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PayPal Execs Lied About New Account Growth, Investor Says

By **Katryna Perera**

Law360 (November 3, 2022, 4:27 PM EDT) -- PayPal's CEO, former chief financial officer and other top brass have been hit with a stockholder derivative suit in Delaware federal court, alleging they misled shareholders about the growth of new active accounts on the digital payments platform.

Investor Alpesh Shah filed his **complaint** Wednesday against PayPal CEO Dan Schulman; the company's former chief financial officer, John Rainey; and several directors. Shah claims that from February 2021 to February 2022, the company and the individual defendants boasted about "massive growth" in net new active accounts, also known as NNAs, which have traditionally been tied to the overall success of PayPal.

The complaint states that in an attempt to increase NNAs, PayPal offered cash incentives to new customers who opened accounts. One such incentive was a $10 reward for each newly opened account.

But Shah says the individual defendants failed to disclose to investors and the public that many new customers acquired through these cash incentive campaigns were fraudulent.

"PayPal failed to disclose that its aggressive cash incentive campaigns significantly increased PayPal's susceptibility to bot farms, which systematically manipulated PayPal's $10 cash marketing incentive by creating millions of illegitimate accounts," the complaint states. "Of course, these fraudulent accounts generated no revenue for the company."

Shah says Schulman, Rainey and the other defendants knew about the fake accounts but maintained them throughout the relevant period to prevent turnover and inflate PayPal's NNA guidance, including the company's prediction that it would add 50 million NNAs in 2021 and 750 million by the end of 2025.

However, at the end of the relevant period, on Feb. 1, 2022, PayPal reported that the number of NNAs for 2021 fell short of its prediction and the company and the individual defendants disclosed that "in connection with the increased use of cash incentive campaigns throughout 2021, [it] identified 4.5 million accounts that [it] believe(s) were illegitimately created," the complaint says.

PayPal subsequently revised its 2022 prediction, stating that it expected only 15 million to 20 million NNAs for the year and that it no longer felt the 750 million goal by the end of 2025 was "appropriate," the complaint says.

Shah says the individual defendants also admitted that PayPal had pursued customer acquisition strategies at the expense of revenue and with no regard to whether the strategies increased turnover.

"For the first time, the company disclosed that '[W]e also leaned into incentivized customer acquisition tactics to a much greater extent than we ever have in our history,' admitting that while 'these programs are very successful in generating account creation, these customers have lower engagement and a higher propensity to churn, and have not met our required level of return. This dynamic compounds over time as it requires increasing investment simply to keep minimally engaged users on our platform,'" the complaint states.

Shah says PayPal told investors that going forward, it would focus only on recruiting active customers rather than trying to grow NNAs, and also admitted that it had manipulated the natural turnover rate to inflate its NNA guidance by giving customers incentives to stay on the platform who otherwise would have been considered inactive.

The complaint states that when all these disclosures were made, PayPal's stock fell $43.23, or 25%, in one day, closing at $132.57 per share on Feb. 2.

In April, PayPal again lowered its NNA guidance for the year, estimating it would add only 10 million new accounts in 2022, according to the complaint. On Thursday, the company's stock was trading around $77 per share.

Shah says as a result of the individual defendants' alleged actions, the company has suffered a hit to its reputation and incurred financial losses, including legal fees to defend itself in a related securities class action. He seeks damages, restitution, attorney fees and improvements in PayPal's corporate governance and internal procedures.

In a statement to Law360 on Thursday, a spokesperson for PayPal said the company is reviewing Shah's complaint and "looks forward to appropriately defending itself once we've had the opportunity to more fully assess these claims."

Counsel for Shah did not immediately respond to requests for comment.

Shah is represented by Seth D. Rigrodsky, Gina M. Serra and Herbert W. Mondros of Rigrodsky Law PC, and Joshua H. Grabar of Grabar Law Office.

Counsel information for the defendants was not immediately available.

The case is Shah v. Schulman et al., case number 1:22-cv-01445, in the U.S. District Court for the District of Delaware.

--Editing by Robert Rudinger.