[Court of Appeals Case No. 81811-2-I]

Case No. 100572-5

SUPREME COURT OF THE STATE OF WASHINGTON

IN RE: FUNKO INC. SECURITIES LITIGATION

FUNDAMENTAL CAPITAL, LLC AND FUNDAMENTAL CAPITAL PARTNERS, LLC,

Petitioners,

v.

ROBERT LOWINGER, ET AL.,

Respondent.

RESPONDENT'S ANSWER TO PETITIONS FOR REVIEW

Juli E. Farris, WSBA #17593
KELLER ROHRBACK L.L.P.
1201 Third Avenue, Suite 3200
Seattle, WA 98101-3052
Tel.: (206) 623-1900

Daniel J. Morrissey
(*pro hac vice*)
Gonzaga University
School of Law
721 North Cincinnati Street
Box 3258
Spokane, WA 99220-3528
Tel.: (509) 313-3693

TABLE OF CONTENTS

I. INTRODUCTION 1

II. THERE ARE NO GROUNDS FOR SUPREME COURT REVIEW 2

III. THE COURT OF APPEALS *DE NOVO* REVIEW APPLIED WELL-SETTLED LAW TO THE ALLEGATIONS PLAUSIBLY PLED IN THE COMPLAINT 5

IV. PLAINTIFFS HAVE PLED A CAUSE OF ACTION AGAINST CONTROL PERSONS OF FUNKO 16

V. CONCLUSION 20

TABLE OF AUTHORITIES

CASES

Akerman v. Oryx Commc'ns, Inc.,
609 F. Supp. 2d 363 (S.D.N.Y 1984) 14

Cyan, Inc. v. Beaver County Employees Retirement Fund,
--- U.S. ---, 138 S. Ct. 1061, 200 L. Ed. 2d 332 (2018) 4, 5

Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund,
575 U.S. 175, 135 S. Ct. 1318, 191 L. Ed. 2d 253 (2015) .....*passim*

United Housing Foundation, Inc. v. Forman,
421 U.S. 837, 95 S. Ct. 2051, 44 L. Ed. 2d 621 (1975) 5

STATUTES AND REGULATIONS

17 C.F.R. § 229.103.....9

17 C.F.R. § 229.303.....9

17 C.F.R. § 230.405.....19

15 U.S.C. § 77a.....1

15 U.S.C. § 77bbbb.....1

15 U.S.C § 77o 17

RULES

RAP 13.4(b).....2

OTHER AUTHORITIES

Cornerstone Research, *Securities Class Actions Filings 2019 Year in Review* 4 (2020) https://securities.stanford.edu/research-reports/1996-2019/Cornerstone-Research-Securities-Class-Action-Filings-2019-YIR.pdf 4

I. INTRODUCTION

This case arises from allegedly false and misleading statements and omissions in a registration statement filed with the Securities and Exchange Commission ("SEC") by Funko, Inc ("Funko" or the "Company"), in violation of the Securities Act of 1933, 15 U.S.C. §§ 77a–77bbbb ("Securities Act" or the "Act'). By it, Funko, an Everett-based maker of novelty products, was selling its stock in an initial public offering ("IPO"). Petitioners are officers and directors of Funko and its underwriter (the "Funko Defendants"). They are seeking discretionary review of a decision by the Court of Appeals, which held that the Trial Court erred by dismissing the operative Complaint.

Section 11 of the Securities Act was designed to give teeth to the requirement that a registration statement must tell potential investors the full truth about all aspects of its business and the securities it is offering. *Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund*, 575 U.S. 175, 179, 135

S. Ct. 1318, 191 L. Ed. 2d 253 (2015). The elements for a cause of action under Section 11 are simple and straightforward: (1) There must be a material misstatement or omission of a material fact in an effective registration statement and (2) Plaintiffs must have purchased securities sold by that registration statement.

The Court of Appeals' unanimous and well-reasoned opinion—based on a straightforward application of well-established law to fact allegations that must be accepted as true at the pleading stage—found that the Plaintiffs had amply satisfied those pleading requirements because the Company's registration statement plausibly alleged multiple material falsehoods and omissions.

II. THERE ARE NO GROUNDS FOR SUPREME COURT REVIEW

The Petitioners now petition this Court for discretionary review of that decision. RAP 13.4(b) states these as the grounds for such a review and none of them are present here.

> A petition for review will be accepted by the Supreme Court only: (1) If the decision of the Court of Appeals is in conflict with a decision of the Supreme Court; or (2) If the decision of the Court of Appeals is in conflict with a published decision of the Court of Appeals; or (3) If a significant question of law under the Constitution of the State of Washington or of the United States is involved; or (4) If the petition involves an issue of substantial public interest that should be determined by the Supreme Court.

The Court of Appeals' ruling, however, is not in conflict with any decision by the Supreme Court or any state appellate court. Thus, Petitioners are now seeking review of the Court of Appeals' decision that applied settled law to facts that must be accepted as true at the pleading stage. But the Petition barely touches on the underlying facts, arguing in a vacuum that the Court of Appeals' ruling misapplied the law. And, as the Petitioners concede, there is a "wealth of case law setting forth the elements of the federal claim" at issue here. (Funko Pet. at 10).

Moreover, Petitioners rely on alarmist rhetoric and supposition to claim that somehow this case represents an

unwarranted intrusion of federal securities law in state court. (*Id.* at 8–9). But in *Cyan, Inc. v. Beaver County Employees Retirement Fund*, --- U.S. ---, 138 S. Ct. 1061, 200 L. Ed. 2d 332 (2018), the United States Supreme Court recently reaffirmed the Act's statutory grant to state courts to decide Section 11 causes of action. Petitioners, however, make a "sky-is-falling" argument that after *Cyan* there has been an alarming increase in such claims, and the failure to reverse the Court of Appeal here would further open the floodgates.

Yet a report using the same statistics as the study Petitioners cite found that, in the year after *Cyan*, there were only 27 total state court class actions under Section 11. Cornerstone Research, *Securities Class Actions Filings 2019 Year in Review* 4 (2020) https://securities.stanford.edu/research-reports/1996-2019/Cornerstone-Research-Securities-Class-Action-Filings-2019-YIR.pdf. And, in that year, there were only 22 parallel filings in state and federal court out of 428 filed. *Id.* Thus, when looking at raw numbers of cases in the

context of overall filings of securities actions, Petitioners' contentions about the rise in state cases are misleading at best.

In addition, Section 22(a) of the Securities Act has always afforded defrauded investors a choice of forum to seek a Section 11 remedy. *Cyan* just reemphasized that. That policy furthered Congress's desire to give investors a strong right to deter abusive practices in the securities markets, *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 849, 95 S. Ct. 2051, 44 L. Ed. 2d 621 (1975), and to "promote honest practices" there. *Cyan*, 138 S. Ct. at 1066.

III. THE COURT OF APPEALS *DE NOVO* REVIEW APPLIED WELL-SETTLED LAW TO THE ALLEGATIONS PLAUSIBLY PLED IN THE COMPLAINT

The Court of Appeals reversed the Trial Court's dismissal of this action finding that Plaintiffs have sufficiently alleged five categories of materially false or misleading statements in Funko's registration statement and prospectus. And, under Section 11 and 12(a)(2) of the Securities Act, the

presence of any one of those categories of material falsehoods will sustain a viable cause of action for the Plaintiffs here.

As the Funko Defendants acknowledge, these are the five categories of material misstatements that the Court of Appeals found: (1) Funko's revenue estimates for its third quarter of 2017 were inflated because it failed to write off an e-commerce platform; (2) Funko was engaging in undisclosed channel stuffing that also caused its financial statements to be inaccurate; (3) Funko failed to disclose that it had obsolete product which caused the value it was placing on its inventory to be materially false; (4) That obsolete product also caused Funko to materially overstate the value of its intellectual property; and (5) Funko's risk disclosures were misleading because they stated problems that "could" arise when in fact they had already transpired. (Funko Pet. at 7–8).

The Court of Appeals' reasoning on all those was convincing. First, Funko's statements of net revenue for its 2017 third quarter as well as those for its first two quarters of

2017 were materially false because the Company failed to write off an e-commerce platform that had ceased to function. The Funko Defendants appear to argue those falsehoods were inconsequential because ultimately their reported revenue during that period exceeded what they stated in the registration statement.

The Court of Appeals however made short work of that fallacious argument by noting that Section 11(a) provides that its cause of action becomes operative on the effective date of a registration statement when material falsehoods exist in it then. That is when sales of a company's securities can be made to the public.

The Funko Defendants also argue that Funko's accounting figures were only subjective statements of opinion and thus not actionable under the *Omnicare* decision. But as the Court of Appeals correctly pointed out, *Omnicare* holds that a false statement of opinion may be actionable if an issuer has reliable information, as Funko allegedly did here, calling such

belief into question, and does not disclose it. *Omnicare,* 575 U.S. at 187–89.

To that end, the Court of Appeals cited specific facts pled by Plaintiffs showing that, before the registration statement's effective date, Funko knew the platform would never work. Moreover, even if Funko had an opinion that it might function again, the platform had failed to work at a Comicon convention several months before the registration statement became effective, which Funko did not disclose. As the Appellate Court held, these facts satisfied the third prong of *Omnicare*'s requirement for a materially misleading statement because that fact was something a reasonable investor would want to know.

Second, the Funko Defendants challenge the Court of Appeals' finding that the Plaintiffs had sufficiently alleged Funko was falsely inflating its sales figures by channel stuffing, i.e., sending its retailers more product than they could sell. The Funko Defendants argue the Court erred by finding that the Complaint adequately alleged a violation of Item 303 of

Regulation S-K of the Securities Act, 17 C.F.R. § 229.103, that requires disclosure of "known trends," and the Funko Defendants had violated that by not disclosing that its purported trend of increased sales was based on channel stuffing.

But the Court of Appeals relied on a straightforward application of 17 C.F.R. § 229.303 (Item 303)'s provisions to rule that Plaintiffs' allegations that Funko failed to disclose its reliance on channel stuffing amply pled a violation of Item 303. While the Funko Defendants argue that the Court of Appeals misapplied the law by glossing over the knowledge requirement of Item 303, the court cited a number of "key metrics" that Plaintiffs alleged indicating that Funko must have been aware that it was channel stuffing and that this practice would likely have a material impact on its sales revenue. (Ct. App. Op. at 17).[1]

[1] The Court of Appeals did not, however, base its holding solely on the Funko Defendants' violation of Item 303. Rather the Court of Appeals also held that, independent of Item 303,

While the Petition also lists the three other categories of material falsehoods that the Court of Appeals upheld in the Company's registration statement – (1) the failure to disclose obsolete inventory, (2) the resulting overvaluing of its intellectual property, and (3) the misleading nature of its Risk Disclosures – it does not appear to refute them. Rather, the Funko Defendants seem to argue once again that these statements were just subjective opinions that are not actionable under *Omnicare*.

But, as has been stated, *Omnicare* holds that such statements of purported opinion are actionable if there are undisclosed facts in a defendant's possession contradicting them which a reasonable investor would want to know. And in each of those categories, as the Court of Appeals found, the

---

Defendants' statement that their business was strong could have been materially false because they were allegedly using channel stuffing "to bolster their misrepresentations in the short term." (Ct. App. Op. at 13).

Plaintiffs have alleged specific undisclosed facts that the Funko Defendants should have stated to qualify those statements and make them not misleading.

For instance, the Funko Defendants' Petition recites that the Trial Court ruled that, "many of the statements Plaintiffs challenged were statements of opinion or puffery." (Funko Pet. at 6). But while the Court of Appeals did agree with the Trial Court that some of the alleged misstatements were inactionable puffery (Ct. App. Opp. at 14–15), it also overruled the Trial Court on others, finding that some of Funko's statements of opinion were actionable. For instance, regarding Funko's inventory control practices, the Court of Appeals correctly applied *Omnicare* to hold, on two grounds, that the Company's reported figures there were not mere subjective judgments.

To that end, the Court of Appeals found that Plaintiffs had alleged facts with sufficient particularly to show that Funko lacked a functional inventory tracking system and that internal Company reports indicated the presence of significant obsolete

merchandise. Funko therefore knew or should have known that statements it made about the value of its inventory violated generally accepted accounting principles (GAAP). And even if Funko subjectively believed its statements to be true, Funko was nevertheless in possession of facts that a reasonable investor would want to know cutting against those representations. Those allegations satisfied *Omnicare's* test for materially misleading statements. (Ct. App. Opp. at 18–19).

And for another reason, this case was an easy one for the Court of Appeals to decide correctly. As it noted, Washington's CR 12(b)(6) pleading standards set a high bar for dismissal—promoting justice by guaranteeing all litigants a day in court if they allege facts that state a meritorious claim. As such dismissal is improper, as it would be here, when facts can be adduced that would secure relief for plaintiffs. (*See, e.g.*, Ct. App. Op. at 12, 18, 25). In addition, as the Court of Appeals stated, its review of the legal sufficiently of pleadings is de novo so any "findings" (Court of Appeals' emphasis) by the

Trial Court under 12(b)(6) are immaterial to the Court of Appeals' analysis of that issue. (*Id.* at 20)

Accordingly, our state's pleading standards, as the Court of Appeals rightly held, allow this case to go forward. The Court of Appeals' rulings that Plaintiffs have pled material misstatements about its inflated revenue fit squarely into the third prong of *Omnicare*'s holding for a meritorious claim. That allows Section 11 claims to go forward when an issuer does not disclose significant facts that cut against its representations in a registration statement. *Omnicare*, 575 U.S. at 187–89.

The Petition's failure to provide any basis for discretionary review is exemplified by its last-ditch argument that Plaintiffs have "ple[]d [themselves] out of court" under Washington's pleading standards (by alleging "lost causation" where it does not exist). (Funko Pet. at 19). Contrary to the red herring that the Funko Defendants seem to be making on page

19 of their brief about the Gandel blogpost[2] not being evidence of "lost causation," Plaintiffs in a Section 11 claim do not have to show that the Funko Defendants' falsehoods caused them to lose money. As the Court of Appeals rightly stated, loss causation is an affirmative defense. (Ct. App. Op. at 25 n.17).[3]

Section 11(e) of the Securities Act gives the Funko Defendants that affirmative defense, and they are welcome to make that case at trial, if they choose, to defeat a recovery by the Plaintiffs. However, as the Funko Defendants seem to concede, Funko Pet. at 20, the Gandel blogpost has nothing to

---

[2] Shortly after Funko's registration statement went effective, Bloomberg analyst Stephen Gandel published a blogpost questioning certain aspects of Funko's accounting.

[3] If a defendant in a Section 11 case can convince a jury that part of Plaintiffs' losses resulted from factors other than the material misstatements in its registration statement, those losses cannot be recovered. Correspondingly, if a defendant can secure a verdict that all the losses resulted from causes extraneous to the falsehoods in a registration statement, it may escape liability all together. *Akerman v. Oryx Commc'ns, Inc.*, 609 F. Supp. 2d 363 (S.D.N.Y 1984), *aff'd*, 810 F.2d 336 (2d Cir. 1987).

do with the material misstatements about Funko's nonfunctioning platform, its channel stuffing, or its obsolete merchandise. Plaintiffs have alleged with particularized facts that each of those falsely inflated Funko's income. The Funko Defendants' attempt to muddy the waters here by bringing in the Gandel blogpost was a transparent attempt to confuse the Court of Appeals. But they failed to do so there and will not succeed either before the Supreme Court.

As the Funko Defendants concede, *id.* at 5, Congress limited the elements of a prima facie case under Section 11 to just allegations that a registration statement contain at least one material falsehood. Thus pled, the statute lets the case proceed to discovery and trial so defrauded investors can secure recovery for being misled. Using that standard for its analysis, the Court of Appeals found exactly that and rightly overturned the Trial Court's dismissal.

IV. PLAINTIFFS HAVE PLED A CAUSE OF ACTION AGAINST CONTROL PERSONS OF FUNKO

The Court of Appeals also reversed the holding of the Trial Court dismissing claims against certain investors who directly or indirectly held substantial amounts of shares in Funko or its predecessor entity. As in the claims against the Funko Defendants, there are no significant questions of law here and the Court of Appeals made a straightforward application of the alleged facts to uphold Plaintiffs' claims.

The affiliated entities alleged to be liable as control persons of Funko are the Fundamental Defendants. They allegedly held 34.9 percent of Funko's Class A shares and 27.7 percent of its class B shares immediately prior to the IPO. They also designated one director who was a member of Funko's board then and would serve in that capacity after the IPO. Another large investor ACON was also named as a control person defendant and joins the Fundamental Defendants seeking to have the Supreme Court review the Court of

Appeals' holding reinstating the case against them. (The Fundamental Defendants and ACON are collectively referred to as the "Control Person Defendants").

The Plaintiffs brought claims against the Control Person Defendants under Section 15 of the Act, which provides for liability against any person who controls a party found liable under Section 11 or 12. It states in part:

> "Every person who, by or through stock ownership, agency or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency or otherwise, controls any person liable under sections 77k or 77l of this title, shall also be liable jointly and severally with and to the same extent as such controlled person…"

15 U.S.C § 77o.

The Court of Appeals stated two elements for such a cause of action: (1) a primary violation of federal securities law and (2) that the defendant exercised actual power or control over the primary violator. (Ct. App. Op. at 26). The Court of Appeals then went on to find that the Plaintiffs alleged that

those individuals and firms were control persons by virtue of their position as directors or senior officers of Funko's predecessor. In addition, those venture capital firms were alleged to be control persons "by virtue of their ownership of Funko securities, board membership, relationships with management, and contractual rights regarding Funko's governance." (*Id.* at 26).

The Control Person Defendants apparently claim that the trial court made no finding on the second element of the Section 15 cause of action because it only dismissed those claims when it found that no primary violation existed. They therefore argue that the Plaintiffs abandoned their "control person" argument by failing to raise it on appeal. The Court of Appeals however appropriately turned that aside finding "there is no clear indication in the record that the trial court ruled against [the Plaintiffs] on this ground." (Ct. App. 27).

In addition, as to the second element of control person liability, the Court of Appeals cited the SEC's definition of

control as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." (*Id.* at 27 (quoting 17 C.F.R. § 230.405)). It then noted that whether such power exists is a factual question. *Id.*

The Court of Appeals further cited the substantial voting power of those Defendants and that one of their designees was a director of Funko. It thus held, "[w]e cannot say, at this stage of the pleadings, that it appears beyond doubt that the Investors can prove no set of facts which would entitle them to relief against Fundamental Capital under Section 15." (*Id.* at 28).

The unanimous Court of Appeals decision on the control person issue like its ruling as to the Funko Defendants is straightforward and convincing. Despite the Control Person Defendants' lengthy and contrived arguments to the contrary, there is no reason for the Supreme Court to review it.

V. CONCLUSION

The Court of Appeals has accurately followed the law here by faithfully applying the correct criteria for a cause of action under the Securities Act. The Petitions for Review by the Funko Defendants, its underwriters, and its Control Persons are therefore without merit and should be denied.

I hereby certify that this document contains 3,232 words in accordance with RAP 18.17.

RESPECTFULLY SUBMITTED this 18th day of February 2022.

Keller Rohrback L.L.P.

By: *s/ Juli E. Farris*
Juli E. Farris, WSBA #17593
Eric Laliberte, WSBA #44840
1201 Third Avenue, Ste. 3200
Seattle, WA 98101
Tel.: (206) 623-1900
jfarris@kellerrohrback.com
elaliberte@kellerrohrback.com

Karl P. Barth, WSBA #22780
Steve W. Berman, WSBA #12536
Dawn D. Cornelius, WSBA #50170
HAGENS BERMAN SOBOL SHAPIRO LLP
1301 2nd Avenue, Suite 2000
Seattle, WA 98101
Tel.: (206) 623-7292
karlb@hbsslaw.com
steve@hbsslaw.com
dawn@hbsslaw.com

Liaison Counsel for Plaintiffs

Samuel H. Rudman
ROBBINS GELLER RUDMAN & DOWD LLP
58 South Service Road, Suite 200
Melville, NY 11747
Tel.: (631) 367-7100
srudman@rgrdlaw.com

James I. Jaconette
ROBBINS GELLER RUDMAN & DOWD LLP
655 West Broadway, Suite 1900
San Diego, CA 92101-8498
Tel.: (619) 231-1058
jamesj@rgrdlaw.com

Aaron L. Brody
STULL, STULL & BRODY
6 East 45th Street, 5th Floor
New York, NY 10017
Tel.: (212) 687-7230
abrody@ssbny.com

Co-Lead Counsel for Plaintiffs

Daniel J. Morrissey (*pro hac vice*)
Gonzaga University School of Law
721 North Cincinnati Street
Box 3528
Spokane, WA 99220-3528
Tel.: (509) 313-3693
morrissey@gonzaga.edu

Counsel for Plaintiffs-Appellants

CERTIFICATE OF SERVICE

The undersigned certifies, I caused to be served via the Court's secure filing portal a true and correct copy of this document to following:

Michael Ross / mross@aegislawgroup.com
Sean Roberts / sroberts@aegislawgroup.com
AEGIS LAW GROUP LLP

David Freeburg / david.freeburg@dlapiper.com
DLA PIPER LLP

Benjamin Naftalis / benjamin.naftalis@lw.com
Kevin McDonough / kevin.mcdonough@lw.com
Thomas J. Giblin / thomas.giblin@lw.com
Melissa Arbus Sherry / melissa.sherry@lw.com
Cherish A. Drain / sherish.drain@lw.com
LATHAM & WATKINS LLP

Carla Wirtschafter / cwirtschafter@reedsmith.com
James L. Sanders / jsanders@reedsmith.com
REED SMITH LLP

Stephen C. Willey / swilley@sbwllp.com
Duffy J Graham / dgraham@sbwllp.com
SAVITT BRUCE & WILLEY LLP

Robin Wechkin / rwechkin@sidley.com
Matthew J. Dolan / mdolan@sidley.com
SIDLEY AUSTIN LLP

Philip S. McCune / philm@summitlaw.com
Lawrence C. Locker / laerryl@summitlaw.com
SUMMIT LAW GROUP, PLLC

DATED: February 18, 2022

s/ Elizabeth A. Burnett
Elizabeth A. Burnett,
Legal Assistant to Juli E. Farris

KELLER ROHRBACK L.L.P.

February 18, 2022 - 4:43 PM

Transmittal Information

Filed with Court:	Supreme Court
Appellate Court Case Number:	100,572-5
Appellate Court Case Title:	In Re Funko, Inc. Securities Litigation

The following documents have been uploaded:

- 1005725_Answer_Reply_20220218161530SC762287_6581.pdf
  This File Contains:
  Answer/Reply - Answer to Petition for Review
  The Original File Name was Respondents Answer to Petition.pdf

A copy of the uploaded files will be sent to:

- abrody@ssbny.com
- benjamin.naftalis@lw.com
- cherish.drain@lw.com
- cwirtschafter@reedsmith.com
- david.freeburg@us.dlapiper.com
- dawn@hbsslaw.com
- dgraham@sbwllp.com
- dmorrissey@lawschool.gonzaga.edu
- elaliberte@kellerrohrback.com
- enorwood@sidley.com
- eservice@sbwllp.com
- jamesj@rgrdlaw.com
- jsanders@reedsmith.com
- kbarth7504@aol.com
- kevin.mcdonough@lw.com
- larryl@summitlaw.com
- marciar@summitlaw.com
- mdolan@sidley.com
- melissa.sherry@lw.com
- morrissey@gonzaga.edu
- mross@aegislawgroup.com
- paige.plassmeyer@us.dlapiper.com
- philm@summitlaw.com
- rwechkin@sidley.com
- sroberts@aegislawgroup.com
- srudman@rgrdlaw.com
- steve@hbsslaw.com
- swilley@sbwllp.com
- thomas.giblin@lw.com

Comments:

Sender Name: Elizabeth Burnett - Email: eburnett@kellerrohrback.com

Filing on Behalf of: Juli Elizabeth Farris - Email: jfarris@kellerrohrback.com (Alternate Email:)

Address:
1201 3rd Ave
Ste 3200
Seattle, WA, 98101
Phone: (206) 623-1900

Note: The Filing Id is 20220218161530SC762287