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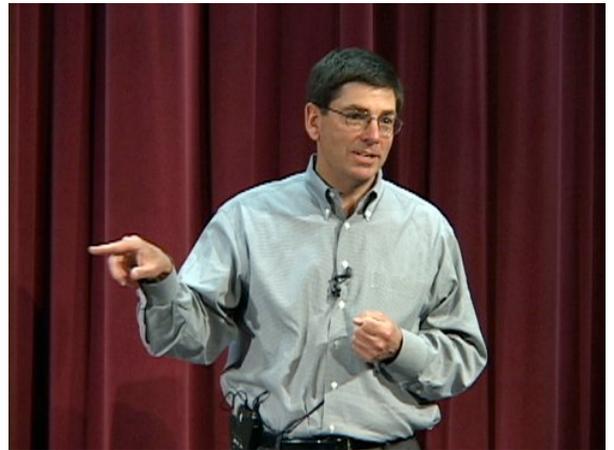
### When is a Dutch Auction Appropriate?

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Video URL: <http://ecorner.stanford.edu/videos/892/When-is-a-Dutch-Auction-Appropriate>

Gordon questions whether the Dutch auction system is ever appropriate for stock, since it was developed for tulips, of which there is a finite quantity. He worries that people will artificially inflate their bids if they know that the company is planning on giving each bidder only a percentage of what they ask. He also speculates that the institutional investors may not bid, but will wait until the market settles. Whatever the case, there is not yet enough data to convincingly predict when a Dutch auction will be successful.



#### Transcript

So are there any other companies where the Dutch auction is not appropriate? It's a good question when it's appropriate for Google. It's a good question whether it even applies for stock. It was invented for Tulips, right? So with Tulips, there's a finite quantity and you know you're going to resell them, right? It's for the wholesale market. And so that's a clever way to deal with the problem of what's the market value. With stock that is constantly turned over, it's not clear. When stock is ever consumed, it's a much more speculative thing. People are going to resell it and resell it and resell it. So I don't know if the Dutch auction method really is appropriate at all. I mean I'm sort of agnostic. I wonder because of the possibility for speculation.

People put in crazy bids. And another big piece of the Google offering is "how is it allocated?" Let's assume that you price a little bit below the clearing price, so not everybody gets a 100% of what they want. And Google said, "We're going to give everybody 80% of what they want." Well, as soon as you know how the pie is allocated then you bid for more shares than you really want. And then you're not really having an accurate price to start with. That's what we used to have with all the IPOs which are priced the conventional way. So that's what the Dutch auction is designed to solve. It's a really good question. I have been working on a small IPO that was going to be Dutch auctioned. It was pulled last week because it didn't close. It was just the expectations of the market and the auction didn't match.

I also have a direct experience with a venture capital Dutch auction, which really gives me pause. I have a really private company that wasn't able to go public. It tried three times. And it ultimately got funding from its existing investors under what you consider some pretty tough terms. For those of you who know what this means, 12X liquidation purpose. It's very tough terms, and 200% more coverage, if you know what that means. Not what you get from a friendly venture capitalist in Sand Hill Road if you're starting up. But if you have a company that's missed its plan, that's kind of the terms of the market. So we're trying to raise probably \$10 million. We really raised 7.5, so the company came up with the bright idea and said, "Let's Dutch auction off 2.5 to a million sell.

Let's ratchet down the price until we clear the market." And the way we were ratcheting down the price was with increasing more coverage to effectively lower price. And we had a minimum. We just have to sell a million of it. Astonishingly, they're sophisticated. We had 300 shareholders so we sent this information statement out to 300 shareholders, a lot of legal work, a lot of legal work for a relatively small amount of money. Lots of little people subscribed, former employees and people who have retired from the company so had very tiny shares or stakes in the company. The big investors didn't invest, didn't bid. The auction didn't close and now, we're negotiating big investors now. So I'm a little bit afraid that in the IPO context, the

institutional investors won't bid. They'll wait and see if it settles out in the after-market.

That's the quick. In theory, it might work for small consumer audience. It doesn't work for institutional investors. We don't know. No one really knows. There have only been maybe a dozen Dutch auction IPOs. Some of them have worked. Some of them have gone up and some of them have gone down. They're not all that different from only different from conventional IPOs. There's not enough data to really know.

I'm not closed to it. I would assume there's still going to be a road show. In a typical Dutch auction IPO, you still do a road show. You still go around and call on the same investors. It's just the process of placing orders is different. I suppose you could skip a road show. in the extreme, especially a well-publicized offering. But I think investors still want to meet the officers of a company face to face, not only in public road shows sessions where there are also one-on-one session with the institutional investors. I think we'll still see road shows