



## Stanford eCorner

### The Initial Public Offering (IPO)

Max Levchin, *Paypal*; Peter Thiel, *Paypal*

January 21, 2004

Video URL: <http://ecorner.stanford.edu/videos/1029/The-Initial-Public-Offering-IPO>

Paypal was the first company to file for IPO status after 9/11 and consequently faced much-stricter-than-normal scrutiny. Additionally, the night before a deadline the founders found out that they were being sued for patent infringement. After a sleepless night and rushed meeting with a lawyer, the suit was dropped. The process was so rushed and stressful that it remains just a blur in the memories of the founders.



#### Transcript

It had a burn rate of, I believe, it was 1,200 a month in September 2000. By September 2001, we turned down. The company was exactly at break-even. That's when we started the whole IPO process which, Max, at the end of the day, very successful. There were certainly many crazy ups and downs in between. The most insane, when we filed going public on September 28, 2001, we're the first company to do so after September 11. I thought this would be a cool thing to do because nobody else would be doing it. The unfortunate downside was that we got way more scrutiny than otherwise we would have. It started with the SEC with our bad luck at the draw. We drew a very short straw.

One of the questions at the SEC who actually reviews these companies, and it turned to be one person in the SEC who was ideologically opposed to companies and thought that all companies in the US were run by crooks, and it was his job as an SEC regulator to prevent companies from ever going public. Normally, what would happen if you have had bad luck of getting this SEC regulator to review you, it would be a very long process. Eventually, supervisors would override it. But there were all these scandals with other companies and other people were starting to think, "You know maybe this guy has been right all these 20 years and maybe no companies should be allowed to go public anymore in the US." And so one of the crazy things to happen in the last month was a Business Week article written on us on January '02 which said PayPal is a great business but unfortunately, it has all these banking regulatory problems. "In particular, it was unclear what their regulatory status was in Louisiana, Idaho, New York and California." And there was this one middle-level bureaucrat in Louisiana who said, "Well, we don't know what they're doing but if they're involved in unregulated banking, they have to stop." And the guy at the SEC read the article and called up the state of Louisiana and then he called us up and announced to us, "Well, you know you have to disclose or you'd be shut down from doing business in Louisiana." And this led to quite a panic because it was a whole network. I mean, Louisiana was not that important a state but if we were stopped in Louisiana, people might think we would be stopped in a lot of other places. And so before the IPO, behind the scenes, there was this frantic effort to be authorized to do business in Louisiana. And this was the middle of Mardi Gras in New Orleans. I think I managed to track down in the middle of Mardi Gras the ex-banking commissioner of Louisiana. I sort of talked about this and he agreed that Louisiana didn't really want to -- I even pointed out we had 100,000 customers in Louisiana.

They were using the product 3,000 times a day. They really want to deal with all these people who after all vote in elections in Louisiana. He agreed that maybe Louisiana didn't really want to get a reputation as an unusually backward state, and perhaps, they should revisit this. And so the morning after Mardi Gras was over, we were back allowed to do business in Louisiana officially and the company successfully went public about a week later. All these things are like layers and layers,

twists and turns. I have to tell one more story as well on the IPO. So the last few days in the last month before the IPO, it was basically this insane race primarily played out in this place called the printers which is where they print these things. The red herring was, I guess, is the jargon for it, but what it was really a prospectus. What it is it's a collection of information about the company mostly saying things like, "We could go out of business. We're really a risky proposition.

You probably don't want to put money into this company. Don't buy our stock. You really don't need to buy these things." Like 90 pages worth of this crap. And you have to send it out to all prospective investors and they have to look at it. It's tightly regulated by SEC. It's really all about not letting getting people to invest in your company. You still have to do it because it's the law. So we had this perpetually sliding date of the IPO. On the night before one of these dates, we find out that we have just been sued, and not just we have been sued for my lack of shaving or something like that. We were being sued for patent infringement.

Usually, the way it works is that you get a notice. Somebody tells SEC a cease-and-desist. Then you try to negotiate and you go out and they go out and try to extort you for money. Patent infringement is all about extortion. They just come in and say, "We have a patent. You have a product. You have a million dollars. We have no money. Hand it to us or we will take you to the cleaners in the court." And the IPO is normally a good time because very time-sensitive. So normally, you just go out and write a check to make them go away.

But these guys actually screwed up their ransoming strategy because they came in too late. They sent it initially to the wrong place. Yeah, they sent the initial extortion letter to the wrong address then they called us up. We were pretty much locked-and-loaded. We were going to go public no matter what. We were pissed off that and been up for a couple of days. These guys are basically saying, "Here's a chopped up baby. Now, pay the ransom." By this point, we don't need the baby anymore. We really didn't care. So we said, "Screw it.

You can sue us all you want. We don't mind." And they did. The Underwriters Council said, "Look, you can't go public because the SEC examiner isn't going to let you go public unless you have at least one opinion from a reputable law firm saying you're not infringing. You want at least some of that in your prospectus because no one is going to buy your stock." So my friend who teaches at Stanford, he is a very, very good cryptography professor at this fine institution. He was also a very, very early on adviser and a personal friend of mine. And I stayed up another all-nighter going through the patent which we have never seen before, trying to figure out exactly how a, I kid you not, telephone network of credit card payments. Basically, it sounded like a patent for 1-800 services but it was written in legalese so you really couldn't tell exactly what it said. It had nothing to do with PayPal. We had to convince a lawyer the next morning which neither of us have ever met, that the two were really very different. So we pulled this crazy all-nighter.

The next morning, this lawyer flew in from Los Angeles who we never met, who had never seen the patent, and who had never met me. He had never heard of the company, trying to help me convince a lawyer somewhere else that the whole thing was really, just hand-waved off. It really came to a heated conversation. I fired the lawyer while he was in the room, broke all the ranks trying to convince the Underwriters council that were all OK, and miraculously enough, they actually bought it. And later on, obviously it had lost and it never went anywhere. PayPal was, of course, not really infringing anything and the extortion completely failed. So that may sound sort of nutty and I hope I gave enough color to it but it was really, really nutty at the time. This was just one of maybe 10 stories like that all occurred the week before IPO. So the IPO party was basically a massive blur in my mind. All I remember was just having a bottle of champagne and a cigar, and then I woke up.

And I think the same goes for most people in the company. I will publicly repeat this again and again. The day PayPal went public was the happiest day of my life. I only had two happiest moments so far but hopefully, I'll top it with the next one.