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IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

FILED

DIVISION FOUR

MAY 30 2007

OVERSTOCK.COM, INC., et al.,
Plaintiffs and Respondents,

Court of Appeal - First App. Dist.
DIANA HERBERT

v.

A113397

By _____
DEPUTY

GRADIENT ANALYTICS, INC., et al.,
Defendants and Appellants.

(Marin County
Super. Ct. No. CV053693)

A company that produces and publishes subscriber-based analytic reports on public companies, regularly collaborating with the principals of hedge funds and other institutional investors to produce custom, negative reports on targeted companies, stepped over the line into defamation and other torts with respect to the flurry and timing of reports on an online closeout retailer. The hedge fund principals took short positions in the stock and worked closely with the publisher to put out reports that were anything but the purported unbiased and objective assessment promised to subscribers. So says the targeted company in its complaint, and so aver various declarants in the papers opposing the anti-SLAPP¹ motions prosecuted by the

¹ Code of Civil Procedure section 425.16 (§ 425.16). SLAPP stands for strategic lawsuits against public participation.

This statute provides in part: “(b)(1) A cause of action against a person arising from any act of that person in furtherance of the person’s right of petition or free speech under the United States or California Constitution in connection with a public issue shall be subject to a special motion to strike, unless the court determines that the plaintiff has established that there is a probability that the plaintiff will prevail on the claim. [¶] (2) In making its determination, the court shall consider the pleadings, and supporting and opposing affidavits stating the facts upon which the liability or defense is based.” (§ 425.16, subd. (b)(1), (2).)

publisher and the hedge fund parties. In this scenario, and at this early stage of discovery, the trial court correctly declined to strike respondents' complaint. Accordingly, we affirm the judgment.

I. BACKGROUND

A. *The Parties*

1. *Overstock.com, Inc.*²

According to the Overstock's first amended complaint, Overstock is an online closeout retailer. It offers customers an opportunity to shop online for brand name merchandise at heavily discounted prices, while offering suppliers an alternative way to distribute inventory liquidation. Overstock launched its first Web site for customers in 1999. Its stock is publicly traded on the NASDAQ (National Association of Securities Dealers Automated Quotation System).

2. *The Gradient Appellants*³

Gradient, formerly Camelback Research Alliance, Inc. (Camelback), provides analytical reporting services on publicly traded companies through a subscription program. Its customer base of approximately 125 subscribers consists almost exclusively of large institutional investors. One product is the earnings quality analytics (EQA) report. The EQA reports rate public companies on an "A" through "F" scale, with "A" being the highest mark.

The base price to subscribe to Gradient services is approximately \$25,000 to \$40,000 or more per year. For the base fee customers receive access to all of Gradient's newly published reports, as well as historic reports on publicly traded companies. Additionally, subscribers are entitled to order two custom reports on a specific company, at any time. Beyond that, subscribers can pay for more custom

² Respondents are Overstock.com, Inc. (Overstock or OSTK), Hugh D. Barron and Mary Helburn.

³ Appellants Gradient Analytics, Inc. (Gradient or the firm), James Carr Bettis, Donn Vickrey and Matthew Kliber are referred to collectively as Gradient appellants.

reports. As a marketing strategy, Gradient commonly offered the service free of charge to hedge fund managers for up to several months before it invoiced the investor and required payment.

3. *The Rocker Appellants*⁴

Rocker and Marc Cohodes are managing members of the Rocker Partners entities. The Rocker Partners' investors include "funds of funds, university and hospital endowments, and individuals and families with substantial assets." Rocker describes Rocker Partners as a "short-biased" hedge fund that invests "long" in public companies but also sells "short" those securities which it believes are overvalued and likely to decline in price in the future. Rocker Partners is best known for its expertise in selling short.⁵

B. *Gradient's Custom Research Reports*

Demetrios Anifantis,⁶ a former customer representative who worked for Camelback from November 2003 through November 2004, submitted a declaration in this litigation, revealing the following:⁷ Typically a subscriber requesting a custom report would supply Gradient with information on the company subject to the

⁴ Appellants (1) Rocker Partners, LP; (2) Rocker Management, LLC; and (3) Rocker Offshore Management Company, Inc., are referred to collectively as Rocker Partners. Rocker Partners, David Rocker (Rocker) and Marc Cohodes are referred to collectively as Rocker appellants.

⁵ A basic definition of "selling short" is: "When someone shorts a stock [sometimes called 'selling short'], [he or she] borrow[s] shares of a company from an investor and sell[s] those borrowed shares at the current market price. The hope is that the stock price will fall so the short seller can repurchase the stock at a lower price and pay back the person [he or she] borrowed from." (From "About: Investing for Beginners" found at <<http://beginnersinvest.about.com/library/glossary/bldef-shortselling.htm>>; italics omitted, first bracketed insertion in original.)

⁶ Anifantis has a master's degree in economics. Prior to employment with Camelback, he was a research and marketing specialist for Thompson Financial.

⁷ On appeal from an order denying a motion to strike, we do not weigh the evidence but accept as true all evidence favorable to the plaintiff. (*Consumer Justice Center v. Trimedica International, Inc.* (2003) 107 Cal.App.4th 595, 605.)

request, with instructions to consider the information and include it in the report. As well, the customer usually would instruct the appropriate personnel to generate either a positive or negative report on the subject company.

Anifantis was present on many telephone conversations between customers requesting special reports and Donn Vickrey, editor-in-chief and executive vice-president of Gradient, in which the customers would suggest that Gradient focus on the negative information the customer supplied for inclusion in the report. Often there was no doubt that the customer was asking Gradient to research and draft a negative report on the target company.

Vickrey commonly altered the report to meet the customer's expectation and request. Vickrey and the customer would discuss the report contents in detail and many times the customer would request, and the company would receive, a lower grading than the grade received in the initial version of the report. Although Vickrey retained the final editorial decisionmaking on these reports, based on his observations Anifantis concluded "there was no doubt that these reports were not the product of an unbiased, objective view of the subject companies, but rather . . . the customer was paying for a report that would heavily favor the requesting customer's negative view of the company."

Indeed it was common knowledge at Gradient that customers who wanted negative reports prepared on subject companies—and who supplied negative information or guidance to Gradient in connection with a custom report—either held short positions in the securities of those companies or intended to take short positions upon publication of the reports. These negative reports on public companies were a key component in the customers' efforts to profit from the anticipated depression of the trading price of the subject companies' stock.

Customers would also ask Gradient not to disseminate the report to the public for a specified time period so they could obtain their position in the targeted company's stock prior to the public receiving the information. Many hedge funds

requested Vickrey to delay public release of reports for three to seven days to allow the funds to take a position in the stock.

Gradient maintained a “Top Ten” list of stocks that performed in accordance with the rankings attributed by Gradient in its reports. The purpose of this list was to provide potential and current customers with the stock performance tracking results in order to demonstrate Gradient’s ability to predict and affect stock performance. Gradient also tracked what it referred to as “ ‘Blow ups by Grade.’ ” “Blow ups” were companies which suffered a one-day decline of -20 percent or more in the price of their stock, or better than -25 percent over the course of a week within 12 months of publication of a report. These reports were a successful part of Gradient’s promotional materials to short-selling hedge fund clients.

Routinely, Gradient would publish all custom reports to their entire client base, without disclosing to the clients that the reports were ordered by subscribers; that subscribers had advance copies prior to publication; or that the subscribers exerted any influence over the content of the report, including influence over the negative assessment of the company. Moreover, Gradient understood that its subscribers intended to republish the custom reports to third parties who maintained positions in the stock, as well as to government regulatory agencies. Vickrey would also permit financial journalists to review the custom reports, knowing that this exposure would provide wider public circulation of the content of the reports.

The analysts who researched and wrote reports on publicly traded companies were recent university graduates with four-year degrees in business-related disciplines. However, when a subscriber asked about the report preparers, management instructed the sales and service representatives to tell them that the analyst team was made up of “ ‘CFAs’ or ‘CPAs’ ” although except for top management, the analysts did not have those advanced-degree designations.

While publishing the research reports described above, James Carr Bettis and Vickrey, the founders of Gradient, were portfolio managers for a hedge fund called Pinnacle Investments Advisors, LLC (Pinnacle). Their management of a hedge fund

conflicted with Vickrey's instruction that if a customer ever inquired whether Gradient invested or managed money, staff should answer in the negative. One Gradient employee in fact answered one telephone on behalf of Gradient and another on behalf of Pinnacle.

C. The Gradient and Rocker Appellants Focus on Overstock

In 2003 and 2004, Rocker Partners, LP began requesting reports from Gradient on Overstock. In February 2004, Rocker Partners began establishing short positions in Overstock. Rocker Partners became a Gradient subscriber in July 2004.

Rocker was in frequent telephone contact with Vickrey concerning the fund's requests for negative reports on Overstock. Anifantis was involved in the publication of three reports and participated in calls in which Vickrey and Rocker discussed the reports in advance of publication. Vickrey sent Rocker drafts of Overstock reports prior to publication. Rocker suggested changes, including underscoring negative aspects, sometimes adding additional negative facts or suggesting a more negative perspective than was reflected in the drafts. At Rocker's request, Gradient wrote several reports on Overstock that gave the company a grade of "D" or "F." Based on his participation in telephone calls with Vickrey and Rocker, Anifantis concluded it appeared "that Vickrey accommodated Rocker's requests for [Gradient] to publish negative information on Overstock 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 and Vickrey and [Gradient] could gain favor with Rocker."

It was apparent to Anifantis that Rocker Partners had a short position in Overstock, or intended to establish such position prior to publication of the reports. Several times Rocker requested that Vickrey delay publication of the final report for a specified period so Rocker Partners could establish their own short position.

D. *Litigation*

1. *The Complaint*

In August 2005 Overstock sued the Gradient and Rocker appellants. The first amended complaint alleged (1) libel and intentional interference with prospective economic advantage, based on allegedly false and defamatory statements contained in the Overstock reports published by Gradient, with the collaboration and cooperation of Rocker appellants; and (2) violations of the unfair competition law (UCL),⁸ based on the alleged “knowing and intentional dissemination of negative reports on Overstock containing false and/or misleading statements,” without disclosing Rocker appellants’ participation in the development of those reports, among other matters. As well, respondents Barron and Helburn, each former owners of Overstock common stock, sued Rocker appellants for violation of the state securities antifraud laws. (Corp. Code, § 25400 et seq.) This cause of action was based on defendants’ actions designed to wrongfully depress the price of Overstock’s common stock for their financial benefit, as parties holding short positions in that stock.

2. *Motions to Strike; Opposition*

Both groups of appellants moved to strike the entire complaint under California’s anti-SLAPP statute. In opposition to these motions, among other items Overstock submitted the declaration of David Chidester, its senior vice-president of finance, who reviewed over 50 Gradient reports on Overstock from June 2003 through December 2005,⁹ and identified multiple statements of fact about

⁸ Business and Professions Code section 17200 et seq.

⁹ Gradient’s first report on Overstock issued in June 2003 and three reports followed that year. Another report issued in March 2004, and after Rocker appellants became subscribers in July 2004, another seven reports issued that year. Moving to the first half of 2005, Gradient increased its reporting with a flurry of over 20 negative reports on Overstock. Initially Overstock received a grade of “D” which dropped to “F” in December 2003 and remained there ever since. In all, Gradient published over 50

Overstock's accounting practices and related matters which in his opinion were "provably false." According to Chidester, these false assertions damaged the corporation. As he explained, prior to January 1, 2005, Overstock stock traded at just over \$73 per share. Thereafter the price began to drop steadily and consistently to a low of under \$30. As of January 2, 2006, it was trading in the high \$20 range.

Chidester further indicated that the performance of Overstock's stock was a major component of its relationship with lenders, suppliers, banks, investors, customers and the media. In November 2005 Overstock's largest factor cut the company's unsecured line of credit in half, based on the price drop in Overstock's stock. This had multiple negative ramifications, including the delayed receipt of contracted-for inventory, the need to resort to a more expensive line of credit, and an increase in the amount the factor charged Overstock's vendors.

In addition, because its stock was not being fairly valued, Overstock had to scuttle the purchase of a company for stock, and instead pay cash, thereby causing its cash position to diminish. Similarly, with the artificially low stock price in 2005, Overstock had to forego negotiating with at least six online retailers that had asked if Overstock were interested in acquiring them in exchange for stock. Finally, because of Overstock's undervalued stock price, it did not issue any stock in 2005 under a shelf registration statement filed with the Securities and Exchange Commission. Not issuing stock that year deprived the company of an ability to raise capital at a reasonable cost of dilution to the shareholders.

3. Trial Court Decision

The trial court found that appellants met their burden of showing that Overstock's complaint targeted acts in furtherance of their right to free speech in connection with an issue of public interest, as required by section 425.16, subdivision (b)(1). However, the court also concluded that respondents fulfilled their burden of

negative reports on Overstock. The Gradient subscription was available to the media at no cost.