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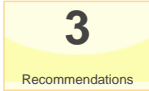
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Overstock's Three Affidavits



By Bill Mann and John Reeves
October 5, 2005

The nearly endless fount of mirth surrounding Patrick Byrne's lawsuit against Gradient Analytics, short-selling hedge fund Rocker Partners, and others is obscuring a case with fairly broad implications for security analysis, First Amendment rights, and the credibility of our public markets.

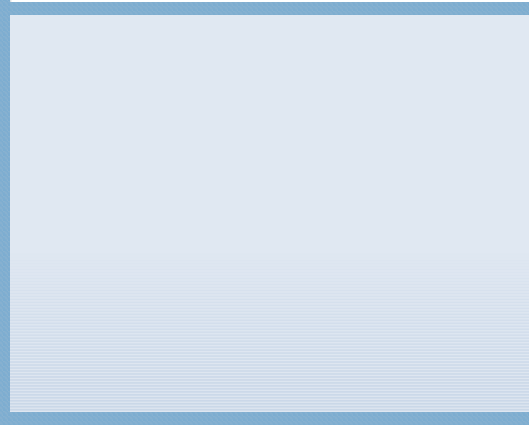
While fanciful visions of Sith Lords and evil shorting hordes make for good copy, this is a lawsuit that is about *something* more substantive: an accusation that Gradient and Rocker resorted to unfair business practices to knock down **Overstock.com's** (Nasdaq: [OSTK](#)) share price. Too much coverage has been spent plumbing the entertainment value, and nearly none on the facts of the suit itself.

It is our hope that the following information, culled from three documents acquired by The Motley Fool, will provide readers with a clear view of what is being alleged.

In an affidavit recently acquired by The Motley Fool, Demetrios Anifantis, who identifies himself as a former employee of the research firm Gradient Analytics, alleges that the company conspired with David Rocker of the hedge fund Rocker Partners to publish damaging information "for the purpose of negatively influencing the price of Overstock shares so that Rocker could profit from its existing or intended short positions in Overstock shares."

Two additional sworn statements in our possession, ostensibly by former Gradient employees Robert Ballash and Daryl Smith, also allege that Gradient provided biased research on behalf of its clients. Both Anifantis and Ballash additionally accuse Gradient of running a hedge fund advisory called Pinnacle Investment Advisors, contrary to the company's public statements at that time. The three affidavits we reviewed were forwarded to us by Patrick Byrne, Overstock's **CEO and president**. **The documents set out some of the rationale for Overstock's complaint filed back in August against Rocker Partners and Gradient.**

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The complaint, which was filed in California state court in Marin County, accuses Rocker Partners and Gradient of violating the unfair competition and deceptive business practices provisions of the Business and Professions Code of California. The relevant statutes are quite broad and may well apply to an alleged campaign to present misleading information in order to drive a stock down.

Note that the above paragraph actually outlines a simple law case. There is no mention of naked shorting, a giant conspiracy involving half of Lower Manhattan, strip clubs, or anything of the sort. We make no judgments on the merits of the case, nor are we, by providing this information, placing any imprimatur on it. In short: What you are reading below is what Overstock's case is about. Nothing more.

The complaint
Despite the high drama surrounding the case, Overstock's complaint is very straightforward. It alleges that Gradient issued approximately 58 earnings quality analytics (EQAs) and various other reports on Overstock, which were almost always negative. In addition, Overstock charges that Rocker collaborated in producing the reports with Gradient's co-founder Donn Vickrey and that Rocker was able to request that Gradient withhold publication of these negative reports until he was able to establish short positions in the stock.

Are these charges true? That's for a court of competent jurisdiction to decide. But is it "crazy" to think that a research firm would offer biased information to move a stock for the benefit of a client? No, we don't think so. We do believe, however, that Byrne's over-the-top presentations and continued public pronouncements on the issue have made it easier for some observers to dismiss his charges out of hand. It may be wise, however, for investors to take a closer look at this complaint. Let's now turn to some of the evidence. Do the affidavits support Byrne's case?

The evidence
The most detailed and apparently most damaging affidavit, if it is true, was delivered by Anifantis. He worked as a customer service representative for Gradient from November 2003 until November 2004. The *New York Post* reported that he was fired from the research firm for forwarding his employer's client list to his personal email.

According to his statement, Anifantis recalled being on phone discussions, during which "David Rocker, Marc Cohodes, or other representatives of a hedge fund called Rocker Partners, LP, requested that the special report contain more negative information, or that the report emphasize a specific negative fact and that the report downplay any positive facts."

Anifantis also states that customers like Rocker would ask that Gradient not disseminate a negative report "to the public for a specific period of time, so the customer could 'get their own' position in the stock before the public got the information." This conspiracy went beyond just Vickrey and Rocker, according to Anifantis, who also says that it "appeared" to him that Herb Greenberg, who then wrote for TheStreet.com, joined in coordinating the attacks on Overstock.

The statements by Ballash and Smith are far less detailed. Ballash, who worked at Gradient for more than two and a half years, was also fired in November 2004, according to the *New York Post*. He states that the research at Gradient was biased and that it published several negative reports on Overstock that had been developed with Rocker via telephone. Smith, who worked for Gradient from October 2002 until October 2003, also describes Gradient as biased in its research and notes that customers had

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Major Indices

considerable input on reports. He does not mention Overstock specifically, however.

Overstock's day in court

At first glance, the affidavits raise troubling questions about the nature of "independent research." If the three former employees of Gradient are telling the truth, the alleged conspiracy between the research firm and Rocker Partners would represent an egregious example of market manipulation, which most likely would have seriously harmed individual investors, as well as Overstock itself.

But the veracity of these individuals has not been established, and Rocker Partners and Gradient vigorously deny the charges. As the *New York Post* has reported, at least two of the affiants may have credibility issues or reasons to hold grudges against Gradient. If this case makes it to trial, Anifantis, Ballash, and Smith will have to testify in court and withstand cross-examination by top defense attorneys. It will be interesting to see whether their charges are supported by documentary evidence -- emails, revised reports, notes of phone calls, and the like. Within the affidavits are charges that would prove quite persuasive if supported with concrete documents. For example, in support of the charge that Rocker had considerable input on the creation of reports, Anifantis's affidavit refers to an "exhibit 5" (which we did not receive) allegedly containing revised reports on Overstock with Rocker's revisions in brackets.

There is quite a lot of speculation throughout all three of the documents, particularly the statement of Anifantis. It is not clear how much of his affidavit is based upon events that he actually witnessed and how much is based upon his opinions, conjecture, or even fantasies. His testimony is peppered with phrases such as "it was common knowledge" and "there was no doubt." Some of the allegations might be far too subjective to hold up in court. For example, when describing the alleged conspiracy among Rocker, Greenberg, and Vickrey, Anifantis states that "it appeared to me that Rocker, Vickrey, and Greenberg were coordinating their attacks on Overstock and Vickrey and Greenberg were coordinating the content and timing of their various reports on Overstock to please Rocker." Does Anifantis have hard evidence for this view, or did he just "feel" that it was true? Furthermore, it would not necessarily be wrong for clients and journalists to influence analyst reports. Although analysts must take responsibility for their own work, how sensible would it be for them to ignore the informed opinions of experienced investors and journalists? The California court may have to answer when the legitimate exchange of information ends and sinister conspiracy begins.

Foolish Take

Ultimately, we believe that these affidavits raise important questions for investors about the integrity of our financial system. Unlike a lot of the silliness in the media relating to Overstock, this complaint is not frivolous on its face, and although Overstock will need to prove its allegations, the case must be taken seriously. The question to us is why the atmosphere around this lawsuit has, from the beginning, been comical. If the behavior set forth in these allegations is true, then the implications of the ease at which the financial professionals can manipulate the public markets are stark.

Again, we make no judgments as to the veracity of the affidavits -- we have no grounds upon which to do so. But we do wish that it were more apparent from coverage to date that the case itself is quite serious, with implications that go far beyond Overstock.com. We will continue to follow this case quite closely.

Neither of the authors has a position in Overstock.com. Overstock is a recommendation of the Motley Fool's [Rule Breakers](#) newsletter. Bill Mann co-authors the [Motley Fool Hidden Gems](#) newsletter.

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