Samex Capital's Stock Market

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SALT LAKE CITY (AP) August 11, 2005-- Overstock.com Inc. said Thursday that it is suing a financial research company and a group of hedge fund managers for conspiracy to drive the online close-out retailer's share price down for the purpose of selling the stock short.

Caveat Venditor

Beginning in November 2004, we ran a series of articles about the first and second phases of the SEC's Regulation SHO and "naked" short selling. A 'naked" short occurs when the shorted shares are not delivered to the buyer. In essence, there are now two owners of the same shares. Since there can only be one legitimate owner, the person on the buy side of the short sale owns the equivalent of counterfeit shares.

Is this a major problem for our financial markets? Given that the SEC has admitted that roughly 6% of the shares traded on the NYSE and Nasdaq fail to deliver, the answer is most certainly, "yes." *The mechanics of the system now permit more shares to exist than the number authorized by companies.*

In the February 7, 2005 issue, we wrote, "What concerns us is the rapidly expanding database of allegations about concerted efforts to bring down the price of companies through the dispersal of misinformation, subsequent 'shareholder' class action law suits designed simply to take share prices lower, regardless of the damage done to present shareholders, and manipulations of price made possible via naked shorting, resulting in 'counterfeit' shares." The practice of targeting microcaps on the Nasdaq Bulletin Board has gone on for years and has been so successful that the logical next step is the strategy has expanded to include billion dollar companies - the rationale being that driving a billion dollar company into bankruptcy means a much larger payday for shorts than the implosion of a $50 million microcap. If we can admit these schemes have occurred with microcaps, they can certainly occur on a much larger scale. *The story is just beginning to make an impact in prime time.* On July 31st, Dateline and Ron Insana illustrated how microcap Eagletech was taken from $11.00 down to $0.50 as part of a scheme for short sale profits. Bear in mind one of the strongest incentives to tilt the playing field by shorts are the laws regarding capital gains taxes. During the Clinton administration, the Federal government operating deficit reversed into the strongest surplus of all time on the strength of huge increases in capital gains taxes while stock prices soared into the peak of the mania. *No such government advantage ever need accrue when shorts win.* Positions may never be closed out. As the maintenance required to leave positions open dwindles, both the original stake and profits are withdrawn without any tax consequence. In effect, the loophole allows the government to be cheated. Short selling has a distinct advantage over owning stock. *This has enabled an environment wherein shorts have every reason to do anything they can to push down the prices of their targets.*

Dr. Patrick Byrne is the Chairman of Overstock.com, allegedly the target of a short seller cabal. OSTK recently filed a lawsuit against Rocker Partners, a New York based hedge fund, and Gradient Analytics, a research firm that has published a "continual slew" of negative reports on the company. According to a recent company conference call*, the evidence consists of numerous affidavits from former employees or associates of those named in the suit linking Rocker and Gradient and even several journalists to schemes whereby the company's business was unfairly denigrated and the stock manipulated. We cannot comment upon the accuracy of the charges or information contained in the lawsuit but there is every reason to believe that the motive for profit can engender the type of behavior the suit alleges. Clearly, Wall Street and greed have always gone hand in hand. As the mania moved into high gear, we witnessed brokerage analysts inflating estimates and price targets for personal gain, we witnessed corporate CEOs cashing in on criminal behavior, we witnessed mutual fund managers front running customers and much, much more. *Why should it be difficult to believe that greed does not labor for profit equally well when prices decline?*

There are several arguments that buttress the belief that Overstock is a target for shorts. First, there is absolutely no way of determining just how many shares of the company's stock have been "naked" shorted. *Transparency in our markets just does not exist.* Thus, the environment affords an advantage to those who wish to profit by destroying companies. The SEC's Regulation

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SHO places companies on a "Threshold" list when failures-to-deliver shorted stock reach at least 0.5% of the outstanding capitalization. These failures are supposed to be resolved within 13 days. However, it seems clear that in many instances, old failures are continually replaced by new failures so that some companies remain on the list indefinitely. An even dozen companies have been on the Threshold list every one of the 156 days since the official list first appeared. Atlhough failures were "grandfathered" for those on the list when the Regulation took effect, it is inconceivable that six months can pass with failures still in place! Ironically, the rationale for the "grandfather" clause was to prevent upside manipulations (read short squeeze). *However, the result of this policy is that downside manipulations have been enabled.* We must ask the obvious question; is this really an improvement? Given that brokers and market makers may be at risk for unresolved failures that could conceivably total into the billions of dollars, we assume the SEC's answer is "yes." The pragmatic view of the government agency (certainly prodded by Wall St.'s interests) may be it that it is best in the long run to protect brokers, market makers (and ostensibly, the business of selling stocks) and to shaft shareholders instead. This alone should send chills up and down the spines of stock market investors.

In the case of OSTK, the company has been on the Threshold list for 84 days with a break of perhaps two weeks, most likely as a large group of fails were finally settled, only to be quickly rolled over into new failures. *However, the reinstatement of OSTK to the Threshold list for the last many weeks is all the proof we require that SHO is simply not working.* Worse yet, since neither Nasdaq, the SEC, the DTCC or the NSCC will deign to divulge the size of failed positions, there is absolutely no way to accurately or effectively determine just how many shares have been effectively counterfeited. How can this be happening in America? Freedom of Information requests are turned down flat as authorities vigorously contest their right to withold the numbers. *Who is being protected here?*

In addition, Overstock is one of 1000 companies that are in Reg. SHO's phase II "pilot program," which permits these companies to be shorted on downticks. Thus, OSTK faces a double barrelled threat as shorts can in theory, routinely drive down the share price without the necessity of an uptick in price beforehand. Clearly, shareholders are in harm's way. Again, we can only ask, *just who is being protected here?*

Another argument that rings clear as a bell is how the company and Dr. Byrne have been treated by the media, including at least one hedge fund manager who writes his own internet "blog." In addition to a constant barrage of negative blog pieces, there has also been name calling and as Dr. Byrne reveals, "smarmy innuendos." In the recent OSTK conference call regarding the lawsuit*, Dr. Byrne charged that several journalists were tightly linked to Rocker Partners. Was a carefully laid out policy designed to harm the company and its shareholders? Google the names that are mentioned and you decide. We can only surmise that there will always be bad players in each chapter of every drama on the human stage we all populate.

Take one Roddy Boyd, who writes for the NY Post. In an August 14th article, Boyd opined that Dr. Byrne was off his rocker (sorry, but we could not resist the play on words) and that the conspiracy outlined on the company conference call couldn't possibly be true. It might not be, but of course, *it could.* Claiming a conspiracy to be impossible without evidence to support the declaration does not make the declaration true, or even believable. As other journalists before him did, Boyd claimed OSTK is being investigated by the SEC, even though Dr. Byrne had only reported a *rumor* that he had heard about an informal inquiry. *A rumor is never a fact before it is confirmed.* And in this case, the SEC has confirmed nothing. Incredibly, Boyd ended his piece by writing, "[An OSTK spokeman] said that Byrne, to his knowledge, is not currently under any psychiatric care and that he was sober when he gave the [conference call] presentation." *Wow, talk about your smarmy innuendo!* It is clear from the article that the "reporter" gratuitously asked the questions of the spokesman, who naturally felt obliged to reply with the truth. We are entitled to our opinion and our opinion is the following; the innuendos were despicable, Dr. Byrne deserves an apology and lastly, Mr. Boyd should find another career.

Another player who has thrown himself into the spotlight is Jeff Matthews, a former employee of Rocker, who now runs Ram Partners, a hedge fund that owns a position in put options on OSTK. Matthews also writes an internet "blog" that has been highly critical of the company and Dr. Byrne. Why are we not surprised to find yet another "media" source who seemingly takes every opportunity to denigrate the stock and its CEO? Why are we not surprised to find out that the blogger has a vested interest in placing the company's shares as close to zero as possible? Why are we not surprised to hear that the blogger is only one degree of separation from one of the alleged conspirators named in the OSTK lawsuit? Both Matthews and Dr. Byrne recently squared off before Ron Insana on CNBC*. The confrontation is almost painful to watch as Matthews has almost nothing substantive to say, just babbling about his belief that Byrne's charges are "bizarre" or "incomprehensible," or for good measure, "incomprehensibly bizarre." After one particular response by Dr. Byrne, Insana asks Mr. Matthews for a rebuttal and the only reply is a "... What?" uttered as if Matthews had just woken up from a deep stupor. Finally, Matthews responds but offers so little of value that Mr. Insana complains "You're dancing around the issue a little...." To be fair, Matthews did offer one brief moment of analysis, claiming that OSTK spends far more on gaining new customers than they earn. So? A revelation? Hardly. Sounds like a plan to gain more new customers, just like the one used by Amazon, a similar and still young (but older) company than Overstock that managed to make over $535 million in profits last year. Also during the interview, Dr. Byrne describes from an affidavit how Rocker, Gradient and journalist Herb Greenberg are entangled and in perhaps the most telling moment of the interview, Matthews complains, "It doesn't work this way. Herb [Greenberg] does his thing, Rocker does their thing, Gradient does their thing.....," implying that each is a separate and distinct entity with no linkage whatsoever as the lawsuit charges. *Yes, that very well may be but just how would Matthews know this for a fact?*

At the conclusion of the interview, Dr. Byrne angrily scolds Matthews for calling Stormy Simon, a Senior VP of Overstock, an "exotic dancer," a charge laid out in a Matthews' blog. Matthews' reaction, replete with nervous tics and rolling

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eyes has got to be seen to be believed. In fact, the entire episode should be witnessed with an eye towards body language. Although the theme of his blog is "Jeff Matthews Is Not Making This Up," the description of the OSTK Senior VP was in fact, untrue. *Ms. Simon was never an "exotic dancer."* Although the reference has been changed on the blog, no apology has yet been offered for the defamation, however temporary. The blog still asks, "Is the Stormy Simon who is a Senior Vice President of Overstock.com--a woman described by Patrick Byrne as 'our secret weapon' and 'my chief of staff'--the same 'Stormy Simon' who was a key witness in a murder trial?" *Who in flaming blazes cares if she is or is not?!* In fact, we can tell you Ms. Simon is one and the same person. Moreover, we'll confide to you that the prosecutor in the case wrote, "Death in a Fish Pond," (# ISBN: 0882822608) in which Ms. Simon turns out to be the heroine because she ignored death threats to stand up and testify against a murderer, who was then put away for life.

Do we really need any more innuendo?

We have saved the best for last. Several weeks ago, Dr. Byrne offered a chilling analysis that showed after counting all OSTK shares owned by himself, his father, his family, his friends and institutions, there were perhaps as few as 300,000 shares for the public to trade. Yet, the stock has been averaging daily trading volume twice that much for months. *However, Dr. Byrne's computations may be quite conservative.* Simply put, no one really knows. Dr. Byrne claims his family holds upwards of 7 million shares and according to the latest information we can find, institutions supposedly now own 12.36 million shares. Since there are 18.696 million outstanding shares, that would leave nothing else to trade, *actually a negative number of shares.* Short interest is listed as 6.5 million, itself a very hefty sum amounting to 14 times daily trading volume, but short interest tallies do NOT include failures-to-deliver. Such failures are at least 93,475 shares (a minimum of 0.5% of the company's 18.696 million outstanding shares) but theoretically could be any number into the millions. *Thus, we have the interesting situation that screams from the rafters that a rather large number of counterfeit shares are likely in circulation.*

Can there be any doubt in a reasonable person's mind that this situation needs to be immediately addressed? In the interim, shareholders are at somewhat of a disadvantage because there is no way to determine just who owns what and if more shares are in circulation than authorized, then the company's valuation per share has been illegally and effectively diluted. Can the SEC halt trading until the dust settles? In our view, this would be the biggest gaffe of all time by a government agency that seemingly does nothing but squat anyway. Consider the following; in the late 60s, the SEC suspended trading in Omega Securities, in which the Mates Investment Fund held a large position in restricted stock. Although the restricted shares could not be traded anyway, the fund had valued them every day at the current market price. When trading in Omega was halted, the fund had no method by which to value its entire portfolio and thus, could not realistically redeem shares at shareholder request. *For the first time in history, trading in a mutual fund was halted.* Overstock's capitalization may be sufficiently high to throw the redemption process off slightly for institutions. But worse yet, consider the problems for any hedge funds short amongst the 6.5 million officially tallied as short plus the mimimum of 93,475 failed shares (and possibly many, many more). Question: how could they handle requests for redemptions from investors? Answer: they could not. *This alone could create pure and unadulterated havoc.*

This brings us to a very interesting circumstance. If there are over 6.5 million shares shorted and only 300,000 shares left in the public float (or perhaps even none), how can shorts ever hope to cover their positions? Of course, their objective is to drive OSTK's share price down to pennies and thereby never need to cover. But what if the company continues to grow and eventually, to turn a profit? What if the lawsuit prevails? What if the SEC and DTCC are finally persuaded that shareholder interests must come before the market, thus forcing naked short positions to settle? At that juncture, as we previously showed in our special report about "The Greatest Short Squeeze Of All Time," when Thomas F. Ryan actually named the price at which Stutz shorts would have to cover in 1920, investors in those hedge funds short OSTK would be absolutely and irrevocably screwed and squeezed without mercy and with no recourse to redeem their invested capital.

In conclusion then, we cannot offer any opinion on the merits of the lawsuit. That part of the equation will simply have to play out in the courts. What is patently obvious is that the catalyst for a huge short squeeze is now in place.

Caveat venditor.

Alan M. Newman, Editor
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* please see
http://www.shareholder/overstock/