahoo, which has a public float of 1.2 billion shares.\textsuperscript{223}

Overall, the market, especially the IPO market, was strong in the second half of 2004. In October, 2004, 33 companies went public, the highest volume of IPOs in a month since August 2000.\textsuperscript{224} The question remains whether this IPO boomlet helped Google, or whether the successful Google opening created an IPO tidal wave that floated all boats.

IV. DID GOOGLE FULFILL THE AUCTION FANTASY?

Whether the Google auction was successful depends what on criteria one uses to define a successful IPO auction. To Wall Street, a successful IPO is one that creates first day "buy" orders, with excess demand increasing the share price. On the other hand, proponents of the auction process define a successful auction as one that prices the original IPO shares as close to the market price as possible. In fact, Hambrecht, the current U.S. auction proponent, considers an auction with a first-day pop of 10\% or more a failure. Therefore, the Google auction would have been a failure in the eyes of at least one group no matter what happened on the first day of trading. Because Google shares did increase in price on the first day, supporters of online auctions criticized the auction process for not being a "true" auction. Auction opponents criticized Google's confusing auction and managerial missteps for destroying much of the value that could have been captured in the IPO and depressing the price. Critics blamed Google both for alienating institutional investors\textsuperscript{225} and for scaring away retail investors.

\begin{itemize}
\item \textsuperscript{219} Jason Draho, \textit{The Google IPO: What Happened and Why?}, http://vcexperts.com (last visited Mar. 30, 2005) ("A defining attribute of the Google IPO was the pervasive uncertainty.").
\item \textsuperscript{220} Francisco, \textit{supra} note 218.
\item \textsuperscript{225} Mark Calvey, \textit{IPO Rebel Defies Wall Street}, S.F. BUS. TIMES, Jan. 31, 2005 (quoting Thomas Weisel, CEO of Thomas Weisel Partners (one of Google’s underwriters) as saying the Google auction
For purposes of this analysis, this section will isolate the auction process and critique it using three criteria of a successful IPO auction: a transparent process, a resulting market price for the shares, and a democratic allocation. If these criteria are met, then the auction process has in large part eliminated the abuses inherent in the bookbuilding process. Also, if the Google auction was a successful IPO auction, then the question to be answered is what impact the offering will have on future IPOs.

A. Was it a True Auction?

Experts on the auction method questioned the Google auction’s mechanisms. For example, Alexander Ljungqvist criticized Google’s auction because it failed to state a firm number of shares available and it did not commit to a method for distribution if oversubscribed at a certain price. In fact, Google reserved the right to employ a “pro rata allocation percentage” calculation or a “maximum share allocation” calculation that would give small bidders their complete allocation, with larger bidders receiving a small portion of their total bid. In addition, the registration statement noted that Google’s management did “not intend to publicly disclose the allocation method that we ultimately employ.” For a mechanism that is designed to increase transparency in the IPO process, these reservations were inconsistent with that philosophy.

In fact, Google drastically changed both the price range and the number of shares available in the auction’s eleventh hour. Although the registration statement had indicated that the issuer might increase both the price range and the number of shares available if demand were high, the issuer failed to describe a plan if faced with the opposite scenario. In addition, the auction’s size and the participation of many investment banks created a hybrid auction process in which a large volume of bidders were bidding at separate investment banks, and then those bids were consolidated onto a second auction platform. The high number of anticipated bidders prevented the Google auction from being distributed through the Hambrecht OpenIPO platform. Instead, Google employed a gaggle of underwriters that had to modify existing procedures to accommodate the auction process. Therefore, the


227. See Google, Inc., Amendment No. 3 to Registration Statement (Form S-1), at 36 (July 12, 2004) [hereinafter Amendment No. 3] (“In addition, we and the selling stockholders may decide to change the number of shares of Class A common stock offered through this prospectus.”).

228. Id. at 38-39.

229. Id. at 38.

230. Id.

231. Id. at 36.

232. See id. at 21 (“Only a small number of initial public offerings have been accomplished using auction processes in the U.S. and other countries, and none on the scale of our offering. We expect
auction process Google created was unique to Google both by design and by circumstance.

B. Did the Process Eliminate Underpricing?

If the auction process is intended to eliminate underpricing by the underwriter, then Google management has to explain how this process created a first-day share price increase equal to the average first-day share price increase in bookbuilding IPOs. However, the 18% increase in share price may not condemn the auction process after close analysis of this unique IPO. Without having Google go public in a bookbuilding process in an alternate universe, critics cannot say decisively that the auction mechanism failed because it underpriced the shares. Arguably, had Google gone public in a traditional bookbuilding offering, the underpricing would have been more severe and the first-day pop would have been substantially larger than 18%.233

In this alternative bookbuilding scenario, Morgan Stanley and CSFB would have marketed Google and pre-allocated the bulk of the IPO shares to regular customers and institutional investors. Moreover, the hordes of investors who wanted in on the Google IPO would have bought in the aftermarket, driving the price much higher than the offering price, generating an extremely nice profit for the institutional investors and regular customers of Morgan Stanley and CSFB. A more enlightened debate would compare Google’s 18% first-day price increase with the first-day pops for other popular technology IPOs, even in the post-bubble 2004 climate. For example, shopping.com’s October 2004 IPO saw a first-day increase of 50%.234 Similarly, Dreamworks Animation SKG, the animation studio behind Shrek and Shrek 2, launched a November 2004 IPO and saw its share price increase 38% on the first day of trading.235

However, a more cynical explanation can also be offered for the price increase. With only hours left in the bidding process, Page and Brin drastically lowered the price range, with the resulting $85 per share being 58% of the highest suggested $135 price, but they also reduced the number of shares that they personally would sell at that price. Instead, they were able to sell shares 180 days later at a much higher price once they shrunk the supply. In a traditional bookbuilding offering, the investment bank can manipulate the price to ensure that certain parties capture part of the demand curve. Likewise, Google insiders may have manipulated the share price to accomplish the same thing.

Most participants agree that there were not enough bids on August 18 to allocate all the shares at $135. However, in the end Google auction bidders received 75% of their bids, strongly suggesting that the shares were oversubscribed at $85 and that

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233. Barlas, supra note 207 (quoting Jocely Arel, co-chairperson of Testa, Hurwitz & Thibeault in noting that “[t]he bump was significantly less than what we saw in the 1990s where some of the gains were in excess of 200%”).


235. Id.
the clearing price was more than $85.236 These facts seem consistent with the argument that the shares were underpriced intentionally. In fact, Page and Brin have been able to time the sale of their stock to coincide with share price increases. Although the founders could not possibly have predicted that the share price would increase to almost $300 in June 2005, they each were able to sell shares worth over $100 million at that time, receiving about 3½ times the value they would have if they had sold the same shares in the August 2004 IPO.237

In any event, the end result of the Google auction process may have been preferable to the bookbuilding system. The optimal system would have captured demand for the benefit of the issuer, not the founders, but perhaps only incremental change is available in the IPO process. Although the public would love to see more power in the hands of retail investors, any movement away from the traditional bookbuilding process that puts all power into the hands of the investment banks and their institutional investor friends has to be a move in the right direction. At least in the Google scenario, the spoils of the IPO went to the individuals who created the successful company, not the financial intermediaries.

C. Did the Auction Create a Democratic Allocation?

The Google auction far exceeded a traditional bookbuilding IPO in terms of retail investor participation. Even though Google did not disclose the names of the lucky successful bidders, most commentators agree that substantially more retail investors were granted original IPO shares than in bookbuilding auctions.238 However, full retail investor participation was not realized because of screening procedures, the complexity of the auction process, and the lack of retail investor access to real financial information regarding the issuer.239

The Google auction appeared accessible to everyone by the release of the third amendment. Under the terms of the third amendment, any retail investor that could open an account at Ameritrade or E*Trade with $2000 and bid for five shares, then could be a Google shareholder. However, two important sentences were buried in the 211-page prospectus:

Because each of the brokerage firms makes its own suitability determinations, we encourage you to discuss with your brokerage firm any questions that you have regarding their requirements because this could impact your ability to submit a bid. For

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236. See IPO Watch: Pop Goes the Google, RED HERRING (Aug. 23, 2004), http://www.redherring.com/Article.aspx?a=10805&hed=IPO+Watch%3a+Pop+goes+the+Google ("In a nutshell, the offering price of $85 per share had to be below the clearing price."). See also Delaney et al., supra note 186 (providing anecdotal evidence that most bids were in the $108 to $135 range or higher).


239. Id.
example, while one of our underwriters may view a bid for 100 shares at $121.50 per share as suitable for an investor, another of our underwriters could determine that such a bid is unsuitable for that same investor and therefore, not submit the bid in the auction.\footnote{240}

Online investment banks like Ameritrade required investors to fill out an online suitability questionnaire.\footnote{241} Reportedly, many investors at several brokerage houses were rejected as unsuitable.\footnote{242} The questionnaire asked registrants for information about financial stability, investment knowledge, and investment experience.\footnote{243} Although many individual investors were able to bid for Google shares, many were screened out of the process.\footnote{244}

In addition, some larger brokerage houses had large minimum account balances; for example, Fidelity required a $100,000 minimum balance. Other unnamed banks required a $200,000 balance or a $500,000 balance.\footnote{245} The largest retail brokerage, Merrill Lynch, dropped out of the IPO; had it been a part of the syndicate, then individual participation may have been increased.\footnote{246}

The process of registering for a bidder ID number at a Google website and then registering for an account at a separate broker may have been too technologically burdensome for some retail investors.\footnote{247} Further, the assiduousness required of bidders to be available electronically to change bids, confirm bids, and accept shares may also have frightened some retail investors away. In addition, retail investors suffered more subtly by receiving a barrage of information on the auction mechanics but a mere trickle of information on Google's financials.\footnote{248} The bidding instructions required pages of text in the prospectus, compared with relatively little financial information that retail investors received.\footnote{249} As in ordinary IPOs, only institutional investors, some investment banks, and a few individuals were invited to the road shows, where detailed financial information is shared by the underwriters.\footnote{250} Most individual investors were not invited to the road shows, and even institutional investor managers complained that Google shared very little information in its road shows.\footnote{251} Practically, allowing access and allowing informed access are not the same.

\begin{footnotes}
\footnotetext[240]{Google, Inc., Amendment No. 5 to Registration Statement (Form S-1), at 42 (Aug. 9, 2004) available at http://www.sec.gov/Archives/edgar/data/1288776/000119312504135503/ds1a.htm.}
\footnotetext[241]{Martinez, Getting in on Google, supra note 238.}
\footnotetext[242]{Id.}
\footnotetext[243]{Id.}
\footnotetext[244]{See Calvey, supra note 225.}
\footnotetext[245]{See Barlas, supra note 207.}
\footnotetext[246]{See Richard Waters, Poor Turnout Mars Google's IPO Democracy, FIN. TIMES (London), Aug. 20, 2004, at 25.}
\footnotetext[247]{See Barlas, supra note 207 (citing a former chief economist for the SEC as saying that the web-based system was too confusing for individual investors due to its unwieldy interface). But see Draho, supra note 219 (presenting the counter argument that the Google auction, while an uncertain process, was no more of a confusing process than an eBay auction).}
\footnotetext[248]{See Martinez, Getting in on Google, supra note 238.}
\footnotetext[249]{Id.}
\footnotetext[250]{See Charles Schwab & Co., 1999 SEC No-Action LEXIS 903, at *15 n.2 (Nov. 15, 1999).}
\footnotetext[251]{See Choo, supra note 106, at 437-38.}
\end{footnotes}
D. Did the Auction Open the Door for Other IPO Auctions?

Without doubt, the Google auction was more transparent, efficient and democratic than a traditional offering would have been. The offering cannot transform Wall Street overnight; however, the offering will surely have some impact on the future of U.S. IPOs.

1. Only Google Has the Market Power to Buck the System

The Google IPO was a promising breakthrough in the market for IPOs in that the company proved to investment banks that it could engage in an IPO on its terms and according to its rules. Google set its own course by not rushing to market during the technology boom, and thus it came to the negotiating table as a seasoned company with some power. Unlike many start-ups, Google did not have to court investment banks or rely on VC relationships to make introductions. Because of this unusual power, Google was able to unilaterally determine who would underwrite the IPO and how the IPO would proceed.

However, this does not then mean that all start-up companies will now be able to follow in Google’s footsteps. Most start-ups do not have the ability to create their own IPO buzz and therefore must rely on investment banks and their brokers to market their shares to investors. Google’s IPO was unique in that the issuer combined the auction platform with the support of traditional investment banks. Other auction IPO users have had the support of only one underwriter, Hambrecht + Co. In addition, smaller companies will not have the clout to negotiate discount rates with investment banks, like Google did.

2. Google Does Provide a Blueprint for Others, Including Morningstar

The Google auction may open up IPOs to retail investors in the same way that online brokerage firms opened up investing in individual stocks. Further, the Google auction illustrates how the Internet creates transparencies, increases access, and reduces transaction costs in IPOs through increased information and elimination of fee-grubbing middlemen.

One aspect of the Google auction legacy is that the business world now knows that the online auction is realistically viable. Many investors are now willing to participate in an online auction, particularly if the auction mechanism is simplified.

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252. Id. at 438-41.
253. Id.
254. See Dutch Treat, supra note 101 ("Less glamorous firms will still have to rely on the traditional investment-banking road shows to drum up investor interest—and pay the big banking fees.").
255. Choo, supra note 106, at 439.
256. The investment banks did support the offering by providing marketing support, but their inexperience with the auction model may have contributed to pricing problems. See id. at 423. ("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.").
257. See Dutch Treat, supra note 101.
In addition, institutional investors may be more eager to participate in future auctions after boycotting the Google auction and having to buy at higher, post-IPO prices. Observers also have learned that the process is not doomed to fail technologically. No bids were lost or ignored; the auction platform did not crash. Google’s auction eased any technological qualms about the online auction mechanism.

Data supports the contention that other issuers may follow Google’s lead. Since the Google auction, seven companies have gone public using an online auction.258 However, the first online IPO following the Google IPO took place several months later. Bofil Holding, Inc. (Bofil) went public in March 2005 using Hambrecht’s OpenIPO system.259 Bofil is a small, profitable company, and its $25 million IPO was tiny compared to Google’s auction.260 Although Bofil looked like a good investment, the company actually had to fight against a negative perception of the online auction system.261 Unfortunately, Wall Street continues to believe that immediate aftermarket demand is the sign of a good LpO.262 When online auctions work, there is no share price increase and no Wall Street excitement.263 Yet, when online auctions, such as the Google auction, are underpriced, Wall Street reacts by calling these auctions “Dirty Dutch” auctions. Thus, online auction issuers seem to have a no-win situation.

Interestingly, Morningstar, Inc., an investment research firm, was the second company to launch an online IPO after the Google auction.264 Morningstar, who had announced its upcoming IPO in May 2004, reportedly had a falling out with its traditional underwriters, Morgan Stanley.265 Then, it announced that it had chosen W.R. Hambrecht to be its underwriter and would conduct an OpenIPO auction.266 Morningstar also announced that it would pay discounted investment banker fees of 4% as compared to the traditional 7% fee.267 The Morningstar auction continues to lend more credibility to the online auction mechanism. Unlike other issuers that have used the auction process, Morningstar is a traditional, seasoned company that is not tied to the technology sector.268 To have a financial services firm with ties to Wall Street abandon the bookbuilding

258. See FRIEDMAN, supra note 1, at 5-10.
260. Compare id., with Knowledge Wharton, supra note 168.
262. Knowledge Wharton, supra note 168.
263. Draho, supra note 219.
266. Gelsi, supra note 264.
268. Id. at 109.
269. Gelsi, supra note 264.
system in favor of an online auction sends a different type of signal. Morningstar's auction avoided the problems that the Google auction encountered. All bidders registered at Hambrecht + Co. and were required only to have a balance of $2000. At that time, Morningstar's $140 million IPO was the largest IPO that Hambrecht has handled as lead underwriter. Following the Morningstar IPO, other firms to use the OpenIPO platform were FortuNet, Inc., Traffic.com, Dover Saddlery, Inc., Avalon Pharmaceuticals, Inc., and Cryocor, Inc.

V. THE FUTURE OF IPO AUCTIONS

A. Google's Unique Auction is Not Representative

Unfortunately, Google does not make a perfect poster child for online auctions, either pro or con, because of Google's uniqueness as an issuer. First, the Google offering was one of the largest in U.S. history. Second, although Google had inherent advantages in the auction process as a well-known company with marketing clout, Google's auction also had some inherent disadvantages that would not exist in other IPO auctions. Because of Google's household familiarity and strong following, the auction had to be engineered to handle both high volume and high interest. This "frenzy factor" is not present in most auctions. Many bidders were merely interested in obtaining Google shares for the intrinsic value of being able to say that they obtained the shares. The value of Google IPO shares was in that way the fundamental value of the company plus the relational utility value of participating in a once-in-a-lifetime event. Most IPOs, whether online auctions or not, are not events in that same way. For example, the Morningstar registration statement contained three benign risk factors associated with the auction process, compared to the nine risk factors listed in the Google registration statement. Moreover, Morningstar did not list as risks the possibility that large numbers of unsophisticated investors who are "less price sensitive" would drive the stock price above the price that sophisticated investors would pay.

270. Id.
271. Draho, supra note 219 ("[I]t is important not to infer too much from the IPO on how well auctions work because it truly was a one of a kind event.").
272. Id.
273. Id.
274. Knowledge Wharton, supra note 168.
275. Id.
276. Amendment No. 3, supra note 227, at 16 ("Potential investors should not expect to sell our shares for a profit shortly after our common stock starts trading.... Some bids made at or above the IPO offering price may not receive an allocation of shares.... Potential investors may receive a full allocation of the shares they bid for if their bids are successful and should not bid for more shares than they are prepared to purchase.").
B. Opening up the Road Show—Another Necessary Aspect of Democratizing IPOs

The promise of auction IPOs cannot be realized without loosening SEC rules on road shows. Retail investors are at a disadvantage when bidding against institutional investors with substantially greater access to company information. However, the SEC has recently promulgated new rules that allow for the delivery of electronic road shows to all interested parties, either simultaneous with live delivery or at a separate time with some restrictions. Overall, this simple change could improve individual investors access to IPOs generally, although some critics have charged that issuers and underwriters will always be able to give superior information to favored investors. Only time will tell whether these new rules change discriminatory information disclosure practices of investment banks and issuers.

The Internet’s unlimited potential in distributing information to potential investors regarding upcoming securities offerings eliminates many practical barriers to opening up traditionally exclusive road shows to any interested investor. In fact, in recent years the SEC issued several no-action letters that permitted issuers to transmit live road shows via the Internet. Additionally, the SEC has allowed both live and on-demand presentations to be viewed over the Internet and has also allowed viewers to submit textual questions during the live presentation that may be answered. However, prior to December 1, 2005, the SEC still limited the audience for electronically transmitted road shows, resulting in the continued

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278. One of the first issues that arose concerning the intersection of securities offerings and the Internet was whether certain written materials, such as a preliminary prospectus, final prospectus, and even annual statements, could be posted on the Internet or delivered to recipients via the Internet. See Use of Electronic Media for Delivery Purposes, Exchange Act Release No. 7233, 60 Fed. Reg. 53,458 (Oct. 6, 1995). In addition, the Internet also allows for direct communication between the issuer and the public regarding the company, the company’s future offerings, current registered securities, and relevant markets, thus creating the potential for violating securities laws via statements, including hyperlinks, on a company’s website. See Use of Electronic Media, Exchange Act Release No. 7856, 65 Fed. Reg. 25,843 (Apr. 28, 2000) [hereinafter SEC Release 7856].


280. See Activate.net Corp., 1999 WL 739423, at *2 (describing how streaming technology would allow viewers to transmit questions to the underwriter and the issuer to be answered in the order received). Note that Activate.net is a third-party vendor that provides Internet services to multiple underwriting firms, similar to other companies asking for no-action status for providing electronic road shows, such as Private Financial Network, Thomson, and Bloomberg. This fact suggests that the rise in electronic road shows was not reflective of a desire to make road shows more accessible to the retail investor but of a profit-seeking motive of vendors looking for a new product.
exclusion of most retail investors. In addition, the SEC had only made the use of electronic road shows available to a set of investors virtually identical to those "qualified investors who would customarily be invited to attend a traditional road show," not the general public.

Another lingering regulation barrier to making electronic road shows generally accessible was the preclusion of written communications by the issuer during the quiet period and before a registration statement is effective. Although face-to-face road shows were allowed as oral communications during the quiet period, the SEC maintained the written versus oral distinction in the face of Internet technology. The rationale behind videotaped road shows was applied to videotaped road shows shown on the Internet to selected viewers. This interpretation allowed Internet transmission of road shows to a select group of investors while avoiding a substantial revision of § 2(a)(10). However, with the recent expansive changes to the rules regarding written communications during the registration period, even new issuers will be able to offer both physical access and informational access to their stock offerings.

C. The Status Quo

Unfortunately, the important players in the market for IPOs, the investment banks and the institutional investors, have a vested interest in criticizing the Google IPO and in making the online IPO auction concept disappear. The withdrawal of Morgan Stanley from Morningstar's IPO after Morningstar decided to use an online

281. See, e.g., Charles Schwab & Co., 1999 SEC No-Act. LEXIS 903, at *14 (indicating that road shows will only be accessible to investors with accounts at the Schwab Signature Services™ Gold level or above). Although the Schwab 1999 Letter contains a persuasive call for the SEC to open up the road show to as many retail investors as possible, the group for which access was sought in 1999 comprised institutional investors and retail investors who either executed 24 trades a year with Schwab or invested $500,000 in equity positions with Schwab. See id. at *14 n.1.

282. Activate.net Corp., 1999 WL 739423, at *3 (describing this set of participants as "institutional investors, securities firms, trading and sales personnel from participants in the offering and research analysts"). See also Thomson Fin. Servs., 1998 WL 575139, at *2 (noting the condition that "the viewer is an institutional investor or other person of a type the underwriter would customarily invite to a road show"); Net Roadshow, Inc., 1998 WL 40252, at *2 (regarding the transmission of road shows via the Internet to "qualified institutional buyers" in a Rule 144A offering); Bloomberg L.P., 1997 WL 739085, at *2 (affirming that "a viewer would not be able to receive the transmission unless the viewer [was] an institutional investor, investment adviser or other person of a type the underwriter would customarily invite to a road show"). But see Charles Schwab & Co., 1999 SEC No-Act. LEXIS 903, at *4 (claiming that making road shows available to customers in Schwab's Gold level or above would be vastly improving access to the retail investor).


284. Laura S. Unger, SEC Commissioner, Technology and Regulation: The Road Ahead, Address before the San Diego Securities Institution (Jan. 27, 2000), available at 2000 WL 132740, at *4 (noting that the SEC staff seemed to be able to go no further at opening up road shows through no-action letters given the existing regulatory framework).

285. Draho, supra note 219 ("The apparent highly profitable collusion that goes on between these two groups in bookbuilt IPOs at the expense of issuers and retail investors obviously implies that they have an interest in maintaining the status quo.").
auction format is symbolic of traditional investment bank disdain for the online process. Without investment bank support in marketing and research before and after the IPO, few issuers will be brave enough to be IPO auction pioneers.

VI. CONCLUSION

The Google auction is like Harry Potter's mirror at Hogwarts because it shows the observer what the observer wants to see. Those critics who denounce IPO auctions and defend bookbuilding as the best IPO distribution method see the Google auction as a failure. Specifically, they fault the Google IPO because the auction offering price underpriced market demand, and Google left money on the table. Google scared off both institutional investors and retail investors with its confusing auction process and regulatory missteps. On the other hand, auction supporters see the Google auction as a necessary first step toward public acceptance of the auction method. Some auction supporters claim that the Google auction succeeded merely because retail investors who had never had the chance to participate in an IPO received original IPO shares. In addition, if the share price was underpriced, the underpricing was negligible compared to the expected underpricing in a traditional bookbuilding IPO.

Because of the idiosyncratic nature of the Google auction, the lessons that can be learned for future issuers are limited. However, with each additional issuer that uses an online auction format, such as Google and Morningstar, the format becomes incrementally more acceptable. At some point, the online auction mechanism could become sufficiently viable as an alternative to issuers and force Wall Street to create a complementary product to Hambrecht's OpenIPO.

286. See Gelsi, supra note 264.
288. See Draho, supra note 219.
289. Id.
290. See, e.g., Francisco, supra note 218.
291. Id.