IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF UTAH

IN RE OVERSTOCK SECURITIES LITIGATION

THE MANGROVE PARTNERS MASTER FUND, LTD.,

Lead Plaintiff,

v.

OVERSTOCK .COM, INC., PATRICK M. BYRNE, GREGORY J. IVERSON, and DAVID J. NIELSEN,

Defendants.

MEMORANDUM DECISION AND ORDER

Case No. 2:19-CV-709-DAK-DAO

Judge Dale A. Kimball

Magistrate Judge Daphne A. Oberg

This matter is before the court on Defendants Overstock.com, Inc., Gregory J. Iverson, and David J. Nielsen's ("Overstock Defendants") Motion to Dismiss Plaintiff's Amended Consolidated Complaint [ECF No. 125], and Defendant Patrick M. Byrne's Motion to Dismiss Plaintiff's Amended Consolidated Complaint [ECF No. 124]. On June 18, 2021, the court held a hearing on the motions by Zoom video conferencing because of the Covid-19 pandemic. Michael B. Eisenkraft, Laura H. Posner, Daniel H. Silverman, Molly J. Bowen, Joseph D. Watkins, and Keith M. Woodwell represented Plaintiff. John C. Dwyer, Jessica Valenzuela Santamaria, Jeffrey D. Lombard, and Erik A. Christiansen represented the Overstock Defendants. Robert N. Driscoll, Alfred D. Carry, Holly Stein Sollod, and Cory A. Talbot represented Defendant Patrick M. Byrne. Having fully considered the parties' written submissions, oral arguments, and the law and facts

related to the motion, the court enters the following Memorandum Decision and Order.

BACKGROUND

This is the second round of motions to dismiss in a securities fraud class action brought by Lead Plaintiff, The Mangrove Partners Master Fund, Ltd., on behalf of persons who purchased Overstock common stock between May 9, 2019, and November 12, 2019. Plaintiff alleges that Defendants made false statements about Overstock's financial projections for 2019 and engineered a scheme to issue a digital dividend that purportedly caused an artificial squeeze on short sellers. The court dismissed the claims in a previous decision, but allowed Plaintiff to amend its Consolidated Complaint based on new evidence.

A. Initial Allegations

As explained in the court's prior decision, Overstock is an online retailer of home goods. In 2014, Overstock began working on initiatives to develop blockchain technologies, which it now pursues through its wholly-owned subsidiary Medici Ventures, Inc. Medici conducts the majority of its business through a subsidiary, tZERO Group, Inc., which is focused on developing and supporting the issuance of digital securities. Through tZERO, Overstock sought to create an alternative trading platform where the investing public could purchase and trade digital securities. However, during the class period, Overstock's retail business generated nearly all of its revenues.

Dr. Patrick Byrne is the founder and former CEO and director of Overstock. He resigned from Overstock on August 22, 2019, during the middle of the class period. Gregory J. Iverson is Overstock's former CFO. He resigned from Overstock on September 17, 2019, during the class period. David J. Nielsen became Overstock's retail division President on May, 9, 2019, the beginning of the class period, and served in that role throughout the class period.

Lead Plaintiff, The Mangrove Partners, is an institutional investor that purchased Overstock common stock during the class period. Plaintiff is a well-known short seller, and Dr. Byrne publicly denounced short sellers for artificially depressing Overstock's share price. Short sellers borrow stock from a brokerage (and pay interest while the shares are outstanding), sell those borrowed shares at a time they believe the company's market price is high, purchase shares back when they believe the stock price is low, and return those newly purchased shares to the brokerage. If their prediction is right, they make a profit. If their prediction is wrong and the stock price rises, they incur a loss. If a dividend is issued on stock a short seller has borrowed, the short seller has a contractual obligation to pay that dividend to the lender. If the short seller cannot pay the dividend, the only way to avoid breaching its contractual obligations is to "close out" or "cover" its short position by purchasing the shorted stock on the open market.

Before the start of the class period at issue in this case, Plaintiff shorted more than 2.5 million Overstock shares. Plaintiff continued shorting Overstock shares throughout the class period. In fact, Plaintiff's only purchases during the class period were pursuant to preexisting contractual obligations owed to lenders whose stock Plaintiff had previously borrowed to sell short.

During the period leading up to the class period, Overstock's retail division had been struggling to regain market share from its main competitor, Wayfair. In early 2018, it cut prices and increased advertising spending, but its efforts to regain market share failed. In the second half of 2018, Overstock reversed course and began focusing on value and running the company profitably by decreasing customer acquisition costs and increasing customer retention.

Two months before the start of the class period, on March 18, 2019, Overstock held its earnings call and disclosed, among other things, that the retail division ended the fourth quarter of 2018 with a $16.9 million "Adjusted EBITDA" loss. Adjusted EBITDA is a non-GAAP financial

measure that approximates cash flow. However, Overstock also announced that it expected the retail division to be profitable in 2019 and provided full year 2019 guidance for Retail Adjusted EBITDA of $10 million.

Overstock explained that the positive guidance was due to a number of factors: (1) retail contribution was $33 million in the fourth quarter of 2018 and was expected to increase to $37 million in the first quarter of 2019; (2) customer retention was up 36% year-over-year; (3) Overstock had already cut 25% of its general and administrative expenses; and (4) after 16 months of search optimization deterioration, Overstock posted six consecutive months of ranking improvements. Plaintiff does not allege that any of these statements are false or misleading.

On May 9, 2009, the first day of the class period, Overstock reported results for the first quarter of 2019. The Retail Adjusted EBITDA improved $14.4 million from the prior quarter, ending with a loss of $2.5 million. Overstock attributed the retail division's improved performance to its continued focus on contribution, expense structure optimization, and improvements in search engine rankings. Based on that performance, and its estimate that contribution from the retail division would increase from the original estimate of between $160-185 million, Overstock raised its full-year Adjusted EBITDA retail guidance by the same amount, $5 million. The revision of the retail guidance is the first allegedly false statement identified in the Consolidated Complaint.

On July 15, 2019, in a Form 8-K filed with the SEC, Overstock disclosed that, based on favorable second quarter results, it was raising retail guidance again by $2.5 million.

On August 8, 2019, Overstock reported its second quarter results. As projected the retail division returned to profitability, generating a positive $1.6 million in Adjusted EBITDA. This was the first time since the second quarter of 2017 that the retail division had posted a positive Adjusted EBITDA. Because the second quarter of the year is traditionally Overstock's softest quarter of the

year, Overstock reconfirmed the retail guidance it provided in July. Overstock also disclosed that its general and administrative expenses in the second quarter of 2019 were higher than the second quarter of 2018, in part, due to a $722,000 increase in corporate insurance costs.

Plaintiff alleges that Overstock failed to announce that Overstock could not obtain insurance coverage going forward for Byrne or any of its other officers or directors due to Byrne's increasingly erratic behavior. Plaintiff asserts that both Byrne and Iverson knew this.

On September 23, 2019, as its third quarter was nearing a close, Overstock issued a press release disclosing that the retail division's third quarter results were expected to approximately "break even." Because the full year guidance previously "envisioned significant positive EBITDA for Q3," which did not materialize, Overstock stated that it would be updating the full-year guidance after the end of the third quarter. Overstock identified five factors that would drive the company's revised retail guidance: increased tariffs, increased freight costs, increased D&O insurance premiums, waning consumer confidence, and slower conversion of search traffic. Overstock also revealed that Defendant Iverson had resigned on September 17, 2020, with no notice and effective immediately. Following the September 23 press release, Overstock's stock dropped by approximately 25%.

With respect to Plaintiff's other claim, on July 30, 2019, Overstock announced that it would issue a dividend of one share of Digital Voting Series A-1 Preferred Stock for every 10 shares of common or preferred stock outstanding. The record date for the Dividend would be September 23, 2019, and the distribution date would be November 15, 2019. Overstock explained that the Dividend would not be, and was not required to be, registered under the Securities Act of 1933. Consequently, the Dividend could not be traded until the shares became eligible for resale under Rule 14 of the Securities Act, approximately 6 months after issuance.

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