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ALAMEDA COUNTY

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CLERK OF THE SUPERIOR COURT

By: *[Signature]* Deputy

**SUPERIOR COURT OF THE STATE OF CALIFORNIA**

**IN AND FOR THE COUNTY OF ALAMEDA**

**PEOPLE OF THE STATE OF CALIFORNIA,**

**Plaintiff,**

**vs.**

**OVERSTOCK.COM, INC.,**

**Defendant.**

**No. RG10-546833**

**TENTATIVE RULING AND PROPOSED STATEMENT OF DECISION**

On September 9 through 12 and 16 through 20, 2013, the parties appeared through counsel for trial on the above-captioned matter. After extensive post-trial briefing, counsel appeared for oral argument on December 19, 2013, and the case was submitted. Having considered the extensive evidentiary record, the exceptional briefing by the parties and the argument of counsel, the court provides the following explanation of the factual and legal basis of its Decision on the principal controverted issues. Unless

within 10 days of service hereof a party specifies further issues or proposes additional provisions per CRC 3.1590(c)(4),<sup>1</sup> this tentative ruling and proposed statement shall become the Decision of the court in this matter.

## **I. GENERAL BACKGROUND**

1. Defendant Overstock.com (“Overstock”) was founded in 1999 and launched its website in October of that year. Initially it posted about 100 products for sale; but that site and the company has expanded dramatically over the past 14 years. Today there are over a million products offered on the Overstock website for sale to consumers nationwide, in California and all of the eight counties appearing in this action. At the beginning, most if not all of Overstock’s offerings were products from manufacturers, retailers or jobbers who were liquidating excess or outdated inventory, and this enabled Overstock to acquire these products at a very substantial discount from the prices at which they were typically offered for sale. Today Overstock still acquires products in this manner, but over the years Overstock has also developed relationships with manufacturers, importers and others who use Overstock as a channel for online distribution of non-distressed merchandise. These suppliers are referred to by Overstock as its “fulfillments partners” or simply its “partners.” Today a majority of the products sold by Overstock are from its partners.

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<sup>1</sup> If the parties want additional time to analyze and respond to this Proposed Decision, they should meet and confer and submit a stipulation or, in the event of disagreement, seek an immediate CMC to discuss scheduling. Putting aside substantive issues that the parties may wish to raise, the court welcomes even minor corrections to transcript and exhibit citations and the like or additional record citations where the court has neglected to provide them..

2. From its inception Overstock has engaged in comparative advertising techniques on its website (URL [www.overstock.com](http://www.overstock.com) and later [www.o.co](http://www.o.co)). These have included the initial practice of displaying on each of its product pages what was referred to as a "list price" for the product above the price at which Overstock was offering it and then showing a calculation of the "savings" expressed in both absolute dollar and percentage terms. The nomenclature and manner of the price comparison have changed over time. At or about September 2007, Overstock started to use the phrase "compare at" instead of "list price," and in April of 2011 Overstock changed the terminology to "compare." The use of such pricing comparisons is referred to in the industry as "advertised reference price(s)" or "ARP(s)." In addition to the nomenclature changes used with its ARPs, Overstock's presentations on its product pages have changed in other ways. For example, periodically font size has changed, the positioning of the actual and reference prices has changed, the color of the actual price has changed, etc. Moreover, there was a period in mid- to late-2008 when all ARPs were taken off the Overstock website and re-posted over time.

3. This action was commenced on November 18, 2010. In the operative First Amended Complaint filed on June 26, 2013 ("Complaint"), the People allege five causes of action based on an extensive and detailed set of common allegations. In general, it is alleged that Overstock's ARPs in all of their various nomenclatures and formats have been false or misleading because, inter alia, Overstock instructed its employees to choose the highest price they could find as an ARP or constructed an ARP using a formula that applied an arbitrary multiplier to Overstock's wholesale cost. The People further allege that Overstock has represented itself as a liquidator of distressed inventory able to offer

products at substantial discounts not available elsewhere, that its prices were therefore the lowest on the internet and that consumers should buy through Overstock without further comparative shopping because “we [Overstock] compare prices so you don’t have to.” It is alleged that all of these representations were and are false because Overstock’s prices were not the lowest available and the “savings” displayed on its product pages were inflated due to the selection of the highest price or application of a formula to manufacture a non-existent, “straw-man” price. Such practices are alleged to violate California law, which the People contend should be interpreted in part by reference to the Federal Trade Commission’s “Guide Against Deceptive Advertising” (16 C.F.R. §233.3)(“FTC Guide”) wherein the practices Overstock has allegedly engaged in are said to be deceptive and misleading.

4. More specifically, the First Cause of Action [“the Pricing Claim”] alleges that Overstock has violated the False Advertising Law (“FAL”)(Bus. & Prof. Code §§17500 and 17536) by making false and misleading statements concerning the pricing of products on its website in various way – e.g., claiming (a) that a unique Overstock product was identical to a product offered by another merchant, (b) that Overstock had previously ascertained the price at which other merchants were selling a product offered by Overstock, (c) that Overstock's ARP was that typically offered by other merchants, (d) that Overstock's “Today’s price” was equal to or lower than that typically offered by other merchants, (e) that Overstock's “Today’s price” was a discount from the price typically offered by other merchants, (f) that the “You save” amount accurately represented the discount customers would receive by buying at Overstock, and/or (g) that Overstock had previously sold the product at the ARP. Further, it is alleged that

Overstock violated the two sections by (i) setting ARPs without ascertaining what other merchants were typically selling the product for, (ii) using formulas to set fictitious ARPs, (iii) using the highest price that could be found as the ARP and (iv) setting its ARPs above "street price."

5. The Second Cause of Action ["the Amount of Price Reduction Claim"] alleges Overstock violated the Unfair Competition Law ("UCL")(Bus. & Prof. Code §17200) and the Consumer Legal Remedies Act ("CLRA")(Civ. Code §1770(A)(13)) by making false and misleading statements of fact to consumers concerning (a) the existence or amount of price reductions represented by the difference between "List Price" and "Today's price," (b) the existence or amount of price reductions represented by the difference between "Compare at" or "Compare" prices and "Today's price," and (c) the existence or amount of savings represented by the dollar amount and percentage next to the term "You save."

6. The Third Cause of Action ["the Source of Products Claim"] alleges that Overstock violated the FAL by representing it was a liquidator selling distressed, second-hand or discontinued items when the majority of products sold were being offered by Overstock's partners through Overstock's website at the partner's usual retail price. In such circumstances, Overstock was being used as an ordinary online channel of retail trade by its partners, who shipped the products from their own warehouses (i.e., "drop shipped").

7. The Fourth Cause of Action ["the Shipping Charges Claim"] alleges that Overstock violated the FAL by representing shipping was "free" or "only \$2.95" when in fact the full cost of shipping had already been factored into the underlying product price.

8. The Fifth Cause of Action [“the Derivative Claim”] alleges that Overstock violated the UCL based on the unlawful conduct alleged in the First, Third and Fourth Causes of Action, which conduct is also alleged to violate the “unfair prong” of the UCL.

9. All five causes of action allege continuing violations from at least January 1, 2006, to the present. Based on all the alleged violations, the Complaint seeks injunctive relief directed at the practices found to be unlawful, civil penalties under the FAL and UCL in the minimum amount of \$15 million, restitution, reasonable investigation costs, costs of suit and whatever else the court finds to be equitable and just.

## **II. THE PEOPLE’S CASE**

10. The People called as live witnesses three consumers and one expert witness. The balance of their case consisted of 26 deposition designations of 25 Overstock employees and one consumer who were all beyond the subpoena power of the court.<sup>2</sup> Many of the deposition designations are patently cumulative and in many instances offered to prove, and prove again and again, undisputed facts – e.g., that prior to the Fall of 2008 on some occasions the ARP was set by means of a formula. Undisputed fact, and yet in one deposition designation after another, testimony to that fact is designated. Had these witnesses all been within the subpoena power of the court, there is no doubt that only a fraction of them would have been called as live witnesses and, of those called, many of the designated questions would never have been asked.<sup>3</sup>

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<sup>2</sup> Designated deposition transcripts are cited by the deponent’s last name, date of deposition and pages, e.g., “King 4/5/13 Tr. at 32-35.” The trial testimony is cited as “Trial at \_\_\_\_.”

<sup>3</sup> It is also clear that, had this been a jury trial, counsel would not have dared read all this cumulative testimony. While for the most part, counsel did an excellent job presenting their respective cases, the

The waste that all of this entails is underscored by the fact that in the People's opening post-trial brief it is difficult to find a single citation to a designated transcript. While the court appreciates that some designations were needed to establish the prima facie case, it is clear that the bulk of the designations go far beyond any conceivable utility.<sup>4</sup>

11. To compound this folly, the defense filed objections that are more often than not also a total waste of time – e.g., “asked and answered,” “statement of counsel,” “assumes facts not in evidence,” etc.<sup>5</sup> – and then the People filed similar objections to the defense counter-designations. The court declines to take the time to record rulings on individual objections that can have no conceivable impact on the analysis of the issues before it. Where the court has nonetheless ruled on some of the objections (perhaps out of force of habit), the rulings sustaining those evidentiary objections may be found in a footnote the first time the deponent's testimony is referenced. All other objections are *overruled*. Where a deposition transcript is not even cited in this Decision, one may infer that the designated testimony was at best cumulative and thus any objections were not

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record is marred by the initial over-designations of transcripts, a similar excess of counter-designations and as noted elsewhere a large number of meaningless objections. This unbridled and exuberant designation frenzy would not have occurred had counsel for both sides been trying this case before a jury. A bench trial should not be an excuse for larding into the record all evidence that passes the “could be relevant” test regardless of redundancy.

<sup>4</sup> When one looks at the defense opening post-trial brief, it is readily apparent that it relies much more heavily on the deposition designations. Apparently the People's election to designate so many transcripts may have benefited the defense more than the People.

<sup>5</sup> The defense counter-designated testimony and then proceeded to call some of the deponents as trial witnesses and tracked the very testimony that was counter-designated. Perhaps such counter-designations were a necessary precaution, but once the deponents were called at trial and provided the testimony previously designated, the defense could have substantially narrowed the counter-designations.

worth the effort of either counsel or the court and are for that reason summarily overruled.<sup>6</sup>

12. Turning to the merits of the People's case, their evidence was organized from the opening statement through trial into three broad time periods corresponding to the ARP nomenclature used during each timeframe – i.e., “list price,” “compare at” and “compare.” The court will summarize the People's case following that convention. But whatever the timeframe, while the nomenclature and formatting changed, all of these labels and ARP displays were intended to convey to consumers that Overstock was a discounter and very substantial savings could be enjoyed by purchasing from its site. In the words of one of its executives in the company's more recent advertising: “we compare prices so you don't have to.” (Byrne 7/9/13 Tr. 97-98, 100-102.<sup>7</sup>) The People contend that in conveying this general message, Overstock used labels, formats and practices that resulted in advertising that was often false or at least misleading within the terms of the relevant statutes, and as a result its advertising practices are actionable.

#### A. The “List Price Era”

##### (i) Initial Policies & Practices re ARPs

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<sup>6</sup> As for deposition exhibits, the only exhibits considered by the court are those identified on the parties' respective trial exhibit lists. Having spent days during trial reviewing, hearing argument and ruling on those, the court has not and will not chase down deposition exhibits and rule on their admissibility if they were not on the exhibit lists. Indeed, the court *had requested that the trial exhibit numbers be inserted into the designated transcripts* so as to aid the court in finding them. Counsel apparently decided the designation and objection exercises were more important than the additional exhibits. The end result is that, as the court has read the designations, it has had difficulty identifying the exhibit being discussed.

<sup>7</sup> Byrne Objection(s) sustained: 7/9/13 Tr. at 189, 190, 206, 214. Hearsay objections to third-party statements in email chains sustained to the extent offered for the truth of the matter asserted as opposed to use for context, notice, etc.



13. The People refer to the period commencing sometime before February 2003 through some point in September 2007 as the "List Price Era." The hallmark of Overstock's advertising during this period was to display for all eligible products what was characterized as (1) a "list price," (2) a "Today's price" to represent Overstock's price and (3) a "You save" figure calculated in absolute dollars and percentage terms. (E.g., Exh. 950; Murakami 4/10/13 Tr. at 54-58, 95-96.<sup>8</sup>) No definition of "list price" appeared on the screen without prompting, but if a viewer's cursor scrolled across the term, a hyperlink to a definition would appear. (Exh. 829, Sp. Inter. Resp. 361, 364.) Throughout this period that definition read in full as follows:

What is "List Price?"

In most cases, list price is the price for the product, new and unused, as recommended by the manufacturer for retail sale, and Overstock.com has confirmed at least one instance in which the product is being sold at that price.

In cases where there is no manufacturer's recommended retail price, list price represents either of the following:

1. The manufacturer's suggested retail price for a comparable product, new and unused
2. An estimated price derived from standard wholesale and retail markups for this type of product
3. The retail price at which Overstock.com has found the product or a comparable product offered for retail sale in at least one instance
4. The comparison price stated by at least one other online vendor for the same product or a comparable product

List price is not necessarily the lowest price at which the product is commonly sold, and often will be higher than the actual price at which the product is sold. However, pursuant to the terms of its Best Price Guarantee, Overstock.com does provide you with assurance that, whatever difference there may be between the list price and the actual selling price, Overstock.com's own price for the product is the lowest you will find anywhere online.

<sup>8</sup> Murakami Objection(s) sustained: 4/10/13 Tr. at 180, 214; 4/11/13 Tr. at 313, 314, 316, 416, 442, 475, 477; 4/12/13 Tr. at 533, 541, 569, 627, 688, 698. Hearsay objections to third-party statements in email chains sustained to the extent offered for the truth of the matter asserted as opposed to use for context, notice, etc.

[Exh. 710.]

There was no way for the consumer to determine which of the above four methods was used to determine “list price” for any particular item on the website. (E.g., Exh. 921.)

14. During the time the above definition was used (from at least 2003 to late 2007), it was Overstock’s complete statement of its requirements for setting the list prices used as ARPs on its website. During this same period, though, Overstock had no processes or procedures in place to confirm for any given list price that there was in fact at least one instance of a sale at the list price stated in the advertisement (Exh. 859, 780), and thus the above policy was not strictly followed in at least this respect. (Murakami 4/10/13 Tr. at 105-107, 122; King 4/5/2013 Tr. at 32-35, 93-95, 193.<sup>9</sup>) Overstock also did not have in place any process for documenting which of the methods for determining list price was used in any particular instance. (Murakami 4/10/13 Tr. at 111-112.) As a result, it is impossible for Overstock to state for this period what percent, if any, of its ARPs for products reflected verified prices from the market place. (Murakami 4/10/13 Tr. at 255-259.)

15. The list price definition quoted above permitted the use as an ARP of an estimated price derived from standard wholesale and retail markups for the type of product in question. (Murakami 4/11/13 Tr. at 414-416.) In these instances a formula was used whereby a “multiplier” was applied to Overstock’s cost to set the “list price” appearing online. The multiplier could vary from product area to product area depending on Overstock’s understanding of industry practice. (Exh. 790, Sp. Inter. Resp. 15.) For

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<sup>9</sup> King Objection(s) sustained: 4/5/13 Tr. at 47, 117, 135; 4/6/13 Tr. at 417. Hearsay objections to third-party statements in email chains sustained to the extent offered for the truth of the matter asserted as opposed to use for context, notice, etc.

example, in the case of jewelry, the formula was to set list price at three times Overstock's cost, while in Home & Garden it was two and a half times Overstock's cost. (Murakami 4/10/13 Tr. at 41-42.) If the partner was a manufacturer who only manufactured for Overstock, the foregoing policy meant in practice that a formula could be used by the partner (or the Overstock buyer) to set the reference price (Murakami 4/10/13 Tr. at 147-149; Ivers 7/26/13 Tr. at 158-159<sup>10</sup>) with the result that the ARP could be "just an arbitrary number." (King 4/6/13 Tr. at 542.) This was a natural consequence of Overstock's practice prior to September 2008 of relying on the list prices provided by its partners without any validation process. (Murakami 4/10/13 Tr. at 151-153.)

16. Where the product being sold was only available at Overstock, the above quoted policy allowed the price of a "comparable" product to be used as the list price for the Overstock offering. Prior to September 2007, Overstock had no written guidelines that set the criteria or parameters buyers or partners were to use in selecting a product to use as a "comparable" for purposes of selecting an ARP. (Murakami 4/10/13 Tr. at 222-223.) This was true as well for products that could be considered "unique." Prior to September 2007, all products including "unique" products had ARPs developed in one of the four ways specified in the list price policy quoted above. (Murakami 4/10/13 Tr. at 229-230.) Consumers were never told on the product page when the ARP was based on a similar but not identical product. (Exh. 1065; King 4/6/13 Tr. at 376 ["Customers wouldn't know"].)

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<sup>10</sup> Ivers Objection(s) sustained: 7/26/13 Tr. at 128. Hearsay objections to third-party statements in email chains sustained to the extent offered for the truth of the matter asserted as opposed to use for context, notice, etc.

17. Whether list price was based on an actual price comparison or MSRP, it was generally understood that the list price was a “high street price” or a “full retail price” as opposed to any attempt to determine a “prevailing market price,” “street price” or lowest competitor’s price. (Exh. 320; Murakami 4/10/13 Tr. at 156-157, 204-205, 212-213; Ivers 7/26/13 Tr. at 87-88.) In the case of a list price based on MSRP – especially where the supplier was a partner manufacturing only for Overstock – the price could easily be manipulated. This is illustrated by instances where a product was only sold on Overstock’s and the manufacturer’s sites and the two of them discussed raising the price on the manufacturer’s site so as to provide a higher ARP for the offering on Overstock’s site. (Exh. 362, 363, 366, 368; Murakami 4/10/13 Tr. at 170-174, 178-180.)

18. Generally speaking, buyers knew what the street price was for products in their category because their objective was to set Overstock’s price “aggressively” – that is, below standard retail or street price. (Murakami 4/11/13 Tr. at 328-329.) Overstock buyers would thus do comparative pricing online to determine a product’s street price so that they could try to price below that and also discuss that issue with its suppliers. (Murakami 4/11/13 Tr. at 352, 365.) In the course of doing this online comparative pricing, Overstock buyers could see that the list prices on the company website were often higher than the prevailing online market price or street price. This led to internal email observations such as “Oh, I think it’s been established that the ‘List Price’ is egregiously overstated. This place has some balls.” (Exh. 1028.)

(ii) The Value of ARPs

19. At all relevant times, including the 2003-2007 period, Overstock viewed the use of ARPs generally as beneficial to both the consumer and to the effectiveness of

its advertising. (E.g., Murakami 4/10/13 Tr. at 62, 64, 88-90, 92-96; Exh. 438.) The strength of that view and the basis for it varied from witness to witness, with some such as the designated PMQ (Lani Murakami) merely stating it had “some benefit” while others expressed stronger views, although the latter are usually found in emails and other documents rather than in the deposition or trial testimony of the witness. Typical of the views expressed in Overstock email traffic is that of Tara Seethaler: “Internal research has shown that the best predictor of whether a customer returns to our site is whether they feel they have ‘received a good deal.’” (Exh. 403; see also, e.g., Exh. 414 [“It definitely helps entice the customer to purchase when compare at pricing is displayed”]; Exh. 430 [“We believe that products with a ‘Compare at’ price sell better than products without a ‘Compare at’ price”]; Exh. 444 [“Compare at prices provide the customer with savings information and make a big impact”].)

20. As discussed in further detail below, some of this internal traffic from the 2008-2009 timeframe refers to the quantitative impact of including or excluding ARPs from product pages – e.g., products without ARPs suffer sales declines of 6% (Exh. 475, 485), 10% (Exh. 462) or even 20% (Exh. 477, 501), while those with ARPs enjoy increased sales of 6% (Exh. 483), 10% (Exh. 487, 503, 510) or 13% to 25% (Exh. 482, 486, 488, 492). The internal traffic also discusses a perceived increase in the “conversion rate” – that is, the percentage of site visitors who purchase products – and refer to ARPs increasing that rate. (Exh. 502 [8.9%].) The figures quantifying the impact of the presence or absence of ARPs vary by document, product line and context. But the overwhelming majority of internal Overstock emails reflect a widespread belief within the company that ARPs matter – that is, their presence has a positive impact on sales.

(iii) Marc Ecenbarger Incident & Others

21. Toward the end of the List Price Era, a consumer in Shasta County, California, named Marc Ecenbarger purchased two patio sets from Overstock based on a product page displaying a "list price" of \$999.00 and showing an Overstock price of \$449.99 for a "savings" of \$549.01 or 55%. (Exh. 950.) Ecenbarger testified at trial that he was familiar with patio furniture pricing and inferred from the stated list price a certain level of quality. (Trial at 156-158.) When the furniture arrived, he was surprised by the relatively poor quality but even more surprised when he found inside the packaging a WalMart price tag for \$247. (Trial at 160-163.) He went online and found the set on the WalMart and other sites for \$247. (Trial at 166-168; Exh. 953, 957.) He contacted Overstock and complained that he had been misled by the ARP on the product page. Overstock first offered to refund the difference and then to refund the entire amount. (Trial at 181-182.) Angered by his experience, on July 23, 2007, Ecenbarger sent a letter to the Shasta County District Attorney complaining of what he believed to be false advertising. Shortly thereafter the D.A. wrote Defendant a letter requesting substantiation of its claims regarding list prices. (Exh. 6.)

22. Overstock looked into the Ecenbarger incident and determined that what apparently had happened with this patio set was that the product had been acquired from a fulfillment partner, which had used a formula to set the ARP. (Trial at 1284-1285; Exh. 10 at 2.) But even after learning these facts, Overstock did not remove the patio set from its website or change the ARP information. (Exh. 850; Trial at 1282-1285.) Moreover, Ecenbarger was not the first consumer to report the above problem with the patio set to Overstock. Defendant had received an identical complaint regarding the same patio set

three months earlier (Exh. 870) and yet continued to advertise the patio set for sale with the same ARP and sold dozens of them at the price paid by Ecenbarger. (Exh. 850.) To this day, Overstock has taken no steps to initiate any remedial action for those consumers who purchased the same patio set as Ecenbarger at \$449.99 based on an ARP of \$999.

23. In an attempt to demonstrate that the Ecenbarger incident was not an isolated event, the People called Sandra Prescott of Pingree, Idaho, Andrew Bride of Fresno, California, and Linda Finke of South Bend, Indiana, and designated the deposition testimony of Julie McIntyre of Columbia, South Carolina. Prescott testified that in 2010 she purchased an all-in-one printer from Overstock for around \$800 based on an ARP of approximately \$4,000 only to learn later that she could find the same printer elsewhere for a price within \$50 of what she paid. (Trial at 132-135.<sup>11</sup>) Bride testified that he purchased a wedding ring set in 2008 from Overstock based on an ARP of \$3,900 and a sale price of \$1,399, but that there were quality issues and, when he had it appraised, the value was substantially less than Overstock's ARP. (Trial at 231-235; Exh. 103, 105.) Finke testified to her familiarity with the Sizzix Essential line of dies and her seeing such dies offered on the Overstock site in 2010 with ARPs for the entire product line that were higher than the MSRPs published on the manufacturer's webpage. (Trial at 216-225; Exh. 164, 167-168.) McIntyre testified that she shopped for a specific tent on Overstock's site and saw an MSRP but that when she checked that against the

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<sup>11</sup> To the extent that this customer testimony contains hearsay statements about the prices discovered elsewhere, an appraisal of the product, etc., such testimony is admitted not for the truth of the matter asserted but as examples of the notice to Overstock of customer complaints regarding the accuracy or fairness of its ARPs.

manufacturer's webpage the MSRP was lower. (McIntyre 7/22/13 Tr. at 36-37, 46.<sup>12</sup>) In each of these instances, the customer complained to Overstock, the complaints were noted in its records, and a standardized response was sent to the consumer.

(iv) Prior Notice of Above ARP Issues

24. In March 2004 an article appeared in Business Week alleging that Overstock may overstate the list prices shown on its website. (Compare Exh. 774 at ¶43 & Exh. 5 with Exh. 775 at ¶43.) Overstock responded, in part, that its suppliers provide it with list prices and "we verify these prices" and that on the rare occasions when suppliers do not provide a recommended retail price "our experienced buying team conducts thorough market research to determine the most accurate list price." (Exh. 2006.) As previously noted, at the time of this response Overstock did not have in place any processes or procedures to confirm for any given list price that there was in fact at least one instance of a sale at the list price stated in the advertisement. The People would argue that the Business Week article put senior Overstock management on notice of the problems inherent in the company's practices for setting the ARPs on its website.

25. As further evidence of notice, the People point to a company-wide email sent in March 2004 requiring fulfillment partners to "submit a link to a valid website where the MSRP was found" (Exh. 666) and the lack of any evidence that any systematic attempt was used to follow-up. The People also rely on various emails from consumers during this era complaining about its list prices. (E.g., Ex. 15 ["I admit it was my mistake not to check local stores before ordering from you, but I made the assumption that you

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<sup>12</sup> McIntyre Objection(s) sustained: 7/22/13 Tr. at 68, 70, 73, 75, 76, 77, 138. Hearsay objections to third-party statements in email chains sustained to the extent offered for the truth of the matter asserted as opposed to use for context, notice, etc.



quote real prices”].) They also argue that notice may be inferred from the fact that such complaints were common enough to warrant a standardized or “canned” response. (Exh. 36.)

(v) The Mondeaux Letter

26. Perhaps in response to the Ecenbarger incident or the inquiry from the D.A., Overstock’s Vice President of Merchandising, Ralph Mondeaux, wrote a letter on September 5, 2007, to Overstock’s fulfillment partners “as a reminder that when you provide ‘List Price’ associated with a product you sell on our website, it must be in compliance with Overstock.com’s policy regarding ‘List Price.’” (Exh. 556.) The letter enclosed a spreadsheet and requested that partners provide the information on the sheet, including “Location of List Price Comparable (where you found the same item sold at the List Price)” and “[i]f you can’t find a comparable price for the exact item, then where the information on a similar product was found.” (*Ibid.*) For further guidance it provided an order of priority for the methods to be used in confirming list prices. First was confirmation of an instance of at least one sale at MSRP; then the sale price for the same item at another online retailer or storefront dealer; then a “nearly identical item” at another online retailer or storefront dealer; and finally an estimated price “derived from standard wholesale and retail markups for this type of product.” (*Ibid.*) On this record, the Mondeaux letter was the first time Defendant made any systematic effort to verify its list prices, and it still allowed the use of a formula if the other methods were unavailable. (Murakami 4/10/13 Tr. at 136-137.)

27. Following the Mondeaux letter there was significant email traffic within Overstock and between it and its partners explaining why the spreadsheet was being

distributed and these new requirements imposed. The explanations included: “It has come to our attention that we have some issues with our MSRP site wide” (Exh. 557); “We have identified many products across the site where MSRP is inflated” (Exh. 269); “Recently we have found some examples of over-inflated MSRP’s/List Prices on our site” (Exh. 270). The People point to all of these communications as Overstock admissions as to the false and misleading use of ARPs during the List Price Era and as notice to Overstock of the problem. There is no way to determine, though, how many or what percentage of products on the company’s website during this era used inflated list prices as the ARP. This is because prior to September 2008 Overstock did not document how any particular ARP on its site was determined.

**B. The “Compare At Era”**

(i) New ARP Language & Policies

28. Beginning at some point in late September 2007, Overstock started to use the phrase “compare at” in its website advertising in lieu of the term “list price.” (Johnson 6/12/13 Tr. at 83; Exh. 795, Sp. Inter. Resp. 23.) The People refer to this period running from September 2007 to early 2011 as the “Compare At Era.” When it began using this new terminology, Overstock replaced the definition of “list price” on its website with a definition of “compare at” that one could find by scrolling over the term where it appeared on a product page. The definition read:

The term “Compare at” means the price at which, in the reasonable judgment of our experienced buyers, manufacturers or suppliers, the item may be sold on an everyday basis. Other vendors sometimes refer to this as the “retail price” exclusive of special promotions or sale prices, at which the item might be offered at retail stores and at customary retail mark-up. In many instances though not all, the “Compare at” price reflects a price suggested by the manufacturer or supplier of these goods, without reference to actual retail sales and include a reasonable average estimated shipping

cost, if ordinary shipping costs have been discounted or eliminated. We make no representation that the products have been sold or offered at the "Compare at" price, and the price may or may not reflect the average or prevailing market price in any area on any particular day. For some items listed as a set, the "Compare at" price may be the aggregate of the suggested or estimated prices for all items included in the set. Actual retail sales in your area may substantially differ from the "Compare at" price. Moreover, the nature of internet sales on a national or international basis, and the fact that we deal in overstocks, closeouts, end-of-season, and unique items that may be sold only on Overstock.com, precludes our ability to know whether our products are sold at the "Compare at" price at any particular location or time by other vendors. You may choose to use the "Compare at" price as an appropriate guide to what you would or could pay for these items in other locations, at other times, or under other conditions, including full retail price.

[Exh. 961.]

29. During the first year of the Compare At Era, there was no substantial change regarding how Overstock set ARPs. (Murakami 4/11/13 Tr. at 302; Exh. 981.) Thus the ARPs typically reflected a price suggested by the manufacturer without reference to actual retail sales, there was no process or procedure for verifying the ARPs provided by suppliers, Overstock continued to allow the use of formulas to develop the "compare at" price, and there was and is no way to confirm any specific number of ARPs that were in fact verified. (Murakami 4/10/13 at 255-257; 4/11/13 Tr. at 304; Exh. 886, RFA Resp. 24; Exh. 859.) What was new was the statement in the Overstock definition available via the hyperlink that it was unable to state whether the "compare at" price represented the actual price of another vendor at any particular place or time.

30. Because formulas could continue to be used, during this timeframe some undetermined number of Overstock buyers continued the practice of negotiating with partners to raise their MSRP so as to create a higher ARP or achieve a certain desired discount off of MSRP (e.g., 40% to 50%). (Exh. 574, 577.) For example, one email from this era reflects a partner telling Overstock that it "bumped" its store price so as to

give Overstock “enough room” for its desired discount and Overstock noting this worked on all but two ARPs where “the compare at site [was] not ... your own.” (Exh. 380.) Another shows Overstock asking to see whether the list price can be increased. (Exh. 371; see also Exh. 251, 248; Murakami 4/10/13 Tr. at 174-177, 183-190.) Defendant continued to use ARPs for unique items without disclosing this on the product page to customers (Exh. 376) and continued to look for the highest ARP even though the street price was substantially lower. (Exh. 334, 337, 735.)

31. In July of 2008 Overstock did a study “to get a feel to see if our MSRP is inflated compared to the market.” (Exh. 677.) The study looked at a random selection of 10 of the top 100 best-selling products in each department and compared the “compare at” price on Overstock’s website to the prices that could be found online: on average the ARPs were 15.30% higher than the *highest* price that could be found online. (Exh. 679.) Among a random selection of 10 of the top 100 products for each department determined by the greatest “You save” percentage, “compare at” prices were on average 32.81% higher than the *highest* price that could be found online. (*Ibid.*) Among a random selection of 10 additional products from each department, the “compare at” prices were on average 12.96% higher than the *highest* price that could be found online. (*Ibid.*)

(ii) Removal of ARPs

32. In September of 2008 Overstock removed all ARPs from its website and only allowed them to be re-posted if the partner supplied a verifiable reference to support the stated ARP. (Trial at 1129.) Among the factors that may have played a role in this policy change were the Ecenbarger incident and its aftermath, the inquiry from the Shasta County D.A., which ripened into an investigative subpoena on April 14, 2008, the July

2008 internal study showing the prevalence of ARPs above the highest prices that could be found on the internet and the continued receipt of consumer complaints (e.g., Exh. 60). The reason given to Overstock's partners was that "most of the pricing (which we called MSRP at the time) really was not accurate in terms of true competing prices that were out there on other retail websites" and the goal was "to ensure that accurate data was being presented to our customers." (Exh. 497.) The People rely on these statements as further admissions that Overstock's prior use of ARPs was false and misleading, but again the record provides no basis for determining the number or percentage of total product listings with these issues.<sup>13</sup>

33. The removal of ARPs from Overstock's website generated a good deal of internal commentary regarding the impact of ARPs. Founder and CEO Patrick Byrne, ("Byrne") warned: "Be aware we rolled out the elimination of 'Compare At' pricing the other night. In testing, that cost us 6%." (Exh. 466.) This general view of the significance of "compare at" advertising was echoed by others. (See, e.g., Exh. 468 ["the impact on sales has been more significant than what we expected"]; Exh. 481 ["when we ran a SiteSpect test which removed 'Compare At' from the site ... we saw a 6% drop in conversion (roughly \$135k/day in revenue)"]; Exh. 482 [25% average increase based on "rough analysis" but 13% "safe" estimate]; Exh. 502 ["11.5% lift in orders overall and an 8.9% lift in conversion" when Compare At added back]; see also Exh. 485 [6% or more];

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<sup>13</sup> One could argue that the July 2008 study (Exh. 677, 679) may provide a metric. The People argue that this internal Overstock document provides a range of percentages for estimating the extent that ARPs were inflated. The defense counters that this study may only show that prices in the market decline over time and thus eventually some ARPs will be relatively "high." Of course, prior to the fall of 2008 Overstock had no rules regarding how long an ARP, once posted, could remain on a page. This alternative theory as to why Overstock's ARPs may have been misleadingly high at the time suggests that the July 2008 study is not a good metric of the impact of the practices challenged in this case; however, the defense argument is somewhat unusual in this context – it's basically an argument that its ARPs were misleading but for a different reason than the ones alleged. Understood.

Exh. 463 [range of 5% to 25%]; Exh. 497 [range of 6% to 20%]; Exh. 475 [6%]; Exh. 462 [10%]; Exh. 477 [20%]; Exh. 494 [5% to 26%].) The variability in these numbers is usually a function of context – some refer to the negative impact of the removal of ARPs, others refer to the positive impact of their restoration measured in terms of uplift, conversion rate or some other metric, some refer to the impact on specific product lines, etc. These and other issues regarding such figures and their foundation were explored in the defense case (see below), but there is no disputing that the contemporaneous internal communications at the company reflect a consensus that ARPs matter because their presence has a positive impact on sales.

34. Because of this belief in the efficacy of ARPs, there was a push by Overstock to motivate its partners to provide it with the source of the ARPs being offered so that Overstock could re-populate ARPs on its site. To do this, Overstock emphasized to its partners the potential for ARPs to increase sales. (King 4/5/13 Tr. at 269.) These efforts included, for example, a communication from Overstock's Senior Vice President Supply Chain (Jacob Hawkins) to all of its partners stating: "'Compare at' prices are a useful tool for our customers. We believe that products with a 'Compare at' price sell better than products without a 'Compare at' price. Because of this we are strongly committed to featuring 'Compare at' pricing on all eligible products by April 1, 2009 ...'" (Exh. 494.) Follow-up emails to this communication reflect Overstock employees representing to fulfillment partners the kind of figures regarding the impact of ARPs noted above. The motivational use of such figures is unmistakable and only serves to reinforce the inference that those in the best position to know at Overstock firmly believed that ARPs affected consumer behavior in a material, positive way.

35. Overstock's belief was, moreover, supported by its own contemporaneous consumer research through a company known as "Communispace," which was used to facilitate two discussion threads among customers. Some commented that, without ARPs, they had to "look at other sites for the same product to see if [the Overstock offer] is even a discount," or were driven "to other websites in search of a deal," or the prior use of ARPs "was the only reason I didnt [sic] shop around." (Exh. 425; see also Exh. 420.) Communispace also conducted a survey of customers regarding the removal of ARPs and their importance. 82.6% of respondents indicated that ARPs were either "extremely" or "somewhat" important. (Exh. 427.) These survey results help explain why Overstock viewed the restoration of ARPs as a high priority, and one can also see in the respondents' comments consumer reactions to ARPs that are consistent with the opinions provided by the People's expert based on his own research and the academic literature on the subject (see below).

(iii) The Price Validation Team

36. At the same time Overstock removed all ARPs from its site, it also inaugurated a group within the company known as the "Pricing Validation Team" or simply the "Validation Team." (King 4/5/13 Tr. at 30-31.) Partners were given a "partner offer spreadsheet" (Exh. 3) to complete on which they were asked to provide certain information on each product, including both the "low" and the "high" street price. By "high street price" it was generally understood Overstock meant the highest price that could be found for the product. (King 4/5/13 Tr. at 180, 269.) It was the responsibility of the validation team to go online, search catalogues or otherwise confirm that the identified high street price was in fact a price at which the product was being offered.

(King 4/5/13 Tr. at 108; 5/6/13 Tr. at 452-453, 467.) This meant that MSRPs could not be used any longer to set the ARPs (King 4/5/13 Tr. at 126, 188), nor could formulas, which could produce “arbitrary” ARP numbers. (King 4/6/13 Tr. at 538-540, 542, 546.) The validation team required proof of an actual offer to sell at the proposed ARP and then documented the source of that ARP.

37. While this was a major change, the practice was still to seek and use as the ARP the highest street price confirmed by the validation team (Exh. 348, 349) and where shipping charges could be added to increase the ARP that was done to ensure “the highest compare at price.” (Exh. 643; also Exh. 418.) The policy of seeking the highest confirmed street price as the ARP was endorsed at the executive level. (Exh. 1061 [Johnson]. Exh. 1068 [McClaughtery], Trial at 906 [Byrne].) Moreover, the validation team could still use similar products to confirm the ARPs submitted by its partners for products that were unique to Overstock. (King 4/5/13 Tr. at 164; 4/6/13 Tr. at 353; Exh. 622.) There were also instances of Overstock employees discussing with partners the possibility of the partner raising the price or MSRP on its own website for the purpose of generating a higher ARP for use on the Overstock website, even though with the advent of the validation team the use of MSRP and partner sites for ARPs was disallowed. (King 4/6/13 Tr. at 327-335; see also Exh. 382, 383.)

38. The People introduced evidence of continued consumer complaints (Exh. 115, 121) and occasions where the customer found price tags on the partner product they received that were lower than the ARP or even the price they paid Overstock. (Exh. 86.) As late as December 2011 one internal email noted that “[t]here have been a number of recent instances where the price tag listed on the product that was shipped to the



customer was less than the price that they paid on our website.” (Exh. 728.) Ms. King (Overstock’s PMQ for this period) responded by advocating the removal of all price tags. (*Ibid.*) The People point to such evidence as exemplifying the problems inherent in the policy of looking for and using the highest online price as the ARP.

### C. The “Compare Era”

39. The People refer to the timeframe beginning in 2011 and continuing to the present as the “Compare Era.” This marks the period where Overstock used the word “compare” in place of the phrase “compare at” and for some products still used MSRP as the ARP. The use of a hyperlink to the definition of “compare” and the wording of it did not change, but Defendant did institute internal guidelines for determining these two types of ARP. (Exh. 566.) “Compare” was defined as “an actual price at which the product is being sold ... It is important to note that a ‘Compare’ price is not an estimate by the submitter of what the product might sell for, and it is not another retailer’s stated estimate of value, but, rather it must be a bona fide price at which the product is being offered for sale or sold.” (*Ibid.*) Where an identical product is unavailable for an ARP, the guidelines continue to allow the use of similar products for ARPs. The guidelines also state that “Compare” prices must be revalidated every three months and MSRPs within six months.

40. The guidelines also cover the use of shipping and handling changes in setting ARP and are consistent with what the record indicates was Overstock’s policy throughout all three time periods. At the time the guidelines were issued, Overstock had a policy of charging \$2.95 for non-expedited shipping on most items. At earlier times Overstock charged \$1 or sometimes advertised “free shipping.” When constructing an

ARP the guidelines indicate that “[i]t is appropriate to take into account the shipping and handling charges applied to an Identical or Similar Product when establishing a ‘Compare’ price.” (*Ibid.*) If the seller charges a flat fee, the amount over Overstock’s flat fee (or no fee) may be added to the ARP. If the seller has a variable fee dependent on destination, the difference between what the seller would charge to ship to Kansas City, Missouri and Overstock’s flat fee may be added to the ARP. (*Ibid.*) The People claim that this approach is deceptive because of evidence that the actual cost of shipping and handling was already factored into the Overstock sales price. (Murakami 4/12/13 Tr. at 723-726; Nielson 5/15/13 Tr. at 301, 304-305.<sup>14</sup>)

41. During the Compare Era and perhaps beginning earlier, one of the tools available to the validation team was third-party services such as WinBuyer and Mechanical Turk that will search the web and “scrape” current product prices. (Trial at 903-904.) Overstock used such services to develop price comparisons, on occasion to determine ARPs and for consideration in setting its own prices. Another such service (Gazaro) was used by Overstock for that purpose with respect to books, movies, music and games (“BMMG”). (Trial at 855-856, 1037-1038.) The People offered such evidence to support an argument that third-party sources have emerged that would allow an online retailer such as Overstock to use ARPs based on the current “prevailing market price” determined in an efficient, automated manner.

#### **D. Compeau’s Expert Testimony**

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<sup>14</sup> Nielsen Objection(s) sustained: 5/15/13 Tr. at 37, 201, 215, 334, 335. Hearsay objections to third-party statements in email chains sustained to the extent offered for the truth of the matter asserted as opposed to use for context, notice, etc.

42. The People called Professor Larry Compeau (“Compeau”) of Clarkson University as an expert witness. Compeau’s research focus for more than twenty years has been the impact that ARPs have on consumer response. Based on his own academic research and review of the extensive literature on the subject, Compeau opined that as the ARP is increased in an advertisement relative to the product being offered for sale, there is (a) an increase in a consumer’s internal reference price (“IRP”), (b) an increase in the consumer’s perception of the quality and value of the product, (c) an increase in the consumer’s “purchase intention” and (d) a decrease in the consumer’s search intentions – meaning a decrease in the likelihood that the consumer will do additional comparative shopping. (Trial at 265-268, 282-287.) As to the increase in the perception of quality and value, Compeau testified that there were at least two dimensions of value – acquisition value (i.e., the perceived value to the consumer of owning the product) and transaction value (i.e., the perceived savings or value of the deal itself) – and both increase as ARPs increase relative to the products advertised. (Trial at 282-283.) He pointed out that in all of these areas, the relationship is not linear – that is, as the gap widens consumer skepticism increases, which dampens the consumer response, but the impact is still positive. (Trial at 337-338, 429-430, 541-542.) Compeau testified that all of these effects apply to the “vast majority” of consumers and are not limited to the naïve, the gullible or the unsophisticated. (Trial at 288-289.) He further noted examples of consumer responses in the records that illustrate all the effects noted in the literature and his own research. (Trial at 335-338.)

43. Based on the foregoing, Compeau testified that in order not to be deceptive, ARPs need to be based on prevailing market prices or at least bona fide prices

in the market and not be without validation, based on MSRP or calculated by some formula. (Trial at 290.) While opining on the cues in Overstock ads, Compeau noted that certain Overstock cues suggested a fleeting opportunity (e.g., “today”) and may tend to decrease search intentions and that the name “Overstock” tended to convey a liquidator with the ability to offer unusually low prices for a period of brief duration. (Trial at 320-321.) If given the opportunity, Compeau would testify that various aspects of Overstock’s use of ARPs had the “capacity” to mislead and confuse consumers; however, the court excluded that line of testimony as either calling for legal conclusion or an otherwise inappropriate use of expert opinion.<sup>15</sup>

44. Compeau’s reliance on the literature included a 1998 article he co-authored with Professor Grewal that reported on a meta-analysis conducted on the 38 articles in the literature at the time containing sufficient data to be included in the analysis. (Trial at 275-276.) The analysis consisted of a widely accepted statistical methodology for analyzing data across a series of studies to determine if they reflect a common phenomenon or not and for reconciling what might otherwise appear to be conflicting individual studies. His 1998 meta-analysis of the available studies at that time supported his opinions in this case – i.e., that the presence of ARPs increases IRP, perceived value, perceived believability of price and purchase intentions, and that these effects increase as the ARP rises compared to the product being advertised. (Trial at 529-531.) Compeau testified that since then the body of scientific research had expanded to approximately 70 published studies, the vast majority of which support his opinions regarding the impact of ARPs on consumer response. (Trial at 289.) He conceded that

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<sup>15</sup> Compeau’s excluded opinions on this subject are memorialized in the trial transcript. (Trial at 314-319, 326-334.)

none of the research would support a method for quantifying the impact of any given ARP in a particular sales transaction and that the strength of the ARP effect was contextual. (Trial at 381.)

45. The court finds Compeau's review of the literature and his conclusions regarding the general impact of ARP as reflected therein to be credible. In making this finding, the court notes that Compeau's opinions from his own research and analysis of the literature predate any forensic work and reflect a long and deep engagement with the literature in the field. He defended his analysis credibly and readily admitted various limitations. For example, when questioned regarding the focus on purchase intentions rather than actual purchases by consumers in real transactions, he explained that to meet professional standards studies needed to be constructed with controls, which limited the ability of independent researchers to analyze actual consumer transactions. (Trial at 531-533.) He made other reasonable concessions on cross-examination and consistently tried to stay within the bounds of the literature in his field. For the foregoing reasons, the court accepts the above opinions with important limitations.

46. Those limitations were developed on cross-examination. With respect to the literature, Compeau was confronted with a number of statements in the literature that, taken in isolation, were counter to his overall conclusions regarding the impact of ARPs, e.g., the higher the reference price the lower its believability, or suggested the complexity of the issue and the variability in consumer response to ARPs. (Trial at 395-397, 403, 406-407, 462-463.) Significantly, with respect to Overstock's advertising in particular, Compeau readily conceded that he had not conducted any specific research on its customers, their buying habits, their interpretations of the semantics used in the

Overstock price comparisons or their reliance on Overstock being a liquidator. (Trial at 411-413, 419.) Compeau also conceded that he had not undertaken to determine which or how many of Overstock's ARPs were higher than appropriate so as not to be deceptive. (Trial at 448-449.) Nor had he conducted a study of Overstock's use of ARPs or underlying practices compared to other online retailers to determine the differences or similarities. (Trial at 412-413, 522.) The defense pointed to the observations in Compeau's 1998 article's that it was possible that, if consumers are overexposed to ARPs, they may become desensitized to such price comparisons and that further research was needed, including study of the impact of repeated exposure to ARPs. (Trial at 465.) He was also presented with research suggesting that the "compare at" cue was very common and widely understood by consumers to mean a comparable product or alternative brand rather than the identical product. (Trial at 423.)

47. The defense cross-examination also spent considerable time on context. This ranged, on the one hand, from questioning on the characteristics of the studies cited and their very substantial differences in many instances from that of an actual online shopper to, on the other hand, research questions in various articles as to how the literature might apply to an internet or other setting and the rapidly changing technological environment. (Trial at 468-472, 490-492, 497-501, 507-512.) With respect to the internet, for example, some researchers have noted that the impact of APRs on consumer response is stronger in a store setting than at home, and of course the defense would analogize the online shopping experience to the at-home scenario. (Trial at 493-494.) The cross-examination also developed how technological innovations have made online price comparisons easier and faster (Trial at 500-501) and questioned Compeau

regarding the relative lack of published research on ARPs in the online context and the absence of such research on Overstock and its practices in particular. These lines of questioning, of course, were by way of preparation for the defense case and its expert's research and the opinions he expressed in response.

### **III. THE DEFENSE CASE**

#### **A. Overstock's Retail Strategy & Use of ARPs**

48. Overstock introduced evidence that during the past 14 years it grew from an online site offering fewer than 100 products acquired from liquidators and the like to an online retailer of over a million items acquired principally from its partners, who use it as a regular outlet. (Trial at 809-810, 860-861.) Throughout Overstock's history, its policy and practice has been to try to sell every product at or below the lowest price on the internet – what it calls “extreme value retailing.” (Trial at 814-15, 1235-1236.) To execute on this strategy, its buyers search the internet and catalogues in a comparative shopping exercise that informs them of the range of prices available and enables them to price at least 10% below the lowest price on the market. (Trial at 1236-1237, 1248-1249.) Given this pricing strategy, Overstock would argue that no consumer could be harmed by any of its advertising because, except in the rare case of an error (e.g., the Ecenbarger incident), its customers always got the lowest price available on the internet.

49. Overstock has used ARPs from the outset for the purpose of branding itself as an extreme value retailer by showing consumers the large savings available on its site. In the words of its CEO, the intent was to communicate that “we're a place where you can save a lot of money.” (Byrne 7/9/13 Tr. at 110.) To ensure that its ARPs were

legally appropriate, Byrne testified that before settling on an ARP policy he consulted with the Better Business Bureau ("BBB") in Salt Lake City and claims he was advised that he could use any price as an ARP as long as he could find one offering at that price in the United States. (Trial at 817.) He further testified that he was advised that he could use a standard retail markup or a "formula" when no actual prices could be found. (Trial at 818, 822.) Overstock produced no documents from its records or the BBB corroborating this advice.

50. During the List Price Era, approximately 90% of Overstock's products carried a list price that came from an industry standard feed. (Trial at 833.) These were mostly BMMG products, which have universal product identification numbers that enable their prices to be tracked electronically. (Trial at 1036; Exh. 2835-2844.) The remaining 10% of the products on Overstock's site displayed as the list price the price provided by Overstock's partners or, where no list price could be located, a price generated by the use of a standard markup or formula. (Trial at 1240-1243, 1246-1250, 1258.) Buyers were supposed to check the reasonableness of the list price as part of their comparative shopping exercise that they engaged in to determine the price at which Overstock would sell any item. (Trial at 1240-1243.)

51. Overstock admitted that on occasion mistakes were made and the Ecenbarger incident was one such isolated case. Byrne testified that, when he learned of the Ecenbarger incident, he was "furious" and announced in writing that he would fire any employee who made that kind of mistake again. (Trial at 846; Exh. 2032.)

Overstock notes, however, that the "mistake" in question was in the first instance that of its supplier, who used a formula to determine the ARP provided to Overstock, and the



only Overstock “mistake” was not catching that error during the course of the buyer’s comparative shopping exercise. At or about the same time as the Ecenbarger incident and the resulting D.A. Investigation, Overstock changed its ARP nomenclature to “compare at” in order to correspond with the nomenclature used by the industry leader – Amazon. (Trial at 846-848.)

52. In the fall of 2008 Overstock implemented its “Validation Team.” This was described as a natural step in the company’s development and paralleled the creation of other specialty teams for functions such as capital allocation, review moderation and the like – all of which had previously been vested in the buyers. (Trial at 849-850, 1263-1265, 1301.) The record indicates that the validation team manually searched for and confirmed every ARP (Trial at 1124-1125), although it may have been for the BMMG products the standard industry feed continued to be relied upon. In any event, formulas were out and each ARP was documented and memorialized with a screen shot of the product page supporting the ARP. (Trial at 1169-1170.) All ARPs were “revalidated” every 90 days. (Trial at 1145-1146.)

53. In 2011 Overstock simplified “compare at” to “compare,” and for some products started to use “MSRP” as the ARP label. (Trial at 1145, 1300.) Whatever the label, though, and even in instances where formulas were used in the earlier timeframe, Overstock maintains that the incontrovertible evidence is that its actual prices were always at or below that of any other online retailer. If it could not achieve that position, Overstock did not want to carry the product. (Trial at 848-849, 854-855, 1237.) The only rare exceptions, it contends, were where a mistake was made such as in the

Ecenbarger incident, and on those occasions the mistake was in the first instance made by the partner providing the ARP information.

54. As for the July 2008 internal study (see ¶31, supra), Overstock dismisses that study because there is no evidence of the underlying methodology and the entire phenomenon may simply reflect the fact that prices decline over time. Thus the defense argues that an ARP initially set based on an actual market price found by a partner and corroborated by a buyer while engaged in comparative pricing could be posted to the site and then days, weeks or months later no longer reflect what the high street price might be at that later time. The defense contends that, at best, the July 2008 study demonstrates that many prices decline over time and they cannot be taken as evidence, for example, that ARPs based on the use of formulas are inflated or arbitrary.

**B. Test, Traffic, Survey & Expert Evidence**

55. The core of the defense case consists of test and traffic evidence introduced through employee Seth Moore (“Moore”) and survey evidence and expert opinions presented by retained expert Professor Joel Steckel of New York University (“Steckel”). Moore has held various positions at Overstock, and through education, training and experience before and during his employment at Overstock he has gained substantial expertise in analyzing data generated through websites and constructing various tests, including what were referred to in the trial as “A/B tests” wherein visitors to the Overstock website are randomly directed to different webpages for the same product with only one variable on the two sets of pages changed. (Trial at 937.) Visitor response to the two sets of pages can then be tracked, tabulated and compared in an attempt to measure the significance of the variable being tested. (Trial at 938.) All

parties agree that, if the tests are properly designed and conducted, they may provide significant insight to consumer behavior because, unlike the academic studies relied upon by Compeau which test consumers' *stated intentions*, an A/B test may be used to examine their *actual purchase decisions*. (Trial at 1356-1357.) Of course, as in all experiments, "the devil is in the details," which was illustrated in the examination of the defense witnesses as it was with Compeau.

(i) Moore's 2008 Tests

56. In the Fall of 2008 Moore participated in an effort to run an A/B test to measure the "conversion rate" of visitors to the Overstock website – that is, the frequency with which visitors actually entered into a purchase transaction – where the variable being tested was the presence or absence of an ARP. One set of visitors who clicked on a product were shunted to the then existing standard format displaying a "Compare at" price, a "Today's price" and a "You save" calculation of the difference in dollars and percentage terms; the other set of visitors were directed to a page that deleted the "Compare at" price and "You save" calculation. (Trial at 940; Exh. 2079, pp. 2-3.) This test was run four times due to various technical difficulties encountered by the testers,<sup>16</sup> which caused the first three tests to be stopped before the two week period Moore believed was appropriate to eliminate any distortion due to the day of the week selected.<sup>17</sup>

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<sup>16</sup> Some of the problems included "broken pages" (which refers to the failure to accurately display all the information on a page), issues with the link to the Finance database that captured some of the transaction information, "fixes" to the foregoing that significantly slowed page navigation due to the complexity of the code on the modified pages, etc. These kinds of problems – individually and collectively – may have undermined the tests and their ability to measure the impact of the variable being tested. (Trial at 940-942, 945-949.)

<sup>17</sup> Moore testified to variances based on the day of the week and weekday-vs.-weekend purchasing patterns and his practice of trying to eliminate that potential impact by running tests over a two week period. One of the problems with the first three tests was that they had to be stopped before results could be

The fourth test avoided most but not all of the problems inherent in the first three.<sup>18</sup>

(Trial at 951.)

57. The four tests may be identified by date, duration and sample size as follows:

- Test 1: August 18, 1 ½ days, 10,000 before stopped
- Test 2: August 20, 3 ½ days, 16,000 before stopped
- Test 3: October 21, 12 days with some interruption, 25,000 before stopped
- Test 4: October 31, 2 weeks, 30,000

The results for each test are tabulated on the last four pages of Exhibit 2902, which were admitted. (Trial at 943 et seq.)

58. The results of Test 4 showed a conversion rate of 3.74% when the ARP information was present (Group A) compared to a 3.71% conversion rate when such information was absent (Group B) – or a 1% “uplift” in conversion rate when ARPs were present. (Trial at 952-953.) The earlier tests showed a more significant uplift, on the order of 6% and even 13% in one iteration; however, Moore testified that these figures reflected the impact of other factors such as the technical difficulties that caused broken pages, the delay factor on the Group B pages, etc. (Trial at 956-957), that the 13% figure had additional methodological problems and that a further analysis performed by staff cast further doubt on these higher uplift figures. (Trial at 962-967.)

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accumulated over a sufficiently extended period to ensure that the results were not corrupted by these kinds of variances. (Trial at 954-955.)

<sup>18</sup> Test 4 continued to have problems with the connection to Finance. It is unclear what that problem was or if it was of the type that could impact the A and B groups differently. (Trial at 1103.)

59. The 6% uplift data from Test 3 (and to a lesser extent the 13% figure) was passed on to others within the company and was probably the foundation for much of the email traffic introduced in the People's case (discussed above) wherein the importance of ARPs was emphasized in the context of urging greater efforts to provide the validation team with comparisons so that more ARPs could be posted. Moore testified that, while he did not view the Test 3 data as accurate as a measure of the impact of ARPs overall, it had some value in showing the *relative* impact of ARP from one "store" or product line to the next (e.g., Home & Garden vs. Jewelry) and thus had some business utility. (Trial at 1091-1092.) He disagreed, though, with the use of Test 3 data by others to claim his testing showed uplift effects of 6%, 8.9%, 11.5% or any other figure. (E.g., Exh. 475, 434.)

60. While Moore thus viewed the Test 4 as statistically the most valid, he conceded on cross-examination that by the time it was run in November 2008 the "holiday factor" had started to ramp up and could have had an impact on the data (as well as the extreme economic downturn at the time). (Trial at 966-967, 1094-1095.) He also agreed that all four tests showed that the use of ARPs resulted in some uplift in the conversion rate and thus sales, and for that reason the more APRs on the website the better. (Trial at 1101-1102.) As for the Test 3 data that was being cited in various internal emails, Moore testified that he had orally communicated his reservations but knew of no email communication from him at the time expressing those reservations. (Trial at 1090, 1093.)

(ii) Moore's 2011 MSRP Test

61. During August 2011 while the litigation was pending, Moore did a second A/B test using the same techniques as in Test 4 but only testing product pages displaying MSRP. (Trial at 984-985.) The test ran for two weeks and generated a sample size of 200,000. The conversion rate for Group A (MSRP present) was 3.23%, while for Group B it was 3.22%, for a 0.3% uplift. (Trial at 987-989; Exh. 2187 at p. .005.) Moore noted the consistency of these results with those of Test 4 and pointed out that the 2011 MSRP test could not have been affected by the “holiday factor.” On cross-examination, he conceded as to both sets of tests that none of them measured the impact of accurate vs. inaccurate ARPs, the effect of ARPs on consumer perceptions of product quality or value, internal reference price, the likelihood of customers returning to the Overstock website, etc. and that all test results point to the use of ARPs causing a bump in sales. (Trial at 1101, 1106-1108.) The only issues in dispute were the appropriate way to measure, and the magnitude of, the “bump.”

(iii) Moore’s Traffic Data

62. Moore also testified to data generated internally and through a third-party under Overstock contract (Hitwise) reflecting website visitor behaviors. For example, in Exhibits 2868 through 2873 he presented information regarding where website visitors came from and went to immediately prior to and following their visit to Overstock – referred to as upstream and downstream data, respectively. (Trial at 994-1001.) The upstream and downstream data shows major traffic to and from Google, Amazon and a host of other comparative shopping sites, all of which led Moore to conclude that Overstock website visitors were actively engaged in substantial comparative shopping of products across websites. (Trial at 999-1003.) As the degree of such activity is a

relevant factor in the analysis of the issues in this case, it is worth noting that all of this data was from the 2010-2012 timeframe rather than from 2004-2008, and Steckel, for example, opined that the ease with which consumers can comparatively shop on the web and the extent to which they engage in comparative online shopping have changed dramatically between 2004 and the present. (Trial at 1573-1576.) Moreover, there is no way to determine from traffic data which are hits by consumers doing comparative shopping versus an automated program scraping data.

63. With respect to the issue of whether site visitors look at the definitions for terms used to explain various ARP labels, Moore testified that Overstock had access to such "click through data" showing how many visitors clicked on the hyperlinks embedded in its product webpages to ARP definitions. (Trial at 1016-1018.) Exhibit 2888 was introduced to show daily website visits from June 27, 2012 through August 13, 2013, the number of "click throughs" to the definitions of "Compare" and "Was/MSRP" and the percentages. The percent of visitors who clicked through to the "Compare" definition ranged from .02% to .08% and for "Was/MSRP" from .005% to .01%. No data was presented for earlier time frames.

64. Moore introduced data on a daily basis as to the number of visitors, orders and conversion rates from September 2005 through December 2008. (Exh. 2867.) He also introduced (a) data on an annual basis as to the number of orders and products (lines) sold (Exh. 2883), (b) data as to "incidents" of contacts by customers to Overstock by category (Exh. 2882), and (c) the number of discreet customer email addresses (Exh. 2884). While Moore did not testify to any inferences to be drawn from such data, the clear purpose was to show how huge the volume of products and number of customers

were compared to relatively miniscule number of contacts that might be construed as complaints. The People inquired as to ways in which the total incident numbers composing the denominator may have been inflated by factors such as automated search engines scarping its site for data. The People also made its standard point on such numbers: consumers who do not know they have been misled by an inflated price are in no position to register a complaint.

(iv) Steckel's Opinions

65. Steckel is the vice dean of doctoral education at the NYU School of Business and has 25 years of academic experience with extensive work in marketing and consumer research. Based on his experience, his review of the literature, the Moore data and an experiment and a survey conducted at his direction (both of which are described below), he offered several opinions. Underling them all was his premise that for Overstock purchasers to be misled, four conditions had to be met: (1) they had to be aware of the ARP, (2) they had to form an expectation as to what the ARP meant, (3) they had to believe Overstock's use of the ARP conformed with their belief, and (4) Overstock's use of ARP differed from their belief. (Trial at 1334.) Steckel did not examine the fourth element but focused on the first three. For reasons detailed in his testimony he opined that most consumers are not aware of the ARP or have no concrete expectation as to its meaning or Overstock's use of it, that to the extent they do have such an expectation it is that the ARP is a high or non-discounted price rather than a market price and thus cannot be misled, and that this is true across all ARP nomenclatures. (Trial at 1335-1340.) He believed these conclusions were supported by Moore's 2008 and 2011 testing, an experiment and a survey he conducted, and the literature and his



experience. He also relied on the widespread use of comparative shopping tools online by consumers to look at prices across different internet sites.

(v) The Steckel Experiment

66. To test the above opinions, in July of 2013 Steckel had Overstock conduct a forensic experiment with the assistance of Moore and two consulting firms (Analysis Group and Applied Marketing Science). The experiment was intended to determine whether online consumers notice ARPs and, if they do, what they think they mean. The experiment had an A/B test component and a survey. (Trial at 1031-1032; Exh. 2830.) Visitors to the Overstock site who clicked on a product that normally has MSRP as the ARP were randomly divided into two groups, one of which saw “MSRP” as the ARP label and the other saw the same page except the ARP label was “compare.” The only difference between what the two groups saw was the ARP nomenclature. (Trial at 1361-1362.) The conversion rate for the two groups was measured and the results showed a rate of 3.18% versus 3.19% for the MSRP vs. the “compare” pages – essentially identical results in Steckel’s view. (Trial at 1362-1363.) Steckel noted conversion rate data for Overstock from October 2007 to the present, observed that the rates were relatively steady even though the ARP nomenclature changed during that period, and thus opined that this corroborated other evidence indicating that ARP nomenclature has no impact on consumer behavior. (Trial at 1365-1366.)

67. The second part of the experiment was to ask those who purchased a product (whether or not they were part of the A/B test) to complete a short survey. (Trial at 1374-1375.) The survey essentially asked five questions: (1) Was the purchase price easy to see? (2) Did you see a reference price above or below the purchase price? (3) Do

you recall the reference price? (4) What was the reference price (in which case the survey noted the number who came within 10%)? (5) What label was used for the reference price? (Trial at 1368.) The results were presented for those who were in the A/B experiment and for all purchasers. (Trial at 1369-1370.) Steckel went through the various survey results and noted what he viewed as the important points – namely, the results did not change materially for different nomenclatures; only a little over a third even recalled seeing the ARP; for those viewing a page where there was no ARP a quarter nevertheless said they saw one; of those who claimed they saw the ARP, roughly half said they recalled it; of those claiming to recall the ARP, less than 10% were able to recall the ARP within 10% of the actual number; and only 6% said they recalled the nomenclature but only a third of those got it right. (Trial at 1370, 1372, 1376-1377.) From this he concluded that most people do not notice the reference price, do not pay enough attention to remember the label or the value and thus do not form any expectations about it. (Trial at 1378.) Absent such an expectation, Steckel concluded that consumers could not be misled by the ARPs.

(vi) Steckel's Zunega Survey

68. Steckel also conducted a survey for a fictional company named "Zunega," in which he tested consumer response to two of Overstock's more popular products (a playhouse and a curtain product) using Overstock pages and four different ARP labels: list price, MSRP, compare and compare at. (Trial at 1386, 1388-1391.) An online panel screened to eliminate certain categories (e.g., persons employed by online retailers) was used with participants randomly assigned to view and answer questions related to the ARPs they were exposed to for one of the two products. (Trial at 1393-1394.) The

participants were asked whether they remembered seeing the selling price (“Today’s price”), seeing the crossed out reference price, etc., and then the results were compared. (Trial at 1394-1399.) Roughly 40% did not remember any prices, and those who recalled seeing both the selling price and the ARP ranged in the mid-to-high 30 percentile. (Trial at 1396-1399.) In Steckel’s view the results did not vary significantly with nomenclature and indicate that the presence or absence of an ARP may matter to roughly a third of consumers but not the ARP label that is used. (Trial at 1400.)

69. The survey also probed what participants thought the ARP meant by giving them possible definitions of *the source* to choose from – i.e., the manufacturer’s recommendation, the nonsale retail price at this retailer, the nonsale price at other retailers, the price of similar products at this retailer, the price of similar products at other retailers, none of the above, no opinion. (Trial at 1402.) Steckel reviewed the results and noted that they did not vary materially by the ARP nomenclature and that there was no consensus understanding as to what any of the labels meant. (Trial at 1409-1413.) Noting the substantial number who did not know or have an opinion, Steckel concluded that they could not be misled at all because “if they don’t know what the label means, they can’t be misled.” (Trial at 1412.) The fifth question in the survey was designed to test participants’ views as to the significance of *the level* of the ARP by asking those who had an opinion as to source to choose one of three definitions of the level of the ARP – to wit, regular/average market price, above regular/average price or no opinion. (Trial at 1416-1417.) Across all ARP nomenclatures, the percentage of participants exposed to an ARP who believed it was the regular/average price (a/k/a “prevailing market price”) was in the 3-to-5% range. (Trial at 1419-1422, 1425.)

(vii) Cross-Examination on Surveys

70. During the direct and cross-examination there was considerable back-and-forth on survey methodology and the potential impact of those details on the results. On the Steckel experiment, for example, there was some lag time and intervening screens between exposure to the product page and responding to the survey, and more screens between the time respondents last saw the ARP than when they last saw the purchase price, which could arguably affect respondents' ability to recall one better than the other. (Trial at 1551-1556, 1559-1560.) There was also a wide range of times respondents took to complete the survey – from less than a minute to more than 30 minutes – with the medium about 5 minutes. (Trial at 1380, 1515-1516.) Steckel threw out the extremes but there was still a very wide range, which the People suggested might skew the results (Trial at 1516); Steckel disagreed because the survey results for those on each side of the medium were similar. (Trial at 1580-1581.) Steckel did concede, though, that the stimuli used were taken from 2013 Overstock ads rather than from earlier periods when a range of details (e.g., font size, color, position, etc.) were different from those in 2013. (Trial at 1490-1496.)

71. The People questioned the survey's use of "other reference price" in survey questions when the actual ARP labels in the survey were "MSRP," "compare," etc. – a change in terminology the People suggested might suppress the number of respondents who recalled seeing the "reference price" – and yet, even with the use of the "reference price" terminology, the People noted that approximately 45% of respondents said they saw the ARP. (Trial at 1557-1559, 1562.) The People also noted what respondents were *not* asked – e.g., whether they recalled seeing the amount "saved."

(Trial 1561.) These lines of cross-examination were used by the People to highlight the significant numbers and percentages of respondents who recalled seeing the ARP even with the survey limitations and the fact that others may have recalled, if asked, whether the Overstock price reflected some kind of savings. To make the same point, the People questioned Steckel's use of recall to "filter" some respondents out of subsequent survey questions. For example, if somebody said the purchase price was not easy to see, they were not asked any of the subsequent questions because Steckel believed it was unlikely they noticed the ARP or other details. (Trial at 1382-1383.) The People explored how this might also skew the results. Thus, for example, depending on the survey in question, the filtering process eliminated respondents who did not see the ARP or know what the ARP label meant from subsequent questions. Yet just because a respondent did not recall the ARP or know what the source of an ARP or its definition, the size of the discount displayed on the page may still have communicated a "deal" at either a conscious or subliminal level and thereby affected consumer behavior. Steckel's rejoinder to such points was that, while that was possible, in the Overstock context the impact of exposure to any ARP regardless of label or to any purported savings was minimal – as illustrated in part by the very minor "bump" in conversion rates measured by Moore when ARPs are shown. (Trial at 1384-1385.)

72. Steckel was led through his July 2013 experiment and the choices presented respondents regarding what the ARP meant. On choices two, three, four and five presented to respondents, Steckel conceded that they all might be read by participants as reflecting "real prices" – either current or former prices at either a particular retailer or a competitor. (Trial 1499-1507.) The percentage results were

displayed in two ways – one using all survey completes as the denominator and the other just based those who responded to the particular question. (Trial at 1516-1517.)

Depending on the denominator used, the combined responses to those four choices reflected that 28-to-30% of all completes and 69-to-76% of all who responded to the question thought that the ARP was a “real price” in one of the four ways that term might be understood. (Trial at 1506-1508, 1517-1518.) Significantly more respondents (double or triple) thought “MSRP,” “list price,” “compare” and “compare at” indicated the “regular/average price” than thought these terms reflected a price that was higher than “regular/average price.” (Trial at 1519-1524.) Steckel did not test how many respondents thought these terms referred to the highest price that could be found in the market. (Trial at 1533.)

73. Steckel conceded that ARPs may increase a customer’s sense that he or she derived some value from the “deal itself” (referred to as “transactional utility”), that ARPs may thus increase customer loyalty, entice the consumer to return to a site or have an “anchoring” effect. (Trial at 1471-1478.) He did not test to determine whether Overstock consumers thought they had received a “genuine bargain” or “true savings” or were more likely to return to the site or not. (Trial at 1528-1529.) Nor did he examine consumer response to relatively high versus relatively low ARPs. (Trial at 1529.) Steckel was questioned about one of his earlier articles in which he wrote that the internet had not led consumers to search more broadly even though the internet provided the means to readily gather more information. (Trial at 1567-1568.) He explained that those observations were based on research dating back well before 2005 and explained the

dramatic changes since then based on the availability of enhanced search engines and comparative shopping sites. (Trial at 1573-1576.)

(viii) Steckel Critique of Compeau

74. Steckel criticized the methodology in some of Compeau's work and the literature he relied up. For example, he criticized those surveys that forced respondents to pick a definition rather than have "no opinion," as such a construct leads many to guess, and he contrasted that to his filtering methodology, which identified and dropped the no opinion respondents. (Trial at 1427-1428.) Steckel also noted that the use of reference prices and the ubiquity of and improvements in comparative pricing software have fundamentally changed consumer reaction to ARP since the period of 1974 to 1992 when most of the research Compeau relied upon was conducted. (Trial at 1354-1355.) Steckel argued that "purchase intent" is extremely variable depending on context and thus research such as Compeau's that focused on "purchase intent" was no substitute for being able to observe actual consumer purchasing behavior as can be seen in Moore's work in his various A/B exercises. (Trial at 1355-1356.)

**IV. THE GOVERNING LAW**

**A. The Legal Framework**

75. The court starts with the statutes and related case law. In this case four of the five causes of action are based directly or indirectly on section 17500 of the FAL, which provides in relevant part:

It is unlawful for any ... corporation ... with intent directly or indirectly to dispose of ... personal property ... or to induce the public to enter into any obligation relating thereto, to make or disseminate ... before the public in this state, ... in any ... publication, or any advertising device ... or in any other manner or means whatever, including over the Internet, any statement, concerning that ... property or ... concerning any circumstance or matter of fact connected with the proposed disposition thereof, which is untrue or misleading, and which is known, or which by the exercise of reasonable care should be known, to be untrue or misleading ...

Section 17536(a) of the FAL provides that anyone who violates section 17500 shall be liable for a “civil penalty not to exceed two thousand five hundred (\$2,500) for each violation.” The other cause of action is based on section 1770(a)(13) of the CLRA, which provides in relevant part:

The following unfair methods of competition and unfair or deceptive acts or practices undertaken by any person in a transaction intended to result or which results in the sale ... of goods ... to any consumer are unlawful:

...  
(13) Making false or misleading statements of fact concerning reasons for, existence of, or amounts of price reductions.

The above substantive provisions are also the basis for asserting violations of the “unlawful prong” of section 17200 of the UCL, and, in addition, the People allege that all of the underlying conduct gives rise to a claim under the “unfair prong” of the UCL.

76. Significantly in both the FAL and the CLRA the key language regarding the kind of advertising statements that are actionable is framed in the disjunctive: “untrue or misleading” in the FAL context and “false or misleading” in the CLRA. Given the derivative nature of the “unlawful prong” of the UCL and the breadth of the “fraudulent” and “unfair prongs,” the same may be said of that statute. The three statutes are thus, at least in this respect, co-extensive. (See, e.g., *Committee on Children’s Television v. General Foods Corp.* (1983) 35 Cal.3d 197, 212 [comparing, inter alia, FAL and UCL]; *Nagel v. Twin Laboratories, Inc.* (2003) 109 Cal.App.4<sup>th</sup> 39, 51-54 [comparing UCL and



CLRA].) In short, on the face of each of the three statutes, an action may be based on statements that are simply false or on statements that, although literally true, are “misleading.” (*Committee on Children’s Television*, supra; *Nagel*, supra.)

77. With respect to the “misleading prong,” all parties agree that what is misleading must be considered in light of the “reasonable consumer” rather than in terms of what might be misleading to the least sophisticated or most gullible consumer. (*Lavie v. Proctor & Gamble Co.* (2003) 105 Cal.App.4<sup>th</sup> 496, 506-507); see also *Quin Quelimane Co. v. Stewart Title Guaranty Co.* (1998) 19 Cal.4<sup>th</sup> 26, 55.) This “reasonable consumer” standard applies under all three statutes. (*Committee on Children’s Television*, supra, 35 Cal.3d at 212 [FAL and UCL]; *Chern v. Bank of America* (1976) 15 Cal.3d 866, 876 [UCL]; *Colgan v. Leatherman Tool Group, Inc.* (2006) 135 Cal.App.4<sup>th</sup> 663, 680 [CLRA].)

78. Based on the foregoing (and subject to the discussion of the “harm issue” below), on an FAL claim the People must prove that Overstock’s use of ARPs on its website (a) was intended to induce consumers to purchase advertised items, (b) contained statements that were either untrue or misleading, and (c) were either known to be untrue or misleading or by the exercise of reasonable care should have been known to be untrue or misleading. With respect to the CLRA cause of action, the People must prove that Overstock’s use of ARPs on its website (a) contained statements of fact concerning the reasons for, existence of, or amounts of price reductions and (b) such statements were either untrue or misleading. On the UCL claim, the People must simply prove either a violation of the FAL or CLRA or that the advertising is otherwise actionable under the “unfair prong” of the UCL.

## B. The Disputed Legal Issues

### (i) Whether “Harm” Is Necessary Element

79. The defense argues that, despite the repeated use of the disjunctive in the relevant statutes, falsity alone cannot support a claim under any of these statutes and that there must be some harm, such as the likelihood of consumers being misled. The argument is based on California cases that often state “it is only necessary to show that ‘members of the public are likely to be deceived’” (see, e.g., *Committee on Children’s Television*, supra, 35 Cal.3d at 211) and the recent Supreme Court case of *United States v. Alvarez* (2012) \_\_\_ U.S. \_\_\_, 132 S.Ct. 2537, which the defense maintains requires an element of harm rather than mere falsity. The court rejects that first of these arguments because such statements are found in the context where the cases are explaining why actual falsity is not a necessary element of a false advertising claim. In that context it is “only necessary” to show consumers are likely to be deceived, but that does not mean that where actual falsity is shown one must also prove likelihood of deception or actual harm. Such a construction would read half of the disjunctive language out of the statutory schemes.

80. Turning to the *Alvarez* argument, the defense argues that this case changes the constitutional landscape in which these kinds of claims must be viewed. In *Alvarez* the Court addressed a facial, constitutional challenge to a statute that criminalized making a false claim that one had been awarded the Congressional Medal of Honor. The plurality opinion noted that the statute on its face applied to any such false statement in any context and was thus unprecedented in its sweep, and in this respect it distinguished the statute from government regulation of “false claims ... made to effect a fraud or

secure moneys or other valuable consideration.” (132 S.Ct. at 2547.) The plurality went on to apply a strict scrutiny test under which the government is required to show that the statute is “the least restrictive means available” to achieve the legislative purpose. (*Id.* at 2549-2551.) The concurring opinion reached the same result but, instead of taking a categorical approach, applied an “intermediate scrutiny” or “‘proportionality’ review.” (*Id.* at 2551-2552.) Like the plurality, the concurrence reviewed a number of common law and statutory contexts in which the making of a false statement is unlawful – e.g., common law defamation, fraud, perjury and trademark infringement statutes. (*Id.* at 2553-2555.) The concurrence was clear, however, that the circumstances listed were not an exhaustive list and stated the principle somewhat more broadly than the defense here would argue:

While this list is *not exhaustive*, it is sufficient to show that few statutes, if any, simply prohibit without limitation the telling of a lie, even a lie about a particular matter. Instead, in virtually all these instances limitations of context, requirements of proof of injury, *and the like*, narrow the statute to a subset of lies *where specific harm is more likely to occur*.

(*Id.* at 2555 [emphasis added].)

Significantly, the above passage does *not* say proof of injury is required. Rather there must be “limitations of context” *or* “requirements of proof of injury” *or* other measures that narrow the scope of the prohibition to specific circumstances “where specific harm is more likely to occur.” The last of these phrases does not suggest that *evidence* of actual harm *or evidence* of likelihood of harm is constitutionally required as part of a party’s case-in-chief. Instead, it indicates that the legislative branch of government may adopt prohibitions directed at categories of false speech that are likely to cause harm, and, when the legislature does so, the judicial branch may review the legislation to balance the harm

the statute seeks to reduce against the attendant burden imposed in order to assess whether the measure “works disproportionate constitutional harm.” (*Id.* at 2555-2556.)

81. In assessing whether a statute “works disproportionate constitutional harm,” one of the relevant factors is whether the statute addresses commercial speech. While commercial speech is entitled to constitutional protection, the First Amendment “does not prohibit the State from insuring that the stream of commercial information flow cleanly as well as freely.” (*Virginia Bd. Of Pharmacy v. Virginia Citizens Consumer Council, Inc.* (1976) 425 U.S. 748, 771.) In *Central Hudson Gas & Elec. Corp. v. Public Serv. Comm’n of N.Y.* (1980) 447 U.S. 557, the Court expanded on how in light of the State’s legitimate interest one should analyze the regulation of commercial speech: “The First Amendment’s concern for commercial speech is based on the informational function of advertising .... Consequently, there can be no constitutional objection to the suppression of commercial messages that do not accurately inform the public about lawful activity. The government may ban forms of communication more likely to deceive the public than to inform it.” (*Id.* at 563.) The *Central Hudson* Court went on to explain that “[i]f the communication is neither misleading nor related to unlawful activity, the government’s power is more circumscribed,” in which case a stricter examination is triggered. (*Id.* at 564.) It is this latter, stricter standard that one sees applied in slightly different ways by the plurality and concurring opinions in *Alvarez*.

82. The court concludes from the above that neither the plurality nor concurring justices in *Alvarez* intended to change the long-standing principles governing the State’s power to regulate commercial speech. Such speech is entitled to First Amendment protection, but given the “informational function” of commercial speech, the

State may prohibit advertising that is either false or misleading. A statute reflecting that exercise of the State's power is constitutional, and *Alvarez* cannot be read as requiring that the State must prove actual harm every time it attempts to enforce a statute prohibiting false or misleading advertising. To try to import that element into existing false advertising statutes would conflate the rationale for allowing a State to adopt such laws with the elements the State must prove at trial. Put another way, the First Amendment protects "the informational function of advertising" and thus the State bears a heavy burden if it seeks to regulate truthful advertising that is not in some way misleading. But where the State bans only advertising that is "untrue or misleading," no evidence of actual harm is required in any given case. (See *People v. Dolezal* (2013) 167, 173 & fn. 3 (a post-*Alvarez* case applying the traditional *Central Hudson* analysis to commercial speech.)

83. The foregoing is consistent with long-standing California law. As stated by our Supreme Court in *Kasky v. Nike, Inc.* (2002) 27 Cal.4<sup>th</sup> 939, 951, the UCL and FAL "prohibit 'not only advertising which is false, but also advertising which [,] although true, is either actually misleading or which has a capacity, likelihood or tendency to deceive or confuse the public.' (*Leoni v. State Bar* (1985) 39 Cal.3d 609, 626.)." The *Kasky* court then reviewed *Central Hudson* and noted its rule that, for commercial speech to be protected under the First Amendment, "*it at least must concern lawful activity and not be misleading*" (*id.* at 952 [italics original]) and where it fails this threshold criteria there is no requirement that one go further and apply the additional tests established by *Central Hudson* and most recently applied in *Alvarez*. The *Kasky* court then cited *In re R.M.J.* (1982) 455 U.S. 191, 203, for the proposition that "commercial

speech that is false or misleading is not entitled to First Amendment protection and ‘may be prohibited entirely,’” and *Bolger v. Youngs Drug Products Corp.* (1983) 463 U.S. 60, 69, for the observation that “[t]he State may deal effectively with false, deceptive, or misleading sales techniques.” To “deal effectively” with such false advertising, California has banned advertising that is either false or misleading without proof that the ad in question actually misled anyone. This means that “[t]he primary evidence in a false advertising case is the advertising itself.” (*Brockey v. Moore* (2003) 107 Cal.App.4<sup>th</sup> 663, 679.) No consumer survey or other extrinsic evidence of actual consumer confusion or other harm is required. (*Id.* at 99; *Colgan*, *supra*, 135 Cal.App.4<sup>th</sup> at 672; *Consumer Advocates v. Echostar Corp.* (2003) 113 Cal.App.4<sup>th</sup> 1351, 1362.)

84. For the above reasons, this court concludes that, if the People introduce evidence that an advertisement contains statements that are not true, then it has carried its burden and need not provide additional evidence that consumers were in fact harmed by the false statements in the ads. In other words, consumer “harm” from advertisements shown to be false *or* deceptive *or* misleading is a valid legislative presumption and that presumption is sufficient to protect a statute banning such advertisement from any First Amendment challenge. The court therefore rejects Overstock’s attempt to inject “harm” as an element the People must prove.

(ii) The “Misleading” Standard

85. With respect to the “misleading prong” of these statutes, the People rely on cases that define this element in terms of “the capacity, likelihood or tendency to deceive or confuse the public” (see, e.g., *Kasky*, *supra*, 27 Cal.4<sup>th</sup> at 951; *Leoni*, *supra*, 39 Cal.3d at 626), while the defense relies on cases that refer to this element more narrowly

as requiring that the challenged advertising must be “likely to deceive” the consumer. (See, e.g., *Chern*, supra, 15 Cal.3d at 876; *Barquis v. Merchants Collection Assn.* (1972) 7 Cal.3d 94, 111.) The defense further argues that this latter formulation “implies more than a mere possibility that the advertisement might conceivably be misunderstood by some few consumers viewing it in an unreasonable manner. Rather, the phrase indicates that the ad is such that it is probable that a significant portion of the general consuming public or of targeted consumers, acting reasonably in the circumstances, could be misled.” (*Lavie*, supra, 105 Cal.App.4<sup>th</sup> at 508.) Further, the defense would argue that this requires that, where the “misleading prong” of these statutes is used, the People must introduce affirmative evidence – i.e., a survey – that shows a significant portion of the general consuming public would be misled.

86. The court disagrees. As discussed in the context of *Overstock’s* constitutional challenge, proof of actual harm is not required. A state may ban commercial advertisements that are false, deceptive or misleading without violating the First Amendment and, in doing so, may presume harm from the fact that an ad is false, deceptive or misleading. This means that “[t]he primary evidence in a false advertising case is the advertising itself” (*Brockey*, supra, 107 Cal.App.4<sup>th</sup> at 679), and no consumer survey or other extrinsic evidence of actual consumer confusion or other harm is required. (*Id.* at 99; *Colgan*, supra, 135 Cal.App.4<sup>th</sup> at 672.) Rather the trier of fact may look at the ad and determine whether on its face it is misleading or has the capacity to mislead a reasonable consumer. A survey may inform that evaluation, but it is not required.

87. Thus, for example, in *Colgan* the issue was whether advertising “Made in USA” violated the UCL, FAL and CLRA because a significant number of a product’s components were substantially made abroad. The appellate court affirmed the trial court’s granting of plaintiffs’ motion for summary judgment where it had examined the advertising itself and considered what a reasonable consumer would infer from “Made in USA.” From its examination of the ad alone, the trial court had concluded as a matter of law that the “Made in USA” representation was deceptive because a reasonable consumer would not expect a significant portion of the component parts of the item to be manufactured abroad. (*Id.* at 682-683.) No consumer survey or other extrinsic evidence was presented by plaintiffs. The *Colgan* case and authorities on which it relied clearly illustrate that these statutes empower the trier of fact to look at the words in an advertisement and decide what a reasonable consumer would take from those words. There need not be proof that actual consumers were in fact misled in the way alleged by plaintiffs; rather the trier of fact may decide if the ad has the *capacity* to deceive.

(iii) The “Unfair Prong” of the UCL

88. As for the “unfair prong” of the UCL, which is pled in the Fifth Cause of Action, there is a split of authority as to the proper standard to apply to consumer cases arising under the “unfair prong” of the UCL. (*Drum v. San Fernando Valley Bar Assoc.* (2010) 182 Cal.App.4<sup>th</sup> 247, 256-257.) One line of cases pre-dates *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal.4<sup>th</sup> 163, and continues to employ a traditionally broad standard that looks to whether the alleged business practice “is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers and requires the court to weigh the utility of the defendant's



conduct against the gravity of the harm to the alleged victim.” (E.g., *Bardin*, supra, 136 Cal.App.4<sup>th</sup> at 1260; *Davis*, supra, 179 Cal.App.4<sup>th</sup> at 594-595; *Ticcono v. Blue Shield of California Life & Health Ins. Co.* (2008) 160 Cal.App.4<sup>th</sup> 528, 539.) A second line of cases reads *Cel-Tech* as substantially narrowing the “unfair prong” even in consumer cases so as to require one to look to the definition of “unfair” in section 5 of the Federal Trade Commission Act (15 U.S.C. § 45, subd. (n)) (“FTC Section 5”). This approach requires that “(1) the consumer injury must be substantial; (2) the injury must not be outweighed by any countervailing benefits to consumers or competition; and (3) it must be an injury that consumers themselves could not reasonably have avoided.” (*Davis*, supra, 179 Cal.App.4<sup>th</sup> at 597-598; *Camacho v. Automobile Club of Southern Calif.* (2006) 142 Cal.App.4<sup>th</sup> 1394, 1403.)

89. The third – and in this court’s view the most persuasive – line of cases is somewhere in between and is exemplified by the First District decision in *Gregory v. Albertson’s, Inc.* (2002) 104 Cal.App.4<sup>th</sup> 845, 854. There *Cel-Tech* was read as rejecting the traditional balancing test previously applied by appellate courts and signaling “a narrower interpretation of the prohibition of unfair acts or practices in *all* unfair competition actions” because “the broad language in earlier decisions [was found in *Cel-Tech*] to be ‘too amorphous.’” (*Id.* at 394-395.) The *Gregory* court thus concluded that “where a claim of an unfair act or practice is predicated on public policy, we read *Cel-Tech* to require that the public policy which is a predicate to the action must be ‘tethered’ to specific constitutional, statutory or regulatory provisions.” (*Ibid.*) Under this third line of authority, FTC Section 5 might provide such “tether” but that is not the exclusive source for such analyses.

90. It appears that this third approach is gaining traction. (See, e.g., *Aleksick v. 7-Eleven, Inc.* (2012) 205 Cal.App.4<sup>th</sup> 1176, 1192-1193; *Durell v. Sharp Healthcare* (2010) 183 Cal.App.4<sup>th</sup> 1350, 1366; *Textron Financial Corp. v. National Union Fire Ins. Co.* (2004) 118 Cal.App.4<sup>th</sup> 1061, 1072; *Byars v. SCME Mortgage Bankers, Inc.* (2003) 109 Cal.App.4<sup>th</sup> 1134, 1147; *Schnall v. Hertz Corp.* (2000) 78 Cal.App.4<sup>th</sup> 1144, 1166.) By adopting this approach, if the UCL claims here are to reach anything *beyond* that encompassed by the first four causes of action, this court would expect the People to show some specific constitutional, statutory or regulatory provision *apart from* the FAL or CLRA that would guide the court's determination of "unfairness."

(iv) The Statute of Limitations Defenses

91. It is agreed that the parties entered into a tolling agreement effective March 24, 2010, but the parties dispute what statute of limitations applies to each cause of action and when that statute began to run. The People allege that the relevant limitation periods are three years for the FAL claims in the First, Third and Fourth Causes of Action (C.C.P. §338(h)) and four years for the UCL claims in the Second and Fifth Causes of Action (Bus. & Prof. Code §17208) and that these periods began to run no earlier than the receipt of the Ecenbarger complaint in July 2007. The defense argues that the statutes began to run at least as early as the publication of the Business Week article in 2004 and that, with respect to any and all claims for civil penalties, the one year statute in Code of Civil Procedure section 340(b) applies.

92. In addressing whether the three and four year limitations specified in the FAL and UCL apply or – at least as to the penalty portion of the causes of action – whether the one year limitation in section 340(b) applies, the court must resolve the

possible inconsistency between subsections 340(a) and (b). The former provides for a one year limit in an action “upon a statute for penalty or forfeiture, if the action is given to an individual, or an individual and the state, except if the statute imposing it prescribes a different limitation,” while the latter states *without any express exception* that the one year limitation applies to an action “upon a forfeiture or penalty to the people of this state.” At first glance, subsection (b) appears to swallow up the exception in subsection (a); however, on closer examination the two can be harmonized by construing section 340(b) to apply where the cause of action is given *only* to the people. Causes of action that are given to *both* an individual and the state come within section 340(a), which in turn allows one to consider whether the underlying statute itself provides a different limitations period.

93. Here the UCL cause of action is given both to an individual and the state, and thus per the express language of section 340(a) the four year period in section 17208 clearly governs rather than the one year in section 340(b). Similarly, section 17535 of the FAL expressly allows for a private right of action, and there are numerous examples of private parties bringing actions under both statutes. (E.g., *Committee on Children’s Television*, supra; *Nagel*, supra.) Accordingly, section 340(a) also applies to the FAL claims, and the three year statute in section 338(h) governs. As to both the UCL and the FAL, this also comports with the general principle that “[w]here more than one statute might apply to a particular claim, a specific limitations provision prevails over a more general provision.” (*E-Fab, Inc. v. Accountants, Inc. Svcs.* (2007) 153 Cal.App.4<sup>th</sup> 1308, 1316.) The defense cites *Gabelli v. S.E.C.* (2013) \_\_\_ U.S. \_\_\_, 133 S.Ct. 1216, 1218, to argue that the stricter one-year limitations period in section 340(b) should apply at least

with respect to the civil penalties provisions in the statutes. The use of *Gabelli* to advance a policy argument cannot overcome the express provisions of the governing statutes and controlling California authorities.<sup>19</sup>

94. As for when these causes of action accrued, the court rejects Overstock's arguments for an accrual date earlier than the Ecenbarger incident. The Business Week article did not trigger the statute for at least two reasons. First, a report of inflated ARPs does not put the reader on notice of the underlying practices challenged in this case – e.g., the use of formulas and similar products to set ARPs, the selection of the highest price as the ARP even when that price does not reflect “street price,” etc. A reader of the article could as easily infer that Overstock's processes were error prone rather than a reflection of a systematic violation of the FAL. Second, and more importantly, law enforcement authorities cannot be held to be “on notice” for statute of limitations purposes of every issue reported anywhere in the press. Such a rule would place an intolerable burden on enforcement authorities and potentially give a “pass” to any person or business that ever attracted the slightest public attention without triggering an investigation.

95. Alternatively, the defense argues that Overstock's use of “list price” and other ARP nomenclatures – as well as the use of such terms by its competitors – has been open and notorious for years prior to the commencement of this action and sufficient to put the People on notice of Overstock's practices so as to trigger the running of any

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<sup>19</sup> To the extent the defense argues for a construction that would at least bring the FAL claims within the one year statute, in the larger picture such a result would not matter because, even if the one year statute applied to an action to recover FAL civil penalties, all of the underlying conduct is covered by the UCL in one cause of action or another. Thus the four year statute governing the UCL claims is applicable to all the challenged conduct, and it does not matter if one might argue that the FAL standing alone could only reach back one year.

statute of limitations. The problem with this argument is that it is one thing to say that the use of the “list price” label and other ARP terms was open and notorious, but it is quite another to say that it was common knowledge that Overstock used formulas to set list price, set ARPs based on similar products or used the highest prices it could find for its ARPs. These particulars are what this case is about – not the generic use of ARPs.<sup>20</sup> The court therefore rejects this alternative argument for an early accrual date for the applicable statute(s).

96. Furthermore with respect to both lines of argument, it is important to note that daily advertising is a recurring event. Every time an unlawful advertisement is posted, the statute is violated. Thus, for example, the Business Week article might arguably have commenced the running of a statute for ads published as of that date, but it is nonsensical to suggest that such notice would bar an action based on any future publication of the same ad. Any other interpretation might give a merchant who was the subject of such publicity a defense to a subsequent enforcement action while all its competitors engaged in the same practice would be exposed to prosecution. That possible scenario illustrates the fallacy of the defense position and the reason why this is a classic example of the continual accrual doctrine. (See *Aryeh v. Canon Business Solutions, Inc.* (2013) 55 Cal.4<sup>th</sup> 1185, 1198.)

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<sup>20</sup> This point also addresses the argument Overstock makes in other contexts that all of its online competitors use ARPs and there is something “unfair” about being singled out for an FAL enforcement action. While “everyone does it” has never been a defense to a FAL action, the more important point is that there is no evidence that it is “industry practice” to use formulas or similar products to set ARPs without any effective disclosure of the practice. There is also scant evidence that Overstock’s use of the highest price it can find as an ARP is the common practice among its competitors. And, again, even if that were true, the People may choose to start its enforcement efforts with Overstock and then move on to others in the industry – e.g., those identified by Steckel as having higher ARPs than Overstock.

## V. ANALYSIS OF THE LIABILITY ISSUES

### A. The Pricing Claim

97. The court starts with the Pricing Claim and the proposition that the underlying statute requires proof that the statement in question be either untrue or misleading. The People allege in the Complaint that several aspects of Overstock's advertising and use of ARPs satisfy one or both prongs. Each of the alleged practices needs to be analyzed under each prong and with reference to the nomenclature used and the related policies during the relevant time period.

#### (i) The "False Prong"

98. Turning first to the practices during the Compare At and Compare Eras, the court notes that each of the nomenclatures used during these times is based on a verb – “compare” – and invites the consumer *to do something*, namely, look at another product and price. Nothing is explicitly stated regarding the referenced product or price, and thus on its face the use of those terms is incapable of being “untrue.” If the People are to maintain a claim based on this nomenclature, the claim must be based on the “misleading prong” of the underlying statutes.

99. The analysis is different, however, when one considers the term “list price.” Obviously the phrase does not contain a verb; the use of the term with an associated number is a factual representation and, as such, is capable of being true or false. To the extent that the ARP is not an actual “list price” but either an estimate of one based on a formula or a reference to a price of a different item – that is, a non-identical product – it is a false representation because it is not the actual list price for the product

being sold. Every time Overstock displayed a list price based on a formula or a similar product rather than the list price established by the manufacturer, distributor or other supplier of that identical product it made an untrue statement. Such a statement was “untrue” because there was *no* list price.<sup>21</sup> Because that statement was untrue, all derivative representations – e.g., the amount of the so-called list price, the “You save” amount and/or the “You save” percentage – were also untrue.

100. In this court’s view all such untrue statements are actionable under the FAL. As previously discussed, the defense objects to this conclusion on the ground that there must also be a showing of harm and that the statute is the least restrictive means of guarding against that harm. If by this argument the defense means to impose a new or implied element to that plain language of the statute to preserve its constitutionality after *Alvarez*, the court disagrees. For reasons previously discussed (see Part IV B (i), *supra*), the statute reflects a legislative judgment that untrue statements in advertising are inherently harmful and enforcement authorities (as opposed to private plaintiffs seeking damages) do not need to introduce proof that consumers were harmed. This is especially the case where the untrue statement is about price, the ARP or the amount of the “savings” – all of which may be viewed as “material” by definition in any commercial transaction. Rather than reflecting an expansion of government regulation of speech, state and federal statutes have long prohibited “untrue” statements in advertising, and for the reasons previously discussed, this court does not view *Alvarez* as undermining those

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<sup>21</sup> The definition of “list price” one could find by clicking on the hyperlink found by scrolling over the term on the webpage does not change this analysis. When asked during closing argument, even Overstock conceded that the hyperlink to a definition could not serve as an adequate “disclaimer” so as to protect the use of the term. The issue of disclaimers is thus not addressed herein. (But see authorities cited in 9/4/13 People’s Bench Brief re Irrelevancy of [Various Defense] at 3-4.)

statutes or the substantial body of authority upholding their application in contexts similar to the case at bar.

101. Furthermore, if a showing of “harm” were required, the court finds there is sufficient evidence in this record that the use of the “list price” nomenclature misled consumers and certainly had the capacity to mislead them. Such evidence is found in the Steckel survey results where a substantial percentage of respondents viewed the term “list price” as reflecting a “regular/average price” rather than a higher price. (Trial at 1519-1524.) While this survey evidence does not directly address the use of formulas to determine “list price,” the use of such formulas was a subset of the Overstock’s policies during the List Price Era that were all designed to lead to the highest possible ARP. The result of that approach was to mislead consumers who viewed that term as reflecting a “regular/average price,” and thus one may infer that the use of formulas to set high ARPs had the capacity to mislead and did mislead consumers. This conclusion is supported, *inter alia*, by the contemporaneous internal email traffic detailed in the People’s case (see ¶¶18, 27, 32-33, *supra*), the consumer testimony and comments (see ¶¶23, 25, 35, 38, *supra*) and admissions such as that by King that the use of formulas to set ARPs led to “arbitrary” reference prices (¶36, *supra*).

102. As for Steckel’s opinion that Overstock’s use of ARPs did not cause any actual harm because of the miniscule impact on conversion rates, the court rejects the notion that a company-wide 1% increase in conversion rate is insufficient proof of harm to support a cause of action. First, this figure is most likely substantially diluted because the majority of Overstock products – 90% according to its CEO – are in the commodity BMMG category, while the practices at issue are primarily in other categories (e.g.,



jewelry, furniture, etc.) where Overstock serves as an outlet for its partners. Formulas and the use of similar products did not arise in the BMMG category because all such products have discrete SKUs that lead to ready comparisons – even without an ARP – to real prices for the identical items on sites like Amazon. The practices at issue here (the use of formulas, similar products and the highest market price as a reference) were more characteristic of partner products and yet the 1% conversion rate was not isolated to those products. Further, Moore conceded that, while the results of his “third test” were not accurate metrics of the various conversion rates in absolute terms, those results did reflect the *relative* impact of ARPs in different product lines – again, corroborating the conclusion that in some product categories the impact was larger than 1%.<sup>22</sup>

103. In addition, to focus on the change in conversion rate during a two week experiment misses the larger picture: Overstock recognized that “the best predictor of whether a customer returns to our site is whether they feel they have ‘received a good deal.’” (Exh. 403.) Compeau referred to this as “transaction value” and Steckel referred to it as “transactional utility.” Compeau testified that the consumer’s perception of both acquisition and transaction value increases as ARP increases relative to the purchase price. (Trial at 282-283.) Thus one of the advantages Overstock gained from inflated ARPs was to increase consumer perception of transaction value and thereby increase the likelihood that they will return to Overstock. Even if the A/B tests conducted by Moore accurately captured the relatively small size of the “bump” engendered by the use of

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<sup>22</sup> As for Moore’s A/B test on the MSRP nomenclature in 2011, the court is skeptical of the results because MSRP appears to have been a label used more often in the BMMG category rather than with furniture, jewelry and certain other products where it appears from this record that the challenged ARP practices were more problematic. While the record could be clearer on the latter point, Moore’s observation based on the Test 3 data that the impact on conversion rate varied by category makes it difficult to see his test of MSRP products as probative without some analysis of the product categories covered and the variation (if any) among those categories.

ARPs compared to products where the ARP was removed, those tests do not reflect the benefit Overstock had received from the prior use of inflated ARPs over an extended period of time or the benefits from that history going forward; nor do the Moore tests measure what Compeau's research and review of the literature identify as the resulting reduction in search intentions. (Trial at 265-268.) While Steckel may be correct that the frequency of comparative shopping online has increased over time, such an observation does not negate the likelihood that consumers' comparative shopping patterns may have been reduced by Overstock's inflated ARPs.<sup>23</sup> In short, the supposed 1% impact on conversion rate does not fully capture the influence of ARPs or the harm that may be caused by inflated ARPs.

104. Perhaps most importantly, though, a 1% increase in conversion rate is viewed as a "home run" by a retailer like Overstock (Trial at 916) and the *raison d'être* for using ARPs. A "bump" from such advertising techniques that is considered so significant to a retailer cannot be easily dismissed as legally insufficient for purposes of a State's false advertising statute, especially when it reflects a very substantial volume of sales to thousands of California customers. At the end of the day, the clear weight of the evidence – from the internal email traffic, the Communispace evidence of consumer reaction to the temporary removal of ARPs, Compeau's recital of the literature on ARPs

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<sup>23</sup> Moore and Steckel also placed reliance on data showing that visitors to the Overstock site frequently come from or leave to other internet shopping sites and would argue from this that consumers these days place less reliance on ARPs, preferring to do their own price comparisons with readily available and recently enhanced tools. The court discounts that data because there is no way to distinguish in the data which visitors are real shoppers versus automated programs "scraping" prices and other data from the Overstock and other sites. Moreover, even with a "consumer visitor," there is no way to determine whether the pattern reflects comparative shopping for the same product or moving down the "shopping list" to search for new items. Further, even if the consumer visitor is doing comparative shopping for the same item, one cannot determine from the Moore data whether the presence or absence of ARPs *reduces* the extent of the consumer's comparative shopping exercise. Finally, while many consumers may be actively engaged in comparison shopping, the Moore data certainly does not show that all consumers do so. Thus if only *some* reasonable consumers believe Overstock's ARPs and rely on them, there is actual harm.

and the myriad ways they influence consumers, Moore's conversion rate data showing a company-wide "bump" from the use of ARPs with higher impacts in some categories, Steckel's July 2013 experiment and survey indicating consumer expectations regarding ARPs reflecting "regular/average prices," and Overstock's clear commitment to the use of ARPs to drive sales – indicates that ARPs matter and thus any confusing or misleading features of Overstock's use of ARPs has the capacity to mislead consumers and in fact did so. Harm has thus been shown.

(ii) The "Misleading Prong"

105. To prove the misleading element in the use of the verb "compare" (and "compare at"), the People rely on the proposition that consumers perceive that when retailers use that term the reference is to the "prevailing market price" for the identical product rather than to some higher price such as list price, MSRP or the "high street price" or to a "similar product." They therefore argue that the use of the "compare" terminology is misleading when the ARP is based on the highest price that may be found anywhere in the market and/or to a "similar product." While the case-in-chief included no survey evidence to support this position, the People argue that the ads themselves support such an inference – especially when the display of the ARP is accompanied by a "You save" amount or percentage. This latter representation, it is argued, would lead a reasonable consumer to infer that he or she is actually "saving" the amount or percentage displayed by buying "today" as opposed to elsewhere in the marketplace. This basic proposition implicit in the structure of the advertisement is said to be sufficient to support a finding that this kind of advertising has the capacity to mislead or confuse reasonable consumers.

106. With respect to the prevailing market price issue, the court is somewhat skeptical of the People's basic proposition or its sufficiency to support their case. Put simply, the inference the People would have the court draw is not as obvious as that supporting summary judgment for the plaintiff in *Colgan*. In contrast to the phrase "Made in USA," the term "compare" coupled with a price does not so clearly imply "prevailing market price" as the "Made in USA" slogan implies manufactured completely in the United States. On the other hand, the People's position draws unexpected support from some of the Steckel survey data and in particular the widespread consensus among respondents that the various ARP nomenclatures used in his July 2013 experiment reflect some version of "regular/average price" rather than a higher price or the highest price that could be found. (Trial at 1519-1524.) This data suggests that, whatever the ARP nomenclature, there may indeed be something misleading in basing ARPs on the highest price Overstock or its partners can find in the marketplace.

107. The difficulty with accepting this evidence as sufficient to support the People's entire case is that the Steckel data also supports the inference that the particular nomenclature may not matter and, whatever the nomenclature, there is a wide range of consumer interpretations of the various ARP nomenclatures' meanings. Moreover, while use of the highest price that can be found may be misleading, it is hard to derive any workable definition of the People's preferred standard: "prevailing market price." Is that the nonsale price found at most brick-and-mortar retail outlets? Or the sale price? Or is it the nonsale price one can find on the internet? Or the sale price? If the internet sites are the relevant reference, at which internet site, if as is frequently the case the internet prices reflect a range? Should the one reflecting the highest volume of sales be used? If

so, how can one determine the volume of a particular product sold at a third-party's website? The Steckel data shows a lack of any consumer consensus on the meaning of *any* ARP nomenclature. One might infer from such findings that *any* use of ARPs based on *any* definition is likely to confuse or mislead a significant number of consumers because they all bring different experiences and expectations to the Overstock site. From such a cacophony one might argue either that the use any ARP is misleading or that the FAL should not reach any of the possible uses.

108. To ban the use of all ARPs would be an over-reaction to the data and clearly frustrate the many consumers who want ARPs. (E.g., Exh. 427.) Further, given the “informational function” of advertising that supports the First Amendment protection such speech does enjoy, banning comparative advertising because of its potential to confuse some consumers might be a constitutional over-reach as well. Yet the FAL requires that some boundaries be set because the evidence in this case clearly shows that unfettered use of ARPs does mislead consumers – a significant number of whom believe ARPs reflect “real prices” or “regular/average prices” rather than prices that are higher than “regular/average prices.” The court concludes that the FAL and the UCL are flexible enough to allow the People to challenge ARPs that frustrate reasonable consumer expectations by using formulas to set ARPs rather than “real prices” and/or by basing ARPs on “similar” products without effectively disclosing that the comparison is to a non-identical item. To some extent these statutes may also be used to curb the practice of using the highest price that can be found to set ARPs without regard to the widespread availability of lower prices at retail and other online outlets.

109. With respect to the use of formulas or similar products to set ARPs, the court finds such practices to be misleading or to have the capacity to mislead consumers as those terms are used in the FAL, UCL and CRLA. This finding of fact is based on several factors. First, the advertisements themselves suggest a comparison to real prices for the identical product when unaccompanied by qualifiers that would signal the use of a formula (e.g., “compare estimated value”) or a similar product (e.g., “compare similar”). Second, the Steckel July 2013 experiment and survey results suggest that, while consumers have varying views of different ARP nomenclatures, with respect to any particular nomenclature, a significant portion of consumers view the given label as reflecting a “regular/average price.” (See ¶72, supra.) Implicit in that assumption for an appreciable number of consumers is that one is looking at the same product rather than an estimated price or a price for a “similar” product. Third, to allow the use of formulas or similar products without any disclosure invites abuse, and examples of such abuse are found in this record. (E.g., ¶¶17-18, 30, supra; Exh. 382, 383.) Fourth, as already noted, there are qualifiers that can easily be inserted into the nomenclature to signal the nature of comparison – e.g., “compare similar” – and given the “informational function” of advertising that supports its First Amendment protection, it is hard to see why it is unreasonable for the State to apply its statutory ban on misleading advertising so as to require more accurate reference terms.

110. With respect to the practice of using the highest available price as the ARP instead of the “prevailing market price,” the application of the statute is more difficult for several reasons. First, as already noted, the People’s preferred standard – “prevailing market price” – is not easily applied and could create such a legal hazard to retailers that

a prudent merchant would avoid ARPs altogether. That would be unfortunate as even Compeau agrees ARPs can provide useful information, consumers appear to want them (e.g., Exh. 427) and their “informational function” has constitutional significance. Second, some ARP terms such as MSRP may be higher than whatever one views as the prevailing market price but nonetheless convey relevant information (e.g., Ecenbarger’s testimony that suggested or initial prices communicate relative quality and similar evidence from Bride) and are readily ascertainable and easy to update so as to maintain accuracy. To require all ARPs to be based on some definition of “prevailing market price” may be over-restrictive and unnecessary to reduce potential consumer confusion. Third, as illustrated by Steckel’s survey of consumer views as to the meaning of different ARP nomenclatures, it is probably impossible to eliminate all potential for confusion.

111. With these considerations in mind, the court finds that it is misleading to set ARPs based on the highest price that can be found without regard to the prevailing market price *and* without any disclosure of the practice. That finding is based, *inter alia*, on the Steckel July 2013 experiment and survey and the other evidence of harm cited in the previous section. Thus if a retailer uses the highest price it can find for an ARP, it should disclose that in the nomenclature – e.g., “compare highest retail” or “compare original retail” as the case may be. If the retailer uses MSRP as the ARP, it should disclose that in the nomenclature – e.g., “compare MSRP.” If an online retailer uses non-sale department store prices as an ARP, it should disclose that in the nomenclature – e.g., “compare regular department store.” If, however, Overstock wants to use an unqualified term such as “compare,” then it needs to either use a range of prices that reflect what may be commonly found on the internet (“compare at \$X to \$Y”) or make an effort to identify

and use the prices it finds at one or more of the major online retail sites (e.g., the top online retail sites over all or the top sites for a particular category of trade such as furniture, jewelry, etc.) – in other words, make a good faith effort to identify what Overstock currently refers to internally as the “street price” and tries to beat by 5-to-10%. Overstock’s failure to follow such practices has resulted in ARPs that are misleading or have the capacity to mislead.<sup>24</sup>

112. In sum, the court finds that Overstock has consistently used ARPs in a manner designed to overstate the amount of savings to be enjoyed by shopping on the Overstock site. While Overstock’s prices may have been the lowest available on the internet,<sup>25</sup> it knew that being in fact lower by a factor of, say, 5% was not as powerful as communicating savings of 40-to-60%, that savings of the latter magnitude were important to reduce search intentions, communicate transaction value, build brand loyalty and encourage repeat business. Because Overstock recognized these marketing basics and their long-term utility, it consciously adopted and maintained policies for setting ARPs that it knew would communicate dramatic savings to consumers that were often overstated and therefore actionable under the FAL. For these reasons, the court concludes that the People have proven that Overstock’s use of ARPs was misleading, or had the capacity to mislead reasonable consumers, in the following ways: (a) using formulas to set ARPs prior to the introduction of the validation team process, (b) using

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<sup>24</sup> The foregoing does not address the issue of *time* – that is, how long may Overstock continue to display an originally appropriate ARP? Neither party directly addresses it, but it is obvious that an ARP can become “stale” and in that process misleading. Overstock has adopted a “90-day” policy under which any ARP must be re-validated every 90 days. The People explained at oral argument that, since that period appears in Section 17501 (in a different context), they chose not to contest that policy. Whether 90 days is too long a period is thus not before the court; however, for that reason this Decision cannot be read as finding that leaving ARPs posted for 90 days is lawful.

<sup>25</sup> Overstock introduced testimony to this effect, which the People did not seriously contest because they contend that is not relevant to the FAL analysis. The court agrees with that legal position.



similar products to set ARPs (before and after the introduction of the validation team) without disclosing on the product page that the ARP was based on a comparison to a “similar” product, and (c) using the highest price that could be found as the basis for an ARP without some qualifier that would signal to the reasonable consumer reading the term that the comparison was not to the prevailing market price. An example of such a “signal” would be “compare MSRP,” which would alert the consumer who cared about such details that the comparison was to something other than the prevailing market price.

(iii) Conclusion on First Cause of Action

113. With respect to the statements the court has found to have been untrue or misleading, the other elements of the FAL are also met. The false and/or misleading statements were made over the internet, concerned matters related to the proposed sale of the advertised product(s) and were known to be untrue or misleading or could be known to be such by the exercise of reasonable diligence. Where formulas were used during the List Price Era, it was known that there was no list price. Indeed the policy was to use formulas only in that circumstance. It was thus known to Overstock that the supposed list price was only an estimate but that fact was not disclosed, except in a definition viewed by only an infinitesimal number of visitors to the site. Where a similar product was used, it was known that the list price on the product page was not the list price for that product; further, when similar products were used by the validation team, it was known that the resulting ARPs were for non-identical products and that that fact was not disclosed. At all times, when the highest price was used as an ARP, it was known that that was the company’s policy and practice and that the ARP thus did not reflect the “prevailing” or “regular/average” price of the product in the marketplace and that as a result the

“savings” displayed to the consumer was false or misleading, as the actual savings, if any, were substantially less. Accordingly the court finds for the People on the First Cause of Action.

**B. The Amount of Price Reduction Claim**

114. The foregoing analysis is dispositive of the Second Cause of Action. Whenever Overstock used a formula to set an ARP and also then displayed a “You save” amount or percentage, it made a misleading statement as to the amount (and perhaps the existence) of a price reduction. When the ARP nomenclature was “list price,” the statement was also false for the same reason: the representation that there was a “list price” was false. In other words, where there was no actual list price but only one set by a formula, the statement as to the dollar and percentage amount of the savings from the nonexistent list price was also false. When Overstock’s ARP was based on a “similar” product and then displayed a “You save” amount or percentage, the company made a misleading statement as to the amount (and perhaps the existence) of a price reduction. Whenever Overstock set an ARP based on the highest price it could find for the product, it made a misleading statement as to the amount (and perhaps the existence) of a price reduction. Accordingly, the court finds for the People on the Second Cause of Action on the same grounds as the finding of liability on the previous cause of action.

**C. The Source of Products Claim**

115. The Third Cause of Action has nothing to do with ARPs but rather is based on Overstock holding itself out as a liquidator of distressed merchandise when, over time, it began selling non-distressed merchandise and for the past several years has sold a majority of its merchandise provided by its fulfillment partners rather than from

liquidations or similarly distressed sources. At oral argument the court inquired if by this claim the People were attacking the mere use of the name "Overstock" and sought an injunction requiring that the name to be changed. In response, the People stated they were not attacking the mere name but rather statements on the Overstock website explaining that it was able to offer such great pricing because it was a liquidator.

116. Specifically, the People refer to Exhibit 963, which is a screen shot from the "About Us" page on the Overstock website in 2007. There one finds a question: "How can we offer such great deals?" Below that question are several short paragraphs, which refer, inter alia, to the Overstock's "partnerships with many companies" and states that these "relationships" provide opportunities to purchase at "significant discounts." It goes on to give as examples manufacturers who overproduce certain products, have cancelled orders or may be downsizing and need to reduce inventory. Nowhere on that page is there a disclosure that since about 2004 the "liquidation" portion of its business has been less than 50% overall and declining. The failure to disclose this fact is said to violate the FAL. To support the allegation that this failure has the capacity to mislead consumers, the People cite two consumer statements suggesting that they thought Overstock prices were the lowest because it was a liquidator. No other evidence is presented to support this claim.

117. The problem with this theory is that, apart from the company name, the evidence is extremely thin. There was no attempt to show that the challenged webpage from 2007 was displayed on a continuing basis or that the "liquidator theme" appears elsewhere or is otherwise touted by Defendant. The claims that are made on the cited page are not shown to be untrue and do not reasonably suggest that all of Overstock's

offerings fit within the examples given. There is no evidence as to the frequency of the “hits” on this page and no effort to link the offending page to the two consumer examples cited. Indeed, it would appear that the two consumers were simply commenting on the inferences to be drawn from the “Overstock” name, but the People do not purport to challenge the continued use of that well-established trade name.

118. Based on the evidence presented, the court finds that the evidence offered to support this claim is insufficient. While the People are correct that an FAL claim may be supported by the advertisement alone, in this instance the one webpage cited to support the claim does not appear to be untruthful and, because the cited comments on the page are by way of example, the court concludes that standing alone the comments on that page do not support an FAL cause of action. The court therefore finds for defendant Overstock on the Third Cause of Action.

#### **D. The Shipping Charges Claim**

119. The claim that advertising \$2.95 or “free” shipping when shipping costs had already been factored into the base price is nonsensical. What if one retailer factors shipping into its cost and another doesn't but uses a 20% gross profit margin? If both advertise “free” shipping, has only the former violated the statute? Do the People seriously contend that one can only advertise “free” shipping if the seller takes a loss or persuades UPS to accept its shipments at no charge? Most importantly, is there any evidence or reason to believe that consumers think that no one pays for shipping? The most logical inference by anyone seeing “free” shipping is that the cost thereof has already been factored into the price. It is no different than advertising “shipping included.” Put another way, “free shipping” is not reasonably understood to mean that no

one pays for shipping; rather the most reasonable inference is that there is no additional charge beyond the stated price of the goods being sold. To argue otherwise is analogous to the notion that advertising “Danish pastries” is false unless the pastries being sold are actually made in Denmark. That is not the law. (*Lavie*, supra, 105 Cal.App.4<sup>th</sup> at 507.) No reasonable consumer could believe that “free shipping” means that the shipping is “free” in the sense urged by the People. Accordingly, the court finds for defendant Overstock on the Fourth Cause of Action.

#### **E. The Derivative Claim**

120. As the court finds for the People on the First and Second Causes of Action, the derivative UCL claim based on the underlying violations of the FAL and/or CLRA also are established. As the court finds for Overstock on the Third and Fourth Causes of Action, the Derivative Claim fails to the extent it relies on those causes of action to support the “unlawful” prong of the UCL. The court had thought that the People were nonetheless relying on the “unfair” prong of the UCL to reach conduct that the court determined not to be actionable under the first four causes of action.<sup>26</sup> At oral argument, however, the People stated that they were *not* seeking a liability determination on the Fifth Cause of Action for any conduct not actionable under the other four. The court thus need not push the analysis any further. The bottom line is that the court finds

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<sup>26</sup> For reasons discussed in Part IV B (iii), the court does not view this prong as a license for a trial court to engage in a free form “balancing” exercise that may have been permitted by pre-*Cel-Tech* authorities. Rather the court must “tether” its analysis to a constitutional, statutory or regulatory foundation. Here First Amendment considerations weigh against any constitutional ground, and the statutory possibilities have been exhausted by the FAL and CLRA analysis of the other causes of action. That leaves at least the theoretical possibility of a regulatory basis and, specifically, the possibility that the FTC Guide might provide a basis for the court to find that advertising not violative of the FAL or CLRA might nonetheless be “unfair.” Based on the oral argument, though, the court concludes it need not go there.

for the People on the Fifth Cause of Action to the extent – and *only* to the extent – that it has found for the People on one or more of the other four causes of actions.

## **VI. REMEDY ANALYSIS**

121. The People have requested an injunction, an order awarding restitution to California consumers, an assessment of civil penalties and an award of various costs. The court reviews each of these below, starting with the request for injunctive relief.

### **A. Injunctive Relief**

122. Section 17203 of the UCL and 17535 of the FAL authorize the court to enjoin persons who have engaged in unfair competition. They provide that “[t]he court may make such orders or judgments ... as may be necessary to prevent the use or employment by any person” of practices which violate their respective chapters. (*Ibid.*) While the People seek broad relief framed in terms of requiring all ARPs to be based on the “prevailing market price” of the advertised product (People’s Op. Br. at 44), the court finds that formulation overbroad and vague and one that would be difficult for either the parties or the court to manage. More importantly, it might lead Defendant and others to simply abandon ARPs altogether, which would deprive consumers of information they in fact want. The challenge is thus to frame any relief in terms that will prevent the clear abuses of reference pricing in advertisements and yet provide enough flexibility to allow Overstock to use ARPs in various ways that may serve what *Central Hudson* referred to as the “informational function” of commercial speech.

123. The court concludes that the injunction should prohibit: (a) the use of ARPs based on a formula, multiplier or other method that would set the ARP on any basis other than an actual price offered in the marketplace at or about the time the advertisement is first placed; (b) the use of ARPs based on a similar but non-identical product than the one advertised for sale unless the use of a similar product as the basis for the ARP is disclosed on the product page in a manner reasonably designed to alert consumers – e.g., “compare similar,” “like product at,” “similar product at,” etc.; and (c) the use of the highest price that may be found anywhere to set ARPs without regard to whether the reference price reflects a substantial volume of recent sales unless the basis of such a comparison is disclosed on the product page in a manner reasonably designed to alert readers to the context or nature of the comparison – e.g., “compare MSRP,” “compare department store retail,” “compare original retail price,” “compare at some retailers,” etc.

124. If the ARP nomenclature is an unmodified term such as “compare,” then the ARP must reflect a good faith effort to determine the “prevailing market price” of the identical product. The “good faith effort requirement” shall be deemed to have been met if any of the following criteria are satisfied: (a) the ARP is a range of prices (i.e., \$X to \$Y) and that range reflects the range that is in fact identified in the validation process; (b) the ARP is a price from one of the five (5) largest internet shopping sites as identified by any third-party/industry source (or an average of such sites) and that method is identified by a hyperlink to the ARP label; or (c) the ARP is a price from one of the three (3) largest shopping sites for the category of product being sold (e.g., furniture, jewelry, etc.) as identified by any third-party/industry source (or an average of such sites) and that method

is identified by a hyperlink to the ARP label. These three alternatives are *not* meant to be the exclusive means of satisfying the “good faith effort requirement” but are only defined “safe harbors” that Overstock may utilize if it so chooses.

125. In the event the nomenclature uses “MSRP” or some other marketing term or acronym, a hyperlink must define that term or acronym – e.g., for MSRP “manufacturer’s suggested retail/resale price” – *and* state that that term or acronym may not be the prevailing market price or regular retail price. When hyperlinks are used to define terms, the definitions must state what the term means rather than list alternatives without providing the consumer with any basis for determining which alternative is being used in a particular instance. The disclosures in any such hyperlink shall be in plain English rather than the “legalese” characteristic of that found in Exhibit 961.

126. In setting the ARP, Overstock may add to the price identified by the validation process an amount to reflect the cost of shipping the product from the source of the reference price *provided that* (a) adding shipping cost is necessary to achieve an “apples-to-apples” comparison to the Overstock price *and* (b) the addition of shipping costs is identified in the nomenclature (e.g., “compare with shipping”) or by hyperlink. And in any event if shipping charges are added, the method used to factor in the shipping costs to the ARP must be clearly explained in text connected to the ARP by hyperlink.

127. As the People do not challenge Overstock’s protocol of re-validating ARPs every 90 days, the court will not require a shorter timeframe, but the injunction shall incorporate the 90-day limit as the maximum such that the ARP may remain posted for *not longer than* the date on which the reference price was validated as a posted price. Whatever timeframe is used (90 days, 30 days, etc.) that parameter shall be noted either



on the product page (e.g., “compare \$999.01 as of 12/27/2013”) or by a hyperlink connected to the ARP nomenclature.

128. Overstock may not post any ARP unless it verifies the reference price and documents that verification by a screen shot of the product offering(s) and price(s) relied upon to comply with this order. The verification documentation shall be maintained for two years from the date the ad containing the ARP is initially posted, and the People may have reasonable access to such documentation throughout the five year period during which this injunction shall be in place.

129. The court expects this Decision to be finalized and a judgment entered thereon sometime in February 2014. As it may take Overstock some time to determine the best way to bring its website into compliance with the terms of the injunction, the injunction shall provide for a period of 60 days after entry of judgment for Defendant to come into compliance and also provide that it thereafter file and serve a declaration of such compliance detailing the steps taken to ensure compliance.

#### **B. Restitution**

130. Citing *Fletcher v. Security Pacific National Bank* (1979) 23 Cal.3d 442, 451, and *People v. Superior Court (Jayhill)* (1973) 9 Cal.3d 283, 286-278, the People request as a form of “ancillary” relief restitution for consumers who were misled by the advertisements found to have violated the consumer protection statutes at issue. Citing the language of the statutes, they argue that such restitution should be the money that “may have been acquired” by the false advertising at issue. To accomplish this, the People suggest that Defendant should be required to contact each California consumer who from January 1, 2004, through the date of judgment purchased any product in which

an ARP was displayed, advise them of the action and offer either the opportunity to return the product or a 5% credit towards future purchases.

131. The request that all California consumers who purchased any Overstock product since January 2004 (or any other date) be offered an opportunity to return the product for a refund is wildly excessive and if ordered on top of the other relief sought could be ruinous. It is also unjustified where there is no reason to believe that *all* purchasers were deceived and the People chose not to contest the evidence offered by Overstock that – except for instances of error as with Mr. Ecenbarger – its products were the lowest in the market. The alternative suggestion that all such consumers be offered a 5% credit is also unsupported: it could as easily be 1% or 10% or whatever. The People made no attempt here to present evidence from which the court could determine what would be an appropriate refund or credit amount. Indeed, the most powerful evidence was not that the advertisements led consumers to pay more than they otherwise would have but that there was a reduction in search intentions, an increase in a perception of transaction value and a greater likelihood that the consumers would return to the Overstock webpage. While there was evidence that ARPs cause a “bump” in sales, there is no way to determine which purchasers accounted for the “bump.” Nor is there any way to identify which consumers may have been exposed to which ARP feature the court has found to constitute a violation. In short, this record simply does not suggest a reasonable metric to determine what might an appropriate award of restitution or any methodology for identifying those who should receive it. For these reasons the court declines to order any form of restitution but has considered this as a factor in setting the appropriate civil penalty.

### C. Civil Penalties

132. The People seek civil penalties pursuant to both the UCL and FAL. Section 17206(a) of the UCL provides that any person who has engaged in unfair competition is liable for a civil penalty not to exceed \$2,500 for each violation, which may be assessed and recovered in a civil action brought by, among others, any district attorney. Similarly, section 17536(a) of the FAL provides that any person who violates any provision of the FAL is also liable for a civil penalty not to exceed \$2,500 for each violation, which also may be assessed and recovered in a civil action brought by, among others, any district attorney on behalf of the People of the State of California. Sections 17206 and 17536 contain the following identical directives to the trial court regarding the assessment of these civil penalties:

The court shall impose a civil penalty for each violation of this chapter. In assessing the amount of the civil penalty, the court shall consider any one or more of the relevant circumstances presented by any of the parties to the case, including, but not limited to the following: the nature and seriousness of the misconduct, the number of violations, the persistence of the misconduct, the length of time over which the misconduct occurred, the willfulness of the defendant's misconduct, and the defendant's assets, liabilities, and net worth. [§§ 17206, subd. (b), 17536, subd. (b).]

133. Citing section 17205 of the UCL, the People argue the penalties under the two statutes are cumulative and note that given the ubiquitous use of ARPs by Defendant since 2006, the total amount of civil penalties at issue is “potentially astronomical.” (People’s Op. Br. at 46:20-21.) The People point to *People v. Superior Court (Olson)* (1979) 96 Cal.App.3d 181, 198, for guidance to the court as to how to proceed under such circumstances. There the alleged violations were found in newspaper advertising and the court found it reasonable under the statute “that a single publication constitutes a minimum of one violation with as many additional violations as there are persons who

read the advertisement or who responded to the advertisement by purchasing the advertised product or service by making inquiries concerning such product or service.” The court reasoned that “[v]iolations so calculated would be reasonably related to the gain or opportunity for gain achieved by the dissemination of the untruthful or deceptive advertisement.” (*Ibid*; see also *People v. JTH Tax, Inc.* (2013) 212 Cal.App.4<sup>th</sup> 1219, 1250-1251.)

134. Here it is impossible to determine how many Californians saw the offending advertisements. The People point to an interrogatory answer as indicating that there were approximately 718 million pages visited from California IP addresses between November 2006 and late 2012. (Exh. 902.) They argue that number reflects the number of views by California consumers during the relevant timeframe. The court is skeptical of that metric as it is impossible to determine whether any given visit was by a consumer or some automated program scraping the website for data. There is also no way to determine what percent of such visits were to pages with ARPs that had offending features. While the People argue that the vast majority of pages were based on the highest available price that could be located, the court notes that a large percentage of pages were for BMMG items and the ARPs there were populated in an automated fashion – often by going to Amazon. These issues undermine the “number of views” data relied upon by the People. Nonetheless, it is beyond cavil that even if one were to try to adjust for such considerations, the number of views by California consumers of pages containing ARPs that were based either on formulas or similar products or on the highest price found in the market is enormous. Taking that approach could result in civil penalties well in excess of a billion dollars.

135. If one did not consider views but looked only at sales, the numbers are still daunting. As the People point out, one could tease out of the data the number of products sold to residents of the eight counties represented in this action from 2004 (or a later year) through the introduction of the validation team and then reduce it by various factors to account for the percentage of BMMG sales and the like, and one would come up with a figure in the hundreds of thousands of violations to be multiplied by a penalty amount of up to \$2,500 per violation. (People's Op. Br. at 49.) One could then try a similar exercise for the post-validation team period and come up with an additional number. However one would do it, the resulting penalty number would total in the hundreds of millions of dollars. Thus whether one approaches the issue based on the number of California views or the number of California sales, or tries to limit it more narrowly to the same metrics but for the eight counties represented in the action, civil penalties at \$2,500 per violation would be enormous and far beyond what the drafters of these provisions would ever have envisioned.

136. Given these issues, the People suggest that the court start with the number of days as a minimum. As the statute of limitations was tolled effective March 24, 2010, the time period for calculating civil penalties under the UCL runs from March 24, 2006, through the date of trial.<sup>27</sup> As the FAL and UCL remedies are cumulative, the maximum daily penalty on a one-per-day basis would be \$5,000 except for the earliest year, which would be beyond the reach of the FAL's three year provision. The People propose that the court not use the maximum but rather a \$1,000 per day penalty for each statute for a total daily penalty of \$2,000. They would add an additional amount to reflect the

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<sup>27</sup> For some reason the People would start the penalty accrual period on January 1, 2004, but fail to explain how they can reach back to 2004 or why they would start on January 1 instead of the anniversary of the tolling agreement.

estimated number of purchases by California consumers of affected products. Using this approach and their estimated numbers, the People request a civil penalty of \$7,102,000. (People's Op. Br. at 48-49.) In requesting such a penalty, the People note the other factors that bear on determining the amount and argue that they all support a penalty in at least the range requested. Thus they argue that the violations were "serious" within the meaning of the statutes, that the number of violations was astronomical, that the conduct was "persistent" in that it was every day for a number of years, and that the conduct was "willful" given the various ways Defendant was put on notice of the misleading nature of its ARP practices (see, e.g., ¶¶24, 25, 27, 31, supra). With regard to Overstock's financial condition, the People point to Defendant's billion dollars in gross revenue, market capitalization of \$600 million and \$84 million in cash on hand. (Exh. 698, 699.)

137. The defense is dismissive of the "seriousness of the misconduct" factor because they continue to argue that there was no harm and the evidence is unrebutted that Overstock's prices were the lowest in the marketplace. (E.g., Trial at 854-856.) They also argue that Overstock's practices with respect to ARPs mirror that of the industry (e.g., Exh. 2727-2805) and its ARPs are lower on average than its competitors. (Trial at 1454-1455.) Defendant also argues that the People have failed to introduce an adequate evidentiary foundation as to the number of violations, rely on pure guess work regarding the number of violations or the number for each feature they complain violate the statutes, and by offering a uniform "per day formula" fail to account for the significant changes (and reduced seriousness or frequency of any violation) after the introduction of the validation team process. On the remaining factors of persistence, length of violation and willfulness, they argue that most of Overstock's products were BMMG and expressly

... tied to Amazon prices for ARP purposes, that Byrne's original adoption of ARP practices was guided by good faith reliance on BBB advice, that the company responded appropriately to the Ecenbarger incident and that its unique validation team process ensures appropriate policies are followed. Regarding Overstock's financial circumstances, the defense argues that the People overlook years of unprofitability, minimal net income in 2012, its losses in 2011 and its relatively modest size in an extremely competitive online retail environment.

138. Considering these arguments and the record as a whole, the court finds that the "seriousness of the misconduct" is moderate in that it was not as serious as may be found in other reported cases where the conduct amounted to egregious fraud, and any harm that occurred was mitigated in part by the fact that Overstock's prices were (at least on this record) at or below that of its competitors. It is also significant that the misconduct did not affect all product lines to the same extent and apparently did not implicate the BMMG category at all. This factor weighs in Overstock's favor. On the other hand, the three practices found to violate the statutes were "numerous" and "persistent" in that they occurred on a daily basis on thousands of product pages until the introduction of the validation team protocol, after which two of the three challenged practices continued on thousands of product pages on a daily basis. That the People cannot quantify whether the number of violations each day totaled in the hundreds, the thousands or hundreds of thousands is hardly a defense to the number or persistency factors, and certainly these factors support some kind of daily penalty over the length of time the practices occurred. Whatever the daily penalty, it should be reduced as of the date the validation team protocol was introduced in order to reflect the fact that at least

one of the three practices was terminated when that new process was implemented and the team protocols reduced the potential for the various abuses documented in the earlier period. (E.g., ¶¶17-18, 30.) With respect to the willfulness factor, the conduct was not as innocent as the defense portrays it. Whatever oral advice Byrne received from the BBB, it is totally undocumented and inconsistent with the FTC Guide or what prudent counsel would have advised; moreover, it was clear to everyone that the objective was to brand Overstock as an “extreme value retailer” and to do so it exaggerate the amount of savings consumers were able to realize on its site. The conduct was in this sense willful. As to Overstock’s financial condition, it is clear that civil penalties on the order of magnitude sought by the People are well within Overstock’s ability to pay without damaging its capacity to compete in the marketplace and that such penalties are necessary for deterrence purposes.

139. Based on the foregoing factors and all of the evidence in the record, the court determines that a daily penalty in the amount of \$3,500 (\$1,000 for each of the three types of violation and \$500 for the lack of controls that led to various abuses) is appropriate from March 24, 2006, to September 24, 2008, which is the approximate date the validation team process was implemented and all ARPs were removed subject to re-posting. Thereafter a daily civil penalty of \$2,000 from September 24, 2008, through the first day of trial (September 9, 2013) is appropriate as the evidence is that the practices in question were continuing through trial. The resulting subtotals are \$3,199,000 for the first period (\$3,500 x 914 days) and \$3,620,000 for the second period (\$2,000 x 1810 days), and combined they come to a total civil penalty in the amount of **\$6,819,000**. The



court finds that this total penalty is the minimum necessary to vindicate the purposes of the statutes and far below what may be within the bounds of its discretion.

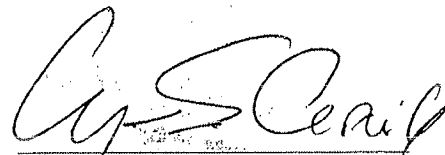
**D. Other Relief**

140. The People seek the recovery of their investigative costs but have not briefed that issue, and the record is devoid of evidence that would support any such award. If the People contend they have a right to attorneys' fees, investigative costs or any other costs, they may seek such an award via the usual method for seeking costs or attorneys' fees. The judgment shall only state that the People are entitled to such costs as allowed by law.

**VII. CONCLUSION**

141. Within ten (10) days after this Decision becomes final, the People are directed to prepare a form of judgment (with a blank for costs in the event there ultimately is such an award) consistent with the foregoing Decision and include therein provisions for an award of civil penalties in the amount of **\$6,819,000** and the form of injunction detailed above. The parties should meet and confer on the form of judgment, and the People shall indicate in their submission the portions (if any) to which the defense has objected. The People are further ordered to submit the form of judgment to the court in both hardcopy and an electronic (Word) format attached to an email to the clerk in D-21.

Dated: January 3, 2014.

  
Wynne S. Carvill  
Judge, Superior Court