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

IN THE SUPREME COURT
OF THE STATE OF WASHINGTON

IN RE: FUNKO INC. SECURITIES LITIGATION

FUNKO, INC., et al.

Petitioners,

v.

ROBERT LOWINGER, et al.

Respondents.

FUNKO, INC., BRIAN MARIOTTI, RUSSELL NICKEL, KEN BROTMAN, GINO DELLOMO, CHARLES DENSON, DIANE IRVINE, ADAM KRIGER, AND RICHARD MCNALLY'S PETITION FOR REVIEW

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

I. Identity Of Petitioners 1

II. Court Of Appeals Decision 1

III. Issues Presented For Review 1

IV. Statement Of The Case 2

V. Argument Why Review Should Be Accepted 8

   A. The Court Of Appeals Improperly Expanded Federal Liability For Opinion Statements Under *Omnicare* 11

   B. The Court Of Appeals Misinterpreted And Misapplied SEC Disclosure Regulations 15

   C. The Court Of Appeals Misapplied Washington's Pleading Standards In Any Event 18

VI. Conclusion 21

Appendix A - Court of Appeals Decision
Appendix B - Trial Court's 2019 Order Granting Motion to Dismiss
Appendix C - Trial Court's 2020 Order Granting Motion to Dismiss
Appendix D - Statutes and Regulations
   1 - 15 U.S.C. § 77k
   2 - 15 U.S.C. § 77*l*
   3 - 17 C.F.R. § 229.303 (2017)

TABLE OF AUTHORITIES

Page(s)

CASES

Atchison v. Great Western Malting Co.,
161 Wn.2d 372, 166 P.3d 662 (2007)..19

Blue Chip Stamps v. Manor Drug Stores,
421 U.S. 723 (1975)..9

Brown v. Ambow Education Holding Ltd.,
No. CV 12-5062, 2014 WL 523166 (C.D. Cal. Feb. 6,
2014) 19

City of Dearborn Heights Act 345 Police & Fire Retirement System v. Align Technology, Inc.,
856 F.3d 605 (9th Cir. 2017) 13

City of Warren Police & Fire Retirement System v. Natera Inc.,
46 Cal. App. 5th 946, 259 Cal. Rptr. 3d 890 (Ct. App.
2020) 16, 17

Cutler v. Phillips Petroleum Co.,
124 Wn.2d 749, 881 P.2d 216 (1994)..19

Cyan, Inc. v. Beaver County Employees Retirement Fund,
138 S. Ct. 1061 (2018)..8

In re Densply Sirona, Inc. Shareholders Litigation,
No. 155393/2018, 2019 WL 4695724 (N.Y. Super. Ct.
Sept. 26, 2019), *aff'd as modified by In re Dentsply Sirona, Inc. Shareholders Litigation*, 191 A.D.3d 404
(N.Y. App. Div. 2021) 16

Dura Pharmaceuticals, Inc. v. Broudo,
544 U.S. 336 (2005)..9

Greenberg v. Sunrun Inc.,
233 F. Supp. 3d 764 (N.D. Cal. 2017) 6

Page(s)

Hampton v. root9B Technologies, Inc.,
897 F.3d 1291 (10th Cir. 2018) 13

J&R Marketing, SEP v. General Motors Corp.,
549 F.3d 384 (6th Cir. 2008) 15, 16

Jaroslawicz v. M&T Bank Corp.,
962 F.3d 701 (3d Cir. 2020), *cert. denied*, 141 S. Ct. 1284 (2021) 13

Local 295/Local 851 IBT Employer Group Pension Trust & Welfare Fund v. Fifth Third Bancorp,
731 F. Supp. 2d 689 (S.D. Ohio 2010) 19, 20

Matrixx Initiatives, Inc. v. Siracusano,
563 U.S. 27 (2011) 12

Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund,
575 U.S. 175 (2015) .... *passim*

Oxford Asset Management, Ltd. v. Jaharis,
297 F.3d 1182 (11th Cir. 2002) 12

Pivotal Software, Inc. v. Superior Court,
141 S. Ct. 2884 (2021) 10

Rubke v. Capitol Bancorp Ltd.,
551 F.3d 1156 (9th Cir. 2009) 5

In re Shoretel Inc. Securities Litigation,
No. C 08-00271, 2009 WL 248326 (N.D. Cal. Feb. 2, 2009) 19

In re Stac Electronics Securities Litigation,
89 F.3d 1399 (9th Cir. 1996) 5

Steckman v. Hart Brewing Inc.,
143 F.3d 1293 (9th Cir. 1998) 16, 17

Page(s)

Tenore v. AT&T Wireless Services,
136 Wn.2d 322, 962 P.2d 104 (1998)..19

Tongue v. Sanofi,
816 F.3d 199 (2d Cir. 2016)..13

TSC Industries, Inc. v. Northway, Inc.,
426 U.S. 438 (1976)..12

Wochos v. Tesla, Inc.,
985 F.3d 1180 (9th Cir. 2021) 13

STATUTES AND REGULATIONS

15 U.S.C. § 77k..4

15 U.S.C. § 77k(a) 5

15 U.S.C. § 77*l*(a)(2)...4, 5

15 U.S.C. § 77*o*..4

17 C.F.R. § 229.303(a)(3)(ii) (2017) 15

OTHER AUTHORITIES

H.R. Rep. No. 104-369 (1995), *as reprinted in* 1995
U.S.C.C.A.N. 730 9

Michael Klausner, et al., *State Section 11 Litigation in the Post-*Cyan *Environment (Despite* Sciabacucchi*)*, 75
Bus. Lawyer 1769 (2020) 9

I. IDENTITY OF PETITIONERS

Funko, Inc., Brian Mariotti, Russell Nickel, Ken Brotman, Gino Dellomo, Charles Denson, Diane Irvine, Adam Kriger, and Richard McNally, defendants in the trial court and respondents in the Court of Appeals, ask this Court to grant review of the Court of Appeals decision identified in Part II.

II. COURT OF APPEALS DECISION

Petitioners seek review of the decision of Division I of the Court of Appeals, entered on November 1, 2021 ("Op."), attached as Appendix A.

III. ISSUES PRESENTED FOR REVIEW

A. Whether the Court of Appeals misinterpreted and misapplied the federal law standard for opinion statement liability as set forth by the U.S. Supreme Court in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 575 U.S. 175 (2015).

B. Whether the Court of Appeals misinterpreted and misapplied the federal law standard for pleading a violation of U.S. Securities and Exchange Commission ("SEC") Regulation S-K Item 303.

C. Whether the Court of Appeals misinterpreted and misapplied Washington law in reversing the trial court's Rule 12(b)(6) dismissal when Plaintiffs' own allegations pose an insuperable bar to relief.

IV. STATEMENT OF THE CASE

This is a putative class action against Funko, an Everett-based producer of pop culture collectibles, along with a dozen other defendants, alleging violations of federal securities law. The question is whether Plaintiffs stated a claim under federal law. The trial court held, twice, that they did not. The Court of Appeals reversed in large part. This Court's review is needed to ensure that the federal securities laws do not mean something different in Washington than in other forums.

A. Founded in 1998, and headquartered in Everett, Funko creates fun and unique products that allow consumers to express their affinity for their favorite pop culture icons, including characters from movies, TV shows, and video games; musicians; and athletes. CP 1410, 1415 (First Am. Compl. ("FAC") ¶¶ 2, 18); *see also* CP 125, 237, 242-43, 396.

1. After nearly 20 years of private ownership, Funko decided to offer its shares to the public in an initial public offering ("IPO"). CP 1410 (FAC ¶ 1); CP 210. Funko filed with the SEC a prospectus, which incorporated a Form S-1 registration statement (collectively, the "registration statement"). CP 1424 (FAC ¶ 36). The 269-page registration statement described Funko and the offered securities in detail. CP 99-367.

As relevant here, the registration statement disclosed extensive information about Funko's historical financial performance. CP 193-95.

The registration statement also provided "preliminary" estimates of forthcoming financial results for the third quarter of 2017 ("Q3 estimates"). CP 1426 (FAC ¶ 41); CP 118. Funko made extensive risk disclosures as well. CP 139-76. Among other things, Funko cautioned that "[i]f demand or future sales do not reach forecasted levels, we could have excess inventory that we may need to hold for a long period of time, write down, sell at prices lower than expected or discard." CP 146; *see* CP 1438 (FAC ¶ 70). And Funko told investors that, to account for that possibility, it "maintain[s] reserves for excess and obsolete inventories." CP 231; *see* CP 1435 (FAC ¶ 63).

2. On November 1, 2017, the SEC declared Funko's registration filing effective. CP 1410 (FAC ¶ 1). Funko common stock was priced at $12 per share and began trading on November 2. CP 1413-14 (FAC ¶ 8). That same morning, the *Bloomberg Gadfly* posted a blogpost authored by Stephen Gandel. Gandel provided his personal interpretation of the information Funko disclosed in the registration statement but did not dispute the accuracy of that information. *See* CP 95-96. He primarily criticized Funko's "focus[]" on a particular measure of earnings called "adjusted Ebitda." CP 95-96. When trading opened, the price of Funko's stock declined, closing at $7.07 on the first day of trading. CP 1774 (¶ 5).

3. On December 7, 2017, Funko reported its actual results for the third quarter of 2017. *See* CP 1604-05. The Company's net income greatly exceeded its projections. CP 1604-05. In the months following the IPO, Funko's share price rebounded. As of September 2018, Funko's stock was trading at $23.66 per share—an increase of 97.17 percent over the $12 IPO price. *See* CP 1257-58.

B. On November 16, 2017, approximately two weeks after the IPO, the first complaint in this action was filed. *See Lowinger v. Funko, Inc.*, No. 17-2-29838-7 SEA (Wash. Super. Ct., King Cnty.). Several follow-on complaints were filed later, and the cases were consolidated. *See* Order Granting Stip. Consol. Cases (July 2, 2018), Dkt. No. 12.

1. In the consolidated complaint, Plaintiffs alleged violations of Sections 11, 12(a), and 15 of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77*l*(a)(2), 77*o*, against Funko, Brian Mariotti, Russell Nickel, Ken Brotman, Gino Dellomo, Charles Denson, Diane Irvine, Adam Kriger, and Richard McNally ("Funko Defendants"), on behalf of an investor class that purchased Funko Class A common stock pursuant or traceable to the registration statement. CP 1416-19 (FAC ¶¶ 19-26); CP 1446 (FAC ¶ 86). Plaintiffs also brought Section 11 and 12(a) claims against the institutions

that served as underwriters for Funko's IPO,[1] and Section 15 claims against ACON Investments, LLC and Fundamental Capital, LLC, private equity firms that held ownership stakes in Funko. CP 1421-23, 1450-51 (FAC ¶¶ 29-30, 109-12).

2. Section 11 provides a cause of action to an investor who purchases a security registered and offered pursuant to a registration statement if the investor can prove that the registration statement either contains an "untrue statement of material fact" or omits a material fact whose disclosure is required by law or is "necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a); *see Rubke v. Capitol Bancorp Ltd.*, 551 F.3d 1156, 1161 (9th Cir. 2009). Section 12(a)(2) establishes a similar cause of action for statements contained in a prospectus. *See* 15 U.S.C. § 77*l*(a)(2). To state a claim under either statute, a plaintiff must adequately allege "(1) that the registration statement contained an omission or misrepresentation, and (2) that the omission or misrepresentation was material, that is, it would have misled a reasonable investor about the nature of his or her investment." *In re Stac Elecs. Sec. Litig.*, 89 F.3d 1399, 1403-

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[1] The underwriter defendants are Goldman, Sachs & Co. LLC (n/k/a Goldman Sachs & Co. LLC), J.P. Morgan Securities LLC, Merrill Lynch, Pierce, Fenner & Smith Incorporated, Piper Jaffray & Co., Jeffries LLC, Stifel, Nicolaus & Company, Incorporated, BMO Capital Markets Corp., and SunTrust Robinson Humphrey, Inc. (n/k/a Truist Securities, Inc.). CP 1420 (FAC ¶ 28).

04 (9th Cir. 1996) (citation omitted); *see Greenberg v. Sunrun Inc.*, 233 F. Supp. 3d 764, 772 (N.D. Cal. 2017) ("The same standard [for Section 11] applies for pleading a violation of Section 12(a)(2).").[2]

3. On August 2, 2019, after full briefing and oral argument, the trial court granted Defendants' motions to dismiss for failure to state a claim but gave Plaintiffs leave to amend. CP 1782. The court held that because "Funko's Registration Statement included and explained the basis for and the limitations of the financial metrics presented," provided "clear warnings," and otherwise disclosed what Plaintiffs alleged was missing, Plaintiffs had not alleged that the challenged "statements regarding [Funko's] financial disclosures" were "materially false or misleading." CP 1779-82. The court also held that many of the statements Plaintiffs challenged were statements of opinion or corporate puffery—neither of which were actionable under the federal securities laws. CP 1781. And, finally, the court determined that Gandel's blogpost could not serve as a "corrective disclosure" because it "did not reveal any new information" and instead merely "provided [Gandel's] interpretation and opinion using Funko's disclosed information." CP 1780.

[2] Because the standards are the same, the petition focuses on the Section 11 claim—but the arguments apply equally to the Section 12(a) claim.

4. On October 3, 2019, Plaintiffs filed their first amended complaint ("FAC"), which restated many of their previous allegations. CP 1409-54. On August 5, 2020, after another full round of briefing and argument, the trial court granted Defendants' motions to dismiss Plaintiffs' claims with prejudice. CP 1784-85.

D. The Court of Appeals affirmed in part and reversed "in substantial part." Op. 1.

The Court of Appeals explained that "[a]lthough" Plaintiffs had "alleged multiple false or misleading statements in the amended complaint, they focus on only five categories of statements on appeal." Op. 8. Those five categories did not include the "adjusted EBITDA" metric that was the focus of the Gandel blogpost. They instead consisted of (i) "statements of net revenue" that were purportedly misleading for failure to disclose that an "e-commerce project" was "valueless," Op. 8-12; (ii) statements about "strong growth" and Funko's "revenue figures" that were purportedly misleading for failure to disclose alleged "channel stuffing," Op. 12-18; (iii) statements about the value of inventory that were allegedly misleading for failure to disclose the existence of "obsolete inventory" or "dead stock," Op. 18-20; (iv) statements about the value of intellectual property that were allegedly misleading for the same reason, Op. 20-21; and (v) a risk

disclosure about inventory that was purportedly misleading for failing to disclose the same alleged "channel stuffing" and "dead stock," Op. 21-25.

The Court of Appeals agreed that a portion of the "channel stuffing" allegations were properly dismissed because they were based on inactionable statements of corporate optimism or "puffery," as were allegations regarding Funko's "inventory management practices." Op. 14-15, 19 n.15. But the court otherwise reversed for three principal reasons. *First*, although the court did not dispute that the financial valuations at issue were statements of opinion, it found them actionable under the U.S. Supreme Court's decision in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 575 U.S. 175 (2015). *See* Op. 11, 19, 21. *Second*, the court believed that Funko had an independent duty to disclose the alleged "channel stuffing" under an SEC disclosure regulation—and held that Plaintiffs had adequately pleaded a violation of that regulation. Op. 18. And, *third*, the court declined to consider an alternative ground for dismissal—*i.e.*, whether the Gandel blogpost was a "corrective disclosure"—at the pleading stage. Op. 25 n.17.

V. ARGUMENT WHY REVIEW SHOULD BE ACCEPTED

This is the first Section 11 case ever to be decided by a Washington appeals court. But it likely will not be the last. In *Cyan, Inc. v. Beaver County Employees Retirement Fund*, 138 S. Ct. 1061 (2018), the U.S.

Supreme Court held that state courts have concurrent jurisdiction to hear Section 11 class actions, and that they cannot be removed to federal court. Since then, the number of "Section 11 filings in state court have skyrocketed." Michael Klausner, et al., *State Section 11 Litigation in the Post-*Cyan *Environment (Despite* Sciabacucchi*)*, 75 Bus. Lawyer 1769, 1789 (2020). Some commentators have suggested that plaintiffs are filing "weaker" cases in state court because of a belief that meritless claims are more likely to survive a pleadings challenge. *Id.* ("[T]here is evidence to suggest that part of what is fueling these state filings are cases that are weaker than those filed in federal court."). That the viability of a federal claim could turn on the forum in which the claim is brought is troubling. That this divergence would arise at the pleading stage is even more problematic. As Congress and the U.S. Supreme Court have repeatedly recognized, the high cost of discovery in securities class actions often forces coercive settlements of even meritless cases.[3] So the mere denial of a motion to dismiss can effectively decide the case.

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[3] The "potential for abuse of" discovery "may . . . exist in [securities class actions] to a greater extent than they do in other litigation." *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 741 (1975); *see also Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 347 (2005) (noting the potential of *in terrorem* settlements); H.R. Rep. No. 104-369, at 37 (1995), *as reprinted in* 1995 U.S.C.C.A.N. 730, 736 ("The cost of discovery often forces innocent parties to settle frivolous securities class actions."); *id.* at 31, 1995 U.S.C.C.A.N. at 730 (observing that plaintiffs "abuse[d] . . . the discovery process to impose costs so burdensome that it wa[s] often economical for the victimized party to settle").

Although this was a Washington appellate court's first foray into Section 11, the Court of Appeals was not writing on a blank slate. There is a wealth of case law setting forth the elements of the federal claim—developed with a firm understanding of the statutory scheme and the risks of *in terrorem* settlements. Under that precedent, this should have been an easy case. The trial court granted the motions to dismiss because Plaintiffs failed to allege a violation of federal law. A federal court would have reached the same conclusion. And the Court of Appeals should have affirmed.

In reversing, the Court of Appeals rested on Washington pleading standards. But those standards provide no license to disregard or misinterpret federal law—and the Court of Appeals misapplied those standards in any event. Three errors in particular highlight why this Court's review is needed. *First*, the Court of Appeals expanded the limited scope of liability for opinion statements that the U.S. Supreme Court carefully delineated in *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, 575 U.S. 175 (2015). *Second*, the Court of Appeals did not require Plaintiffs to plead the additional elements for liability under the SEC's disclosure regulations. And, *third*, the Court of Appeals misapplied Washington pleading standards by allowing this case to go forward even though Plaintiffs' own pleadings allege facts that make recovery impossible. This Court should not allow that decision to stand as Washington's final word on the scope of Section 11 liability. *Cf. Pivotal*

Software, Inc. v. Superior Court, 141 S. Ct. 2884 (2021) (granting certiorari in Section 11 case after California Supreme Court denied review).

A. The Court Of Appeals Improperly Expanded Federal Liability For Opinion Statements Under *Omnicare*

Many of the allegedly false or misleading statements in this case are statements of opinion, not fact. Opinion statements are actionable under federal law, but only in very limited circumstances. In *Omnicare*, the U.S. Supreme Court identified three such instances—and the Court of Appeals relied exclusively on the third. Op. 9-11. Specifically, an opinion statement may be actionable if a plaintiff alleges "facts going to the basis for the issuer's opinion . . . whose omission makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context." *Omnicare*, 575 U.S. at 194. Federal law makes clear that this "omission" avenue of proving falsity is narrow in scope; that disclosure of all possible facts is neither required nor beneficial; and that it should be difficult to plead such a claim. The Court of Appeals' decision takes that carefully circumscribed avenue for relief and expands it to swallow the rule.

1. This third way to plead an actionable opinion statement is narrow. The U.S. Supreme Court gave an illustrative example in *Omnicare*: a company's statement that "[w]e believe our conduct is lawful" may be "misleadingly incomplete" if made "without having consulted a lawyer." 575 U.S. at 188. That is because, in those circumstances, an investor would reasonably expect the company to have performed some "meaningful legal inquiry" and not simply relied on "intuition." *Id.* But the Court made clear

that issuers do *not* have to disclose all contrary facts. So it is not enough to say that "an issuer kn[ew], but fail[ed] to disclose, some fact cutting the other way." *Id.* at 189. "Reasonable investors," the Court explained, "understand that opinions sometimes rest on a weighing of competing facts; indeed, the presence of such facts is one reason why an issuer may frame a statement as an opinion, thus conveying uncertainty." *Id.*

This "omissions" path to opinion liability is narrow for a reason. There is no freestanding duty to disclose all facts an investor might find interesting. "Section 11's omissions clause . . . is not a general disclosure requirement; it affords a cause of action only when an issuer's failure to include a material fact has rendered a published statement misleading." *Id.* at 194. And requiring broader disclosure runs the risk of burying shareholders in an avalanche of information. *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 448-49 (1976); *see Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 38 (2011); *Oxford Asset Mgmt., Ltd. v. Jaharis*, 297 F.3d 1182, 1190 (11th Cir. 2002).

The intentionally limited scope of the third prong of *Omnicare* is not just a matter of what an investor might prove—but also what it can allege. An investor, the Court explained, must "identify particular (and material) facts going to the basis for the issuer's opinion—facts about the inquiry the issuer did or did not conduct or the knowledge it did or did not have—whose omission makes the opinion statement at issue misleading to a reasonable person reading the statement fairly and in context." *Omnicare*, 575 U.S. at

194. The Court did not mince words: "[t]hat is no small task for an investor." *Id.*

For many courts, the takeaway has been clear. *Omnicare* recognized a "meaningful distinction between statements of opinion and statements of fact." *Hampton v. root9B Techs., Inc.*, 897 F.3d 1291, 1299 (10th Cir. 2018). And it "cautioned" against an "overly expansive reading" of the omission "standard." *Tongue v. Sanofi*, 816 F.3d 199, 210 (2d Cir. 2016); *see City of Dearborn Heights Act 345 Police & Fire Ret. Sys. v. Align Tech., Inc.*, 856 F.3d 605, 615 (9th Cir. 2017) ("[T]he Supreme Court cautioned that pleading falsity under an omissions theory would be 'no small task for an investor.'" (citation omitted)). The standard so articulated stands as a "rigorous benchmark," *Jaroslawicz v. M&T Bank Corp.*, 962 F.3d 701, 717 (3d Cir. 2020), *cert. denied*, 141 S. Ct. 1284 (2021), that imposes "substantial limits" on applying an omission theory to a "pure statement of honest *opinion*," *Wochos v. Tesla, Inc.*, 985 F.3d 1180, 1188-89 (9th Cir. 2021).

2. The Court of Appeals found "the third prong of *Omnicare*" satisfied—three times over—in disregard of those substantial limits and without applying the necessary rigor. Op. 11; *see* Op. 19-21. The court's overarching theory was that "undisclosed facts" may have rendered inherently subjective financial valuations (or even preliminary *estimates*) misleading. The first was the "possib[ility]" that Funko "did not have a factual basis for the actual net revenues reported in the registration statement" because it allegedly did not include "expenses" for an "e-

commerce platform." Op. 11. The second was alleged "undisclosed facts" about obsolete inventory that "undermin[ed]" the value of Funko's inventory, Op. 20, even though there was no allegation that the value of the inventory was actually false or incorrect. And finally, those same alleged "undisclosed facts" purportedly made the separate valuation of Funko's intellectual property misleading. Op. 21. Each of these assertions fails in its own right—and, collectively, they are a dramatic expansion of *Omnicare*'s "third prong."

Washington pleading standards do not compel that result. Op. 10-11. The operative question is whether Plaintiffs adequately stated a claim under the substantive requirements of *federal* law. *Omnicare* announced a narrow standard of omission liability in the context of opinion statements—a standard that would be a challenge ("no small task") for an investor to satisfy even at, indeed *especially* at, the pleading stage. After all, it is the high cost of discovery following denial of a motion to dismiss that triggers the coercive pressure to settle even meritless claims. *See supra* n.3. The U.S. Supreme Court did not permit state courts to undermine the "rigorous benchmark" it adopted by applying their respective pleadings standards in a way that would expand substantive liability under federal law. This Court should grant review to make clear that—contrary to the Court of Appeals' decision—Washington law does no such thing.

B. The Court Of Appeals Misinterpreted And Misapplied SEC Disclosure Regulations

Under federal securities law, an omission is actionable only when it renders an affirmative statement misleading or when there is an independent duty to disclose. *See J&R Mktg., SEP v. Gen. Motors Corp.*, 549 F.3d 384, 390 (6th Cir. 2008). The Court of Appeals relied exclusively on SEC disclosure regulations (*i.e.*, an independent duty to disclose) to reverse the dismissal of Plaintiffs' "claim based on the allegation that Funko failed to disclose its channel stuffing practices." Op. 18. Specifically, the court held that Plaintiffs had stated a violation of "17 C.F.R. § 229.303(a)(3)(ii), known as Item 303 of Regulation S-K of the Securities Act." Op. 13-14 (footnote omitted). In sustaining the "Item 303 claim," the Court of Appeals reached out to decide an issue not fairly briefed by Plaintiffs and, in doing so, misinterpreted and misapplied federal law.[4]

Item 303 requires the disclosure of "known trends or uncertainties" that the issuer "reasonably expects will have a material . . . unfavorable impact on . . . revenues or incomes from continuing operations." 17 C.F.R. § 229.303(a)(3)(ii) (2017). Although scienter generally is not an element of a Section 11 claim, the reference to *known* trends or risks in Items 303

[4] Plaintiffs' assignments of error contained no reference to Item 303, and Plaintiffs did not argue in their briefs that Item 303 provides an independent basis for liability under Section 11.

requires a plaintiff to plead knowledge. *See Steckman v. Hart Brewing Inc.*, 143 F.3d 1293, 1297 (9th Cir. 1998); *J&R Mktg.*, 549 F.3d at 391-92. Conclusory assertions do not suffice: "Item 303's disclosure mandate requires that a plaintiff plead, with specificity, facts establishing that the defendant had actual knowledge." *City of Warren Police & Fire Ret. Sys. v. Natera Inc.*, 46 Cal. App. 5th 946, 960, 259 Cal. Rptr. 3d 890, 901 (Ct. App. 2020) (citation omitted).

State and federal courts alike have applied Item 303's knowledge requirement as a pleading rule, and have dismissed claims where plaintiffs offer only vague allegations of an issuer's knowledge. In *In re Densply Sirona, Inc. Shareholders Litigation*, for example, a New York court dismissed an Item 303 claim based on similar channel-stuffing allegations where plaintiffs had alleged that the inventory problems "'were common knowledge in the industry'" and that the company's "management was 'aware' based on undescribed reports received." No. 155393/2018, 2019 WL 4695724, at *7 (N.Y. Super. Ct. Sept. 26, 2019) (quoting consolidated amended complaint), *aff'd as modified by In re Dentsply Sirona, Inc. S'holders Litig.*, 191 A.D.3d 404 (N.Y. App. Div. 2021). Such "general allegations," the court concluded, were inadequate to plead the required knowledge. *Id.* In *City of Warren Police & Fire Retirement System*, a California court similarly affirmed dismissal of an Item 303-based claim

because the plaintiffs "fail[ed] to allege specific facts establishing that any of the defendants had actual knowledge." 46 Cal. App. 5th at 960-61, 259 Cal. Rptr. 3d at 902. And in *Steckman*, the Ninth Circuit—applying the pre-*Twombly/Iqbal* federal pleading standard—dismissed an Item 303-based claim related to channel stuffing (among other things) because the plaintiffs' allegations about accounts receivables were insufficient "to show knowledge of an adverse trend which could be reasonably expected to have a material impact." 143 F.3d at 1298.

In sustaining the "Item 303 claim" in this case, the Court of Appeals did not demand the specificity in pleading required by this line of cases.[5] The court rested instead on Washington pleading standards. Op. 15-16, 18. But those standards (again) provide no license to rewrite federal law. And Plaintiffs came nowhere close to pleading, with specificity, actual knowledge of an alleged channel-stuffing "trend" that was "not disclose[d]" and that was "reasonably likely to have a material effect on the company's financial condition." Op. 15 (citing *Steckman*, 143 F.3d at 1296-97).

To avoid Superior Court Civil Rule 9(b), Plaintiffs specifically disclaimed "scienter" and "fraudulent intent." CP 1448-49 (FAC ¶¶ 94,

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[5] The Court of Appeals' suggestion that Funko relied on Section 10(b) cases that require scienter for this point is incorrect. Op. 16 n.12. The portion of Funko's brief addressing Item 303's knowledge requirement relied exclusively on Section 11 cases. *See* Answering Br. 43.

104). And they nowhere alleged that the named defendants had actual "knowledge" of a "channel-stuffing" trend that would have a material impact on revenue. The allegations of so-called "channel stuffing" were based on metrics *disclosed* in the registration statement itself. *See* CP 1433 (¶ 59) (comparing accounts receivables to sales); CP 135-36, 327-28 (reporting accounts receivables and sales in registration statement). And they are inconsistent with Plaintiffs' own theory of channel stuffing. Plaintiffs argued that "[a] high[] number of [inventory] turnovers" was indicative of channel stuffing, but alleged (and argued) that the "inventory turnover ratio *declined*" during "2016 to 2017"—*i.e.*, during the 12 months leading up to the IPO. Opening Br. 37-38 (emphasis added); *see* CP 1433 (FAC ¶ 59), 1718; Op. 17. So Plaintiffs' own allegations support the reality: there was no channel stuffing.

Plaintiffs thus failed to plead sufficient facts to state an Item 303 claim. And if what they pleaded *was* enough, then Item 303 means something fundamentally different in Washington than it does in other states (and in federal court). That cannot be the law.

C. The Court Of Appeals Misapplied Washington's Pleading Standards In Any Event

Not only did the Court of Appeals misapply federal law, it also misapplied Washington's pleading standards. Most notably, the Court of

Appeals failed to recognize that a plaintiff can effectively plead itself out of court by alleging facts that pose an insuperable bar to relief. *See Tenore v. AT&T Wireless Servs.*, 136 Wn.2d 322, 329-30, 962 P.2d 104, 107 (1998); *see also Atchison v. Great W. Malting Co.*, 161 Wn.2d 372, 376, 166 P.3d 662, 663 (2007); *Cutler v. Phillips Petroleum Co.*, 124 Wn.2d 749, 755, 881 P.2d 216, 219-20 (1994). That is precisely what Plaintiffs did here. Plaintiffs alleged that the stock drop was caused by a "corrective disclosure" that did not disclose anything about the only alleged misstatements that remain in this case. The Court of Appeals' footnote-dismissal of that argument was wrong.

An investor cannot recover under Section 11 unless the market reacted to the actionable misstatements and not something else. This is an affirmative defense, but courts "routinely" dismiss Section 11 claims "when the face of the complaint demonstrates that the plaintiff cannot establish loss causation." *Brown v. Ambow Educ. Holding Ltd.*, No. CV 12-5062, 2014 WL 523166, at *14-16 (C.D. Cal. Feb. 6, 2014); *see Local 295/Local 851 IBT Emp. Grp. Pension Tr. & Welfare Fund v. Fifth Third Bancorp*, 731 F. Supp. 2d 689, 710 (S.D. Ohio 2010); *In re Shoretel Inc. Sec. Litig.*, No. C 08-00271, 2009 WL 248326, at *5-6 (N.D. Cal. Feb. 2, 2009). These courts recognize that while a plaintiff need not plead the cause of its loss, if it chooses to do so and that cause does not qualify as a "corrective

disclosure" as a matter of law, dismissal is the only appropriate remedy. This makes sense since, in those circumstances, the plaintiff's own allegations demonstrate that recovery is impossible.

Plaintiffs' allegations pose that insuperable bar to recovery here. The FAC hardly could have been more clear about Plaintiffs' theory: "there is a 99% chance that the stock price movement resulted from the release of . . . the *Bloomberg* article [*i.e.*, the Gandel blogpost], and not market factors." CP 1411 (FAC ¶ 4). But remember, the only alleged misstatements (or, really, omissions) remaining in the case are about the e-commerce platform, channel stuffing, and obsolete inventory. Op. 12, 18-19, 21, 25. The Gandel blogpost said nothing about the e-commerce platform. It said nothing about so-called channel stuffing. And it said nothing about obsolete inventory. So the only facts even arguably disclosed by the Gandel blogpost were not corrective as a matter of law. *See Fifth Third Bancorp*., 731 F. Supp. 2d at 710 (dismissing Section 11 claim when "press release did not contain any disclosures or corrections addressed" to the misrepresentations alleged).[6] It is clear on the face of the complaint that Plaintiffs have no cognizable federal securities law claim.

[6] The Gandel blogpost at most raised concerns about Funko's use and depiction of the "adjusted EBITDA" measure of accounting, and opined that it was "odd" for the Company's "intellectual property" to be worth "$250 million" when its "main products are based on others' intellectual

The Court of Appeals' cursory rejection of this argument has significant consequences for the parties and for Section 11 litigants more generally. A motion to dismiss is *the* critical stage for federal securities cases like this one. *See supra* at n.3. To send a case back for discovery when Plaintiffs cannot prevail under binding federal law exerts significant settlement pressure having nothing to do with the merits of the claims and wastes judicial and party resources. Further review is needed now.

VI. CONCLUSION

For the foregoing reasons, the petition should be granted.

This document contains 4,842 words, excluding the parts of the document exempted from the word count by Rule of Appellate Procedure 18.17.

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property." CP 96. But as the Court of Appeals recognized, Plaintiffs abandoned any alleged misstatements based on adjusted EBIDTA, Op. 8-9, and "do not now contend that Funko failed to disclose its reliance on third-party licensors," Op. 21.

Respectfully submitted this 13th day of January, 2022.

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I declare under penalty of perjury under the laws of the state of Washington that the foregoing is true and correct.

Dated this 13th day of January, 2022.

s/ Paige Plassmeyer
Paige Plassmeyer, Legal Practice Specialist

APPENDIX A

FILED
11/1/2021
Court of Appeals
Division I
State of Washington

IN THE COURT OF APPEALS FOR THE STATE OF WASHINGTON

IN RE FUNKO, INC. SECURITIES LITIGATION.	No. 81811-2-I DIVISION ONE UNPUBLISHED OPINION

ANDRUS, A.C.J. — Investors purchasing Funko, Inc. securities during a 2017 initial public offering (IPO) sued Funko, its officers and directors, the IPO underwriters, and allegedly controlling venture capital firms for violations of Sections 11, 12(a)(2), and 15 of the Securities Act of 1933.[1] They now appeal the dismissal of their claims under CR 12(b)(6), arguing they adequately allege material omissions and misstatements in Funko's registration statement and prospectus. We affirm in part, reverse in substantial part and remand for further proceedings.

FACTUAL BACKGROUND

Founded in 1998 in Everett, Washington, Funko designs, creates, and distributes collectible products depicting characters and icons from movies, television shows, video games, sports teams, and other pop culture celebrities. On October 6, 2017, Funko filed a registration statement with the Securities

[1] 15 U.S.C. § 77a *et seq*.

Exchange Commission (SEC) in anticipation of the IPO. On November 3, 2017, the company filed a prospectus, which incorporated and formed part of the registration statement (collectively referred to here as "the registration statement"). Funko used the registration statement to sell approximately 10.4 million shares of Class A common stock in the IPO.

The registration statement described Funko, its products and customers, its business model and strategies for mitigating market risk, historical financial data for Funko and its predecessor, Funko Acquisition Holdings, LLC (FAH), between January 2015 and June 2017, and its estimated revenue for the three months ending September 30, 2017.

The SEC declared Funko's registration filing effective on November 1, 2017. Funko common stock began trading at a price of $12 per share on November 2. That same day, Bloomberg Gadfly, an online business blog, posted an article written by financial journalist Stephen Gandel, which criticized Funko's registration statement for misstating its earnings. Gandel wrote:

> In Funko's IPO prospectus, in a chart with a big arrow pointing up, the company says that an important measure of its income, which it uses to determine the success of its operational strategies, rose by an average of 86 percent in its past two full years. The actual bottom line, though, was up an average of just 16 percent in 2015 and 2016 and has turned negative lately. Funko lost just more than $10 million in the first half of this year. How the toymaker gets a loss of $10 million to reflect back as an 86 percent earnings increase is the latest example of fun-house accounting on Wall Street.

At the close of trading that day, the price of Funko stock dropped to $7.07, described by the Seattle Times as "the worst first-day return for an IPO in 17 years."[2]

Several IPO investors (Investors) filed this lawsuit on November 16, 2017. Multiple additional lawsuits followed, all of which were consolidated in the trial court. The Investors claimed they purchased Funko stock sold in or traceable to the offering, and that Funko, certain Funko officers and directors,[3] the IPO underwriters,[4] and allegedly controlling venture capital firms[5] violated Sections 11, 12(a)(2), and 15 of the Securities Act of 1933 by making materially false or misleading statements in the registration statement.

The Investors initially alleged that the registration statement made false and misleading statements regarding the company's financial growth in the years before the IPO, based on the Gandel article, and failed to disclose that this growth was due in large part to Funko's reliance on the intellectual property of third-party content providers.

Funko, the Underwriters, and the Venture Capital Firms moved to dismiss the Investors' claims under CR 12(b)(6). Funko argued it made no materially false

[2] Seattle Times Staff, Funko stock plunges in 'worst first-day return for an IPO in 17 years', THE SEATTLE TIMES, https://www.seattletimes.com/business/funko-stock-plunges-in-ipo-shocker/.
[3] The named officers and directors were Brian Mariotti, Russell Nickel, Ken Brotman, Gino Dellomo, Adam Kriger, Richard McNally, Charles Denson, and Diane Irvine. Funko and its officers and directors will be referred to collectively as "Funko."
[4] The named underwriters were Goldman Sachs & Co.; LLC, J.P. Morgan Securities LLC; Merrill Lynch, Pierce, Fenner & Smith Incorporated; Piper Jaffray & Co.; Jeffries LLC; Stifel Nicolaus & Co.; BMO Capital Markets Corp.; and SunTrust Robinson Humphrey, Inc. These named defendants will be referred to hereafter as "the Underwriters."
[5] The named venture capital firms were Fundamental Capital Partners, LLC, Fundamental Capital Partners, LLC, and ACON Investments, LLC. These named defendants will be referred to hereafter as "the Venture Capital Firms."

or misleading statements in the registration statement and that some of the statements on which the Investors relied were inactionable opinions or puffery. The Venture Capital Firms also argued that they could not be held liable under Section 15 of the Securities Act because they did not in fact exercise any power or control over Funko.

In an order dated August 2, 2019, the court dismissed the Investors' Section 11 and 12(a) claims without prejudice. The court found that the registration statement did not contain any materially false or misleading financial disclosures. The court further found that the Gandel article did not question the accuracy of Funko's disclosures and was therefore not a "corrective disclosure" revealing any falsity in the registration statement. To the extent that the Investors challenged allegedly false and misleading opinions, rather than statements of fact, the court concluded that the Investors had not established that the opinions were misleading under the standard set forth in Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 575 U.S. 175, 135 S. Ct. 1318, 191 L. Ed. 2d 253 (2015). The court also dismissed without prejudice the Investors' Section 15 claim against the Venture Capital Firms, concluding that they could not be secondarily liable if Funko was not liable for any primary violations of the Securities Act.

Although the trial court concluded the Investors failed to state claims under the Securities Act, it allowed them to amend their complaint. The Investors filed an amended complaint on October 3, 2019, adding specific allegations that Funko's financial disclosures were misleading because Funko failed to disclose it had abandoned a $1.4 million e-commerce platform, had engaged in "channel

stuffing" to artificially inflate its revenue in the months preceding the IPO, failed to disclose that it lacked the ability to track and record the value of obsolete inventory, and made false statements about the value of its intellectual property.

Funko, the Underwriters, and the Venture Capital Firms again moved to dismiss the amended claims, making the same arguments as in their initial CR 12(b)(6) motions. The trial court again dismissed the lawsuit, this time with prejudice. The Investors appeal.

ANALYSIS

The Securities Act of 1933 protects investors by ensuring that companies issuing securities make a "full and fair disclosure of information" relevant to a public offering. Pinter v. Dahl, 486 U.S. 622, 646, 108 S. Ct. 2063, 100 L. Ed. 2d 658 (1988). "The linchpin of the Act is its registration requirement." Omnicare, 575 U.S. at 178. In general, an issuer may offer securities to the public only after filing a registration statement. See 15 U.S.C. §§ 77d, 77e. A registration statement must contain specific information about both the company and the security for sale. See 15 U.S.C. §§ 77g, 77aa. "Section 11 of the Act promotes compliance with these disclosure provisions by giving purchasers a right of action against an issuer or designated individuals . . . for material misstatements or omissions in registration statements." Omnicare, 575 U.S. at 179.

Section 11 of the Securities Act provides:

> In case any part of the registration statement . . . contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security . . . may, either at law or in equity, in any court of competent jurisdiction, sue.

15 U.S.C. § 77k(a). To prevail on a claim under Section 11, a plaintiff must prove (1) that the registration statement contained an omission or misrepresentation, and (2) that the omission or misrepresentation was material, meaning that it would have mislead a reasonable investor about the nature of their investment. Rubke v. Capitol Bancorp Ltd., 551 F.3d 1156, 1161 (9th Cir. 2009). No scienter is required for liability under Section 11; a defendant can be liable for innocent or negligent material misstatements or omissions. In re Daou Sys., Inc., 411 F.3d 1006, 1027 (9th Cir. 2005).

Section 12(a)(2) of the Securities Act imposes civil liability on

> [a]ny person who . . . offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading . . . .

15 U.S.C. § 77*l*(a)(2). To prevail under Section 12(a)(2), a plaintiff must demonstrate (1) an offer or sale of a security, (2) by the use of a means or instrumentality of interstate commerce, (3) by means of a prospectus or oral communication, (4) that includes an untrue statement of material fact or omits to state a material fact that is necessary to make the statements not misleading by any person. Miller v. Thane Int'l, 615 F.3d 1095, 1099 (9th Cir. 2010).

For a misstatement to be actionable under Section 11 or 12, it must be both false and material. In re Restoration Robotics, Inc. Sec. Litig., 417 F. Supp. 3d 1242, 1254 (N.D. Cal. 2019) (citing Basic Inc. v. Levinson, 485 U.S. 224, 238, 108 S. Ct. 978, 99 L. Ed. 2d 194 (1988)). For a statement to be misleading, it must

affirmatively create an impression of a state of affairs that differs in a material way from the one that actually exists. Id. (quoting Brody v. Transitional Hosp. Corp., 280 F.3d 997, 1006 (9th Cir. 2002)). Materiality is fact-specific and turns on context. Id. at 1257. Statements in a prospectus must be read in the context of the whole document and be judged based on the facts as they existed when the applicable registration statement became effective. Id. The issue is not whether the statements, taken separately, are literally true; the issue is whether the statements, taken in context, would have misled a reasonable investor about the nature of the investment. Id. at 1258.

Although the Investors' claims arise under federal law, we apply state rules of civil procedure to test the sufficiency of the Investors' allegations at the CR 12(b)(6) stage. Dismissal is warranted under CR 12(b)(6) only if it appears beyond doubt that the plaintiff can prove no set of facts consistent with the complaint that would entitle him or her to relief. Leishman v. Ogden Murphy Wallace, PLLC, 196 Wn.2d 898, 903-04, 479 P.3d 688 (2021). All facts alleged in the complaint are taken as true and "a court may consider hypothetical facts not part of the formal record in deciding whether to dismiss a complaint pursuant to CR 12(b)(6)." Haberman v. Wash. Pub. Power Supply Sys., 109 Wn.2d 107, 120, 744 P.2d 1032 (1987) (citations omitted). Under CR 12(b)(6), a plaintiff must merely demonstrate that it is possible that facts could be established to support allegations in a complaint. McCurry v. Chevy Chase Bank, FSB, 169 Wn.2d 96, 101, 233 P.3d 861 (2010). We review CR 12(b)(6) dismissals de novo. FutureSelect Portfolio

Mgmt., Inc. v. Tremont Group Holdings, Inc., 180 Wn.2d 954, 962, 331 P.3d 29 (2014).

Although the Investors alleged multiple false or misleading statements in the amended complaint, they focus on only five categories of statements on appeal. We address each category of statements in turn.

Statements of Net Revenue

The Investors first claim that Funko's registration statement included materially false and misleading statements of net revenue for the first three quarters of 2017. They allege that the reported revenue was misleading because Funko failed to disclose that it "was capitalizing an abandoned e-commerce project and over one million dollars in expenditures that should have been entirely written off the bottom line." They contend that Funko had a duty to disclose the fact that the asset was valueless. Under Generally Accepted Accounting Principles (GAAP), when a long-lived asset ceases to be used, the carrying amount of the asset should equal its salvage value, if any. Accounting Standards Codification (ASC) 360-10-35-47.[6] The Investors allege that had Funko written off these expenses, as required by GAAP, the company's reported net income for the first six months of 2017 would have reflected a net loss and would have reduced estimated net income for the third quarter of 2017 by almost 20 percent.

Funko argues that its estimated net revenue for the third quarter of 2017 could not have been false or misleading because its actual sales, reported to the

[6] The ASC is the source of authority on the GAAP published by the Financial Accounting Standards Board. In re Perrigo Company PLC Securities Litigation, 435 F. Supp. 3d 571, 582 (S.D.N.Y. 2020).

SEC in December 2017, exceeded the prospectus estimates.[7] But to state a claim under Section 11 of the Securities Act, a plaintiff need only plead that "any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading." 15 U.S.C. § 77k(a) (emphasis added). The Investors here did just that. The Investors alleged that Funko omitted information from the 2017 financial statements and the missing information rendered the financial information contained in its registration statement misleading at the time the registration statement became effective. That Funko later proved to outperform those estimates does not exclude the possibility that its failure to write off the value of the e-commerce platform was a material omission. Nor is there any indication in the record that Funko's exceptional financial performance was due to its accurate treatment of the e-commerce platform in its financial disclosures.

Funko next contends that subjective "accounting judgments," such as whether Funko's financial statements complied with ASC standards, are nonactionble statements of opinion. Id. at 20-21. For this proposition, Funko cites to In re Hertz Global Holdings, Inc., 2017 WL 1536223 (D. N.J. 2017). In that case, the plaintiff investors alleged that Hertz's financial statements were false or

[7] Funko submitted SEC filings to support its argument that it made no materially false or misleading statements about its estimated third quarter 2017 sales revenue. "Generally, in ruling on a CR 12(b)(6) motion to dismiss, the trial court may consider only the allegations contained in the complaint and may not go beyond the face of the pleadings. Rodriguez v. Loudeye Corp., 144 Wn. App. 709, 725, 189 P.3d 168 (2008). But "the trial court may take judicial notice of public documents if their authenticity cannot be reasonably disputed in ruling on a motion to dismiss." Id. at 725-26. In Rodriguez, this court held that SEC filings are properly subject to judicial notice at the CR 12(b)(6) stage. 144 Wn. App. at 728. The Investors do not challenge the trial court's review of and reliance on these SEC filings.

misleading because they "were presented in violation of GAAP." Id. at *7. The federal court in that case concluded that because GAAP standards are often subjective, and involve "a range of possible treatments instead of a single objective set of calculations," a company's representation that its financial statements were GAAP-compliant was not a matter of objective fact. Id. at *11. The U.S. Supreme Court has recognized that GAAP does not present a "canonical set of rules," but rather tolerates a range of reasonable treatments left to the discretion of those preparing financial reports. See Thor Power Tool Co. v. Comm'r, 439 U.S. 522, 544, 99 S. Ct. 773, 58 L. Ed. 2d 785 (1979) (accountants have long recognized that "generally accepted accounting principles" will not ensure identical accounting treatment of identical transactions).

But there is a difference between alleging that a company engaged in improper accounting practices and alleging that a company simply applied a GAAP rule incorrectly. Fresno County Employees' Ret. Ass'n v. comScore, Inc., 268 F. Supp. 3d 526, 546 (S.D. N.Y. 2017) (distinguishing Hertz). And even if a company's statements about GAAP compliance are subjective opinions, they may still be actionable under the Securities Act. Id.

Although Sections 11 and 12 refer to misrepresentations and omissions of material fact, matters of opinion are not beyond the purview of these provisions. See Omnicare, 575 U.S. at 188-89. The Supreme Court in Omnicare established three different standards for pleading falsity of opinion statements. First, every statement of opinion explicitly affirms one fact: that the speaker actually holds the stated belief. Id. 184. Second, some statements of opinion contain embedded

statements of fact. Id. at 185. Third, a reasonable investor may, depending on the circumstances, understand an opinion statement to convey facts about how the speaker has formed the opinion—or, otherwise put, about the speaker's basis for holding that view. Id. at 188. Such a statement could give rise to liability under an omission theory if the facts conveyed in that fashion are untrue. Golub v. Gigamon, Inc., 994 F.3d 1102, 1106 (9th Cir. 2021).

In this case, the Investors allege Funko knew it had invested over $1 million to develop a new e-commerce platform and knew by early 2017 that it did not work. They further allege that by July 2017, Funko realized it was not usable at all, abandoned the project, and returned to using an old e-commerce platform. Yet, the Investors allege Funko did not include these expenses in calculating its net income for any part of 2017. Given that the net income for all of 2017 was only $7.3 million, the Investors contend that an expenditure of $1.4 million for a failed e-commerce platform would have been material to any reasonable investor.[8] In other words, it is possible—based on the Investors' allegations—that Funko did not have a factual basis for the actual net revenues reported in the registration statement. We conclude that these allegations are sufficient to survive a CR 12(b)(6) motion to dismiss under the third prong of Omnicare.[9]

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[8] Funko's financial statement revealed a net loss in the first six months of 2017 of $5.4 million. The Investors appear to allege that Funko should have reported an additional $1.4 million in losses in that six month period *or* in the three month period ending September 30, 2017.

[9] Funko argues that the Investors abandoned this claim on appeal because, although they included it in their assignments of error, they did not adequately address the issue in their brief. We disagree. In referring to the e-commerce platform, the Investors argue that "Funko did not write it off and failed to disclose the underlying fact that the platform was not functioning." The Investors further argue that "Funko's failure to disclose the write-off of this important asset along with other material inaccuracies in Funko's Registration Statement was information that would mislead investors." The Investors adequately raised the issue in their brief.

Funko disputes whether the ASC standard invoked by the Investors actually required it to write off the e-platform asset before it issued the registration statement. It suggests that Funko had not abandoned the asset as of July 2017. Id. But whether Funko knew before July 2017 that the asset had no value to the company and whether it should have written that asset off as a loss are questions of fact not properly addressed at the pleading stage. See In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1421 (3rd Cir. 1997) (whether company's earnings overstatement can be fully explained by the company's use of a different accounting method should not be resolved on a motion to dismiss). We reverse the dismissal of the Investors' Section 11 and 12 claims arising out of the allegedly failed e-commerce platform.

Channel Stuffing

Funko's registration statement contained several statements attributing Funko's "strong growth" in the years before the IPO to "strong licensing relationships with many established content providers," "a nimble and low-fixed cost production model," and a "dynamic business model." The Investors allege that these statements, as well as Funko's 2017 revenue figures, were false and misleading because the company's growth and revenue in the year prior to the IPO was driven, not by its production or business model, but by its practice of "channel stuffing."

"Channel stuffing is the oversupply of distributors in one quarter to artificially inflate sales, which will then drop in the next quarter as the distributors no longer make orders while they deplete their excess supply." Steckman v. Hart Brewing,

Inc., 143 F.3d 1293, 1298 (9th Cir. 1998). The Supreme Court recognized that channel stuffing may be "the illegitimate kind (e.g., writing orders for products customers have not requested) or the legitimate kind (e.g., offering customers discounts as an incentive to buy)." Tellabs, Inc. v. Makor Issues & Rights., Ltd., 551 U.S. 308, 325, 127 S. Ct. 2499, 168 L. Ed. 2d 179 (2007). Courts have also recognized that there may be legitimate reasons to shift sales earlier in the cycle. For example, in Waterford Twp. Police v. Mattel, Inc., 321 F. Supp. 3d 1133, 1148 (C.D. Cal. 2018) and In re ICN Pharma, Inc. Sec. Litig., 299 F. Supp. 2d 1055, 1061-62 (C.D. Cal. 2004), federal courts recognized that when the demand for a company's products is seasonal, that company may choose to drive up sales during the high season to make up for lower sales later on. "Channel stuffing" is therefore not inherently improper and not always guaranteed to lower sales in the future. Yaron v. Intersect ENT, Inc., 2020 WL 6750568 at *6 (N.D. Cal. 2020).

But even legitimate channel stuffing may be part of a scheme to hide poor business fundamentals. Id. Because channel stuffing "borrows" from future demand, the underlying weakness will necessarily reveal itself in time. Id. Channel stuffing will support a Securities Act claim when a plaintiff alleges that the defendants knew the business was weak, falsely represented to investors that business was strong, and used channel stuffing to bolster their misrepresentations in the short-term. Id. Alternatively, channel stuffing that involves shipping unneeded or unordered products may also be actionable. Id. at *7.

A company's failure to disclose its reliance on channel stuffing may also form the basis of a claim under Section 12 if such nondisclosure violated former

17 C.F.R. § 229.303(a)(3)(ii),[10] known as Item 303 of Regulation S-K of the Securities Act. Steckman, 143 F.3d at 1296. Item 303 requires a company to

> [d]escribe any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that are reasonably likely to cause a material change in the relationship between costs and revenues (such as known or reasonably likely future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship must be disclosed.

To the extent the Investors allege that Funko made statements attributing its success to its "dynamic business model," rather than channel stuffing, we agree these allegations are insufficient, by themselves, to establish a Section 11 or 12 claim. An actionable statement must be "capable of objective verification." Retail Wholesale & Dep't Store Union Local 338 Ret. Fund v. Hewlett-Packard Co., 845 F.3d 1268, 1275 (9th Cir. 2017). Statements that lack a standard against which a reasonable investor could expect them to be pegged are puffery. City of Roseville Emps.' Ret. Sys. v. Sterling Fin. Corp., 47 F. Supp. 3d 1205, 1219-20 (E.D. Wash. 2014). As a result, business puffery or opinion (vague, optimistic statements) are not actionable because they do not induce the reliance of a reasonable investor.[11] Or. Pub. Emp. Ret. Fund v. Apollo Grp. Inc., 774 F.3d 598, 606 (9th Cir. 2014).

The Investors point to statements in the registration statement that "[w]e have developed a nimble and low-fixed cost production model," and "we can dynamically manage our business to balance current content releases and pop culture trends . . . ." Whether Funko is a "nimble" company or its management

[10] Now codified as 17 C.F.R. § 229.303(b)(2)(ii).

[11] "Puffing" concerns expressions of opinion, as opposed to knowingly false statements of fact. Or. Pub Emps. Ret. Fund, 774 F.3d at 606.

"dynamic" are statements not subject to objective verification. We agree with the trial court that such statements, by themselves, are puffery and not actionable. We therefore affirm the dismissal of any claim based on these statements alone.

But to the extent the Investors allege Funko failed to disclose its reliance on channel stuffing in violation of Item 303, the allegations are sufficient to pass CR 12(b)(6). To state a claim of a violation of Item 303, a plaintiff must allege facts showing that (1) management knew of a trend, demand, commitment, event or uncertainty (2) the trend, demand, commitment, event, or uncertainty was reasonably likely to have a material effect on the company's financial condition or results of its operations and (3) management did not disclose these facts in the offering statement. Steckman, 143 F.3d at 1296-97.

In paragraph 47 of the amended complaint, the Investors allege:

> The statements [in the registration statement] were materially false and misleading when made because . . . they failed to disclose:
> . . . .
>
> (b) that the Company had overloaded its sales channels with excess inventory, including with its flagship Pop! collectibles line, as demand for the Company's products had slowed during the same quarter in which defendants had carried out the IPO, increasing the likelihood that Funko products would be sold at a discount or on clearance during the critical 2017 holiday shopping season.

They allege that Funko relied on channel stuffing to boost its sales revenue and did not disclose that this business model created a significant risk that retailers would return excess products to Funko or would have to sell excess products at deeply discounted prices. They further alleged that the company was aware it was experiencing adverse sales and earnings trends far below the reported 86% compound annual growth rate reported in the registration statement, from which a

trier of fact could infer knowledge. And they allege that in November 2017, just weeks after the IPO, market analysts reported that retailers had a significant amount of Funko's products on their shelves and were selling more items at clearance prices.

The overloading of inventory, per the Investors, damaged Funko's business. When securities analysts reported about slow sales at major retailers and the risk that demand would be satiated and the market saturated, Funko's stock price dropped from $9.85 per share to $8.67 per share. Subsequent reports identified this market saturation as a "warning sign," and downgraded the company. In late December 2017, the Investors allege, Funko's common stock closed at $6 per share, a 50 percent decline from the IPO stock price just two months earlier.

Funko contends that the Investors' Item 303 claim fails because the Investors failed to plead that Funko knew of the omitted trend or risk and that it reasonably expected the trend would have a material impact on revenue or income. We can easily dispose of these arguments because the allegations in the complaint are sufficient, particularly under the state CR 12(b)(6) standard, to allege this requisite knowledge.[12] The Investors allege that Funko had accounts receivable growing faster than the rate of its sales growth, that internal documents

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[12] Funko cites multiple federal cases indicating that a Section 11 channel stuffing claim must be supported by specific factual allegations to survive a motion to dismiss for failure to state a claim. But these cases were dismissed under FRCP 12(b)(6) and involve claims brought under Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), which requires a plaintiff to plead scienter and are thus inapposite here. See Makor Issues & Rights, Ltd. v. Tellabs Inc., 513 F.3d 702, 712 (7th Cir. 2008); In re Cabletron Sys., Inc., 311 F.3d 11, (1st Cir. 2002); In re ICN Pharm., Inc. Sec. Litig., 299 F. Supp.2d 1055 (C.D. Cal. 2004); Sekuk Glob. Enters. v. KVH Indus., Inc., No. 04-cv-306, 2005 WL 1924202 (D.R.I. Aug. 11, 2005).

recognized that customers were taking longer to pay for the products Funko was delivering to them, and Funko was extending payment terms to these customers. They contend Funko knew that the average number of days it was taking to collect payment was increasing and the company recognized its inventory turnover had decreased by double digits. The Investors further allege that Funko engaged in channel stuffing for "at least the twelve months leading up to the IPO" and that this practice rendered Funko's stated growth strategies "impotent" and that its statements concerning the company's growth and revenue during that period were misleading because they were based on those undisclosed practices. They allege that all of these key metrics constitute evidence that management knew it was channel stuffing and that this practice would likely have a material impact on its sales revenue. These allegations adequately satisfy CR 12(b)(6)'s pleading standard.

Funko also argues the Investors' Item 303 claim fails because it is premised on financial information that it fully disclosed in the registration statement. Funko cites Dropbox Sec. Litig., No. 19-cv-06348, 2020 WL 6161502, at *8 (N.D. Cal. Oct. 21, 2020), to support its argument that a Section 11 claim is appropriately dismissed where "[a]nyone with basic mathematical skills" could discern the allegations from the disclosed information. First, we do not read the Investors' claim to be based exclusively on disclosed information. The Investors' complaint makes reference to "internally reported accounts receivable amounts," and "internal reports" indicating saturated sales channels. They thus allege that there

are records in Funko's possession that prove it stuffed sales channels with its products in the run up to the IPO.

Second, whether a reasonable investor could discern the possible presence of channel stuffing from Funko's financial statements is a question of fact that we will not decide on the pleadings under CR 12(b)(6).[13] See In re Control Data Corp. Sec. Litig., 933 F.2d 616, 621 (8th Cir. 1991) ("whether a misrepresentation would have the effect of defrauding the market and inflating the stock price is a jury question.") (citing TSC Indus. Inc. v. Northway, Inc., 426 U.S. 438, 450, 96 S. Ct. 2126, 48 L. Ed. 2d 757 (1976).

We reverse the CR 12(b)(6) dismissal of the Investors' Item 303 claim based on the allegation that Funko failed to disclose its channel stuffing practices. We affirm the dismissal of the claim to the extent it is based on unverifiable descriptions of the company as "nimble" or its management "dynamic."

Inventory Control Practices

The Investors next contend the trial court erred in dismissing their claim that Funko failed to disclose that it lacked the ability to track obsolete inventory and included "dead stock" (outdated stock it could not sell) in its reported inventory figures in violation of GAAP standards.[14] The Funko consolidated balance sheet

[13] Funko also argues that the channel stuffing claim cannot survive because the company's performance after the IPO exceeded its estimates, making it impossible for any jury to conclude that it engaged in channel stuffing. But the Investors' channel stuffing claim does not fail as a matter of law at this stage simply because the company's revenues have grown in the years following the IPO. Although the company's post-IPO performance may undercut the Investors' claim of channel stuffing on summary judgment or at trial, it does not preclude the possibility that Funko inflated its sales numbers before the IPO, or that Funko continued to artificially inflate its revenue by engaging in channel stuffing following the IPO, as the Investors allege.

[14] The Investors rely on former ASC 330-10-35-1, which states:

valued its inventory at the end of 2016 at $43.6 million and at the end of 2017 at $79 million. The Investors allege that Funko had warehouses full of excess and outdated inventory that it was moving between warehouses and once moved, these items would vanish from the company tracking system. They allege Funko did not write down the value of this dead stock, resulting in an overstatement of the value of its inventory.

We conclude that the allegation that Funko overstated the value of its inventory in its financial statements is sufficient to state a Section 11 and 12(a) claim under CR 12(b)(6).[15]

Funko argues that the valuation of its inventory is an accounting judgment and thus a nonactionable statement of opinion under Omnicare. The consolidated balance sheets did explain how the company valued its inventory:

> Inventory consists primarily of figures, plush, accessories and other finished goods, and is accounted for using the first-in, first-out ("FIFO") method. The Company maintains reserves for excess and obsolete inventories to reflect the inventory balance at the lower of cost or net realizable value. This valuation requires us to make judgments, based on currently available information, about the likely method of disposition, such as through sales to customers, or liquidation, and expected recoverable value of each disposition category. The Company estimates obsolescence based on assumptions regarding future demand. Inventory costs include direct product costs and freight costs.

> A departure from the cost basis of pricing the inventory is required when the utility of the goods is no longer as great as their cost. Where there is evidence that the utility of goods, in their disposal in the ordinary course of business, will be less than cost, whether due to physical deterioration, obsolescence, changes in price levels, or other causes, the difference shall be recognized as a loss of the current period. This is generally accomplished by stating such goods at a lower level commonly designated as market.

[15] The Investors also alleged that Funko's statements regarding its inventory management practices were rendered misleading by the fact that the company did not have an effective inventory management system. Because the Investors failed to identify an affirmative misstatement or omission, this allegation was appropriately dismissed.

But the Investors allege that Funko lacked a functional inventory tracking system and that "internal reports at the Company as of the IPO indicated that Funko's inventory included significant amounts of obsolete merchandise." If true, Funko was aware of undisclosed facts undermining the reported valuation it placed on its inventory and this awareness is sufficient to establish falsity of an opinion statement at the pleading stage under Omnicare.

Value of Intellectual Property

The Investors next claim the Funko registration statement "materially overstated the value of its intangible assets, including its intellectual property." According to these documents, as of December 31, 2016, Funko reported $243 million in net intangible assets, including $107 million in intellectual property. The Investors allege these figures were misleading because Funko failed to disclose the fact that its intellectual property valuation included the value of the items already deemed unsaleable by the company. We conclude the Investors have satisfied the CR 12(b)(6) pleading standard as to this claim.

Funko first contends we should not reach the issue because the trial court found that Funko adequately disclosed that it licenses all of its intellectual property from third parties and the Investors failed to assign error to this finding. But our review is de novo so any trial court "findings" on CR 12(b)(6) are immaterial to our analysis. See Deegan v. Windermere Real Estate/Center-Isle, Inc., 197 Wn. App. 875, 884, 391 P.3d 582 (2017) (because de novo review is based on the complaint and hypothetical facts, findings of fact by the trial court are superfluous).

Moreover, Funko mischaracterizes the Investors' argument. The Investors do not now contend that Funko failed to disclose its reliance on third-party licensors, but that the reported value of its intellectual property licenses was undermined by the amount of dead stock in its warehouses. If these allegations are true, the reported value of Funko's intellectual property was overstated and materially misleading.

Funko also argues that the valuation of its intellectual property is nonactionable statement of opinion. But as with the statements about the value of its inventory, the Investors have satisfied the Omnicare standard by alleging facts demonstrating that the company knew its purported opinion was not factually supportable because that valuation was based in part on the amount of unsaleable stock in its inventory.

Adequacy of Risk Disclosures

Lastly, the Investors contend the trial court erred in concluding, as a matter of law, that Funko's disclosure of "Risk Factors" was neither false nor misleading. The Investors allege that a number of risks Funko identified as events that "could occur," had already come to fruition. They allege:

> The Registration Statement contained pages and pages of numerous generalized possible "Risk Factors" that might occur and "[in] case" they did actually occur, then Funko's financial condition and results of operation "could be materially and adversely affected." Those statements were false or misleading and omitted material information. For example, the Registration Statement listed a host of factors and stated "[i]f demand or future sales do not reach forecasted levels, we could have excess inventory that we may need to hold for a long period of time, write down, sell at prices lower than expected or discard." . . . . What the Registration Statement described as future possibilities had already occurred.

They allege that this disclosure violated Item 503 of SEC's Regulation S-K, former 17 C.F.R. § 229.503,[16] by not describing one of the most significant factors making Funko's stock risky.

Funko's registration statement included the mandatory "Risk Factors" discussion. The Investors point to the section entitled "Our success depends, in part, on our ability to successfully manage our inventories." In this section, Funko stated:

> We must maintain sufficient inventory to operate our business successfully, but we must also avoid accumulating excess inventory, which increases working capital needs and lowers gross margin. We obtain substantially all of our inventory from third-party manufacturers located outside the United States and must typically order products well in advance of the time these products will be offered for sale to our customers. As a result, it may be difficult to respond to changes in consumer preferences and market conditions, which for pop culture products can change rapidly. If we do not accurately anticipate the popularity of certain products, then we may not have sufficient inventory to meet demand. Alternatively, if demand or future sales do not reach forecasted levels, we could have excess inventory that we may need to hold for a long period of time, write down, sell at prices lower than expected or discard. If we are not successful in managing our inventory, our business, financial condition and results of operations could be adversely affected.

The Investors allege that this statement is materially misleading because "the Company's inventory problems had <u>already</u> arrived, born of channel stuffing and Funko's poor internal controls over inventories," leading to the improper postponement of write-downs on obsolete inventory.

The Investors also point to the section entitled "Failure to successfully operate our information systems and implement new technology effectively could

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[16] Now codified as 17 CFR § 229.105. This regulation requires securities registrants to "provide under the caption 'Risk Factors' a discussion of the most significant factors that make the offering speculative or risky."

disrupt our business or reduce our sales or profitability." In this section, Funko stated:

> We rely extensively on various information technology systems and software applications to manage many aspects of our business, including . . . management of our supply chain [and] sale and delivery of our products. . . .
>
> In addition, we have recently implemented, and expect to continue to invest in and implement, modifications and upgrades to our information technology systems and procedures to support our growth and the development of our e-commerce business. These modifications and upgrades could require substantial investment, and may not improve our profitability at a level that outweighs their costs, or at all.

The Investors allege this statement was misleading or omitted material facts because "Funko's business had already been harmed by the failure of a new ecommerce platform and a recent past implementation failure."

As the Investors argue persuasively, risk disclosures that describe factors that could occur in the future are misleading if they fail to disclose that the risk has already transpired. "Cautionary words about future risk cannot insulate from liability the failure to disclose that the risk has transpired." Rombach v. Chang, 355 F.3d 164, 173 (2d Cir. 2004). And perhaps even more persuasive is Ferreira v. Funko, Inc., 2021 WL 880400 (C.D. Cal. 2021), in which a federal court examined Funko's statement in a 2019 SEC filing that, like its registration statement, identified as a risk factor that its "success depends, in part, on [its] ability to successfully manage [its] inventories." Id. at *16. The plaintiffs in Ferreira, as the Investors here, alleged that this statement was misleading because Funko knew that the risk of excess inventory had already materialized. Id. at *17. The

court concluded that the plaintiffs had adequately pleaded facts to support the allegation that the risk disclosure was misleading:

> While the Court agrees with the Funko Defendants that the risk disclosure only discussed possible future risks and did not affirmatively state Funko had no excess or obsolete inventory, the disclosure is misleading and not meaningful because it sets forth various hypothetical risks associated with maintaining excess inventory without disclosing that this risk had materialized, as alleged by Plaintiffs. This is exactly the circumstance under which the Ninth Circuit has found this type of statement to be misleading.

Id. at *18. See also Siracusano v. Matrixx Initiatives, Inc., 585 F.3d 1167, 1181 (9th Cir. 2009) (company made material misrepresentations where it disclosed the risks of possible product liability lawsuits without disclosing that a product liability lawsuit had already been filed).

Funko argues that dismissal of this claim was appropriate under the "bespeaks caution" doctrine. Dismissal on the pleadings under this doctrine is appropriate only where "the documents containing defendants' challenged statements include enough cautionary language or risk disclosure that reasonable minds could not disagree that the challenged statements were not misleading." Fecht v. Price Co., 70 F.3d 1078, 1082 (9th Cir. 1995) (citations and quotations omitted), cert. denied, 517 U.S. 1136 (1996). To meet this standard, the language bespeaking caution must relate directly to the language which plaintiffs claim to be misleading. In re Atossa Genetics Inc. Sec. Litig., 868 F.3d 784, 798 (9th Cir. 2017).

Funko did caution potential investors that "if demand or future sales do not reach forecasted levels, we could have excess inventory that we may need to hold for a long period of time, write down, sell at prices lower than expected or discard."

But Funko's risk disclosures did not directly address the issue of which the Investors now complain: that its collection of unsaleable stock had already negatively impacted the value of its inventory, the value of which was thus overstated in the consolidated balance sheets. In light of these factual allegations, reasonable minds could disagree on the sufficiency of this cautionary language and thus the bespeaks caution doctrine does not warrant dismissal at the CR 12(b)(6) stage.

We therefore conclude that, under CR 12(b)(6), the Investors adequately allege material omissions in the registration statement's risk disclosures. The trial court erred in concluding otherwise.[17]

Section 15 Claims

Section 15 provides investors with a private cause of action against anyone who "controls" a party found liable under Section 11 or 12:

> 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

[17] Funko argues that the trial court's finding that the Gandel article was not a "corrective disclosure" provides an independent basis for dismissing the Investors' claims regarding its financial disclosures. We reject this argument. To recover for securities fraud under Section 10(b) of the Securities Act of 1934, 15 U.S.C. § 78j(b), a plaintiff must establish "loss causation," i.e., a causal connection between a material misrepresentation and the plaintiff's loss. In re Iso Ray, Inc. Sec. Litig., 189 F. Supp. 3d 1057, 1079 (E. D. Wash. 2016). One method of proving loss causation is by showing that a corrective disclosure, or a disclosure that reveals the fraud, caused the stock to decline. Id. But under Section 11, damages are measured by the difference between the amount paid for a security and its price either at the time it was sold or the date the Section 11 claim was filed. 15 U.S.C. §77k(e). Loss causation is thus not an element of a Section 11 claim, but can be used as an affirmative defense if the defendant can prove that the depreciation in value of its security resulted from factors other than the alleged material misstatements or omissions in the registration statement. In re Worlds of Wonder Sec. Litig., 35 F.3d 1407, 1421-22 (9th Cir. 1994). Because the Investors here allege claims under Section 11 of the Securities Act of 1933, and not Section 10(b) of the Securities Act of 1934, they do not have to show that the stock price drop occurred as a result of a corrective disclosure. The trial court's finding that the Gandel article did not disclose any fraud and merely disclosed an analysis of Funko's financial condition based on disclosures in the registration statement does not require a dismissal of the Investors' claims, as Funko has not established this affirmative defense as a matter of law.

> ownership, agency, or otherwise, controls any person liable under sections 77k or 77*l* of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

15 U.S.C. § 77*o*(a).

In order to state a prima facie case under Section 15, a plaintiff must allege: "(1) a primary violation of federal securities law and (2) that the defendant exercised actual power or control over the primary violator." No. 84 Emp'r–Teamster Joint Council Pension Tr. Fund v. Am. W. Holding Corp., 320 F.3d 920, 945 (9th Cir. 2003) (quoting Howard v. Everex Sys., Inc., 228 F.3d 1057, 1065 (9th Cir. 2000)) (quotation marks omitted). Because the Investors adequately allege primary violations of Sections 11 and 12(a) of the Securities Act, the Investors adequately pleaded the first prong of their Section 15 claim.

As to the control prong, the Investors allege that each of the individual defendants were control persons of Funko by virtue of their positions as directors or senior officers of Funko's predecessor, FAH LLC. The Investors also allege that the Venture Capital Firms were control persons of Funko and FAH by virtue of their ownership of Funko securities, board membership, relationships with management, and contractual rights regarding Funko's governance.

Fundamental Capital LLC and Fundamental Capital Partners, LLC moved to dismiss the Investors' Section 15 claim on the ground that, as a minority shareholder, they could not be a "control person" as a matter of law under the Securities Act. The trial court granted their motion without specifying whether the

dismissal was based on the primary violation prong or the control prong of the Section 15 test. Fundamental Capital argues that the Investors have abandoned their “control person” argument by failing to raise it on appeal. We decline to conclude that the Investors abandoned a legal argument when there is no clear indication in the record that the trial court ruled against them on this ground.

Fundamental Capital contended below that the Investors failed to allege facts to support the contention that they had the power to direct Funko’s management policies or day-to-day activities or had the ability to control the content of the registration statement. We disagree. The Investors allege that Fundamental Capital owned 34.9% of the Funko Class A common stock and 27.7% of the Funko Class B common stock as of the IPO. They also allege that Fundamental Capital was a part of a group that, with a representative from ACON and the chief executive officer, remained on Funko’s board after the IPO. The Investors further allege that Fundamental Capital was a member of FAH and through that membership had the ability to control the board, the power to cause the registration of the stock sold in the IPO, and through their representative on the board, signed the registration statement, affirming the statements the Investors now claim to be false or misleading.

The SEC defines 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.” 17 C.F.R. § 230.405. The determination of who is a control person is “an intensely factual question.” Arthur Children’s Tr. v. Keim, 994 F.2d 1390, 1396 (9th Cir.

1993). We 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. For this reason, we reverse the dismissal of the Investors' Section 15 claim against both Venture Capital Firms.

Affirmed in part, reversed in part, and remanded for further proceedings consistent with this opinion.

Andrus, A.C.J.

WE CONCUR:

Brennan, J. Appelwick, J.

APPENDIX B

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
IN AND FOR KING COUNTY

In re FUNKO, INC. SECURITIES LITIGATION This Document Relates to: ALL ACTIONS.	No. 17-2-29838-7 SEA (Consol. with Nos. 18-2-01264-3 SEA, 18-2-01582-1 SEA, 18-2-02535-4 SEA, 18-2-08153-0 SEA, and 18-2-12229-5 SEA) **ORDER GRANTING FUNKO DEFENDANTS' MOTION TO DISMISS CONSOLIDATED COMPLAINT** ***CLERK'S ACTION REQUIRED**

This matter came before the Court on Defendants Funko, Inc., Brian Mariotti, Russell Nickel, Ken Brotman, Gino Dellomo, Charles Denson, Diane Irvine, Adam Kriger, and Richard McNally's (collectively, "Funko Defendants") Motion to Dismiss the Consolidated Complaint ("Motion to Dismiss"). The Court heard the oral arguments of counsel and has considered the following pleadings and all attached exhibits:

- Plaintiffs' Consolidated Complaint, Dkt. No. 18A;
- Funko Defendants' Motion to Dismiss, Dkt. No. 37H;
- The Declaration of Kevin M. McDonough in support of Funko Defendants' Motion to Dismiss and its attached exhibits, Dkt. No. 37I;
- Underwriter Defendants' Joinder in the Funko Defendants' Motion to Dismiss, Dkt. No. 38;

- Plaintiffs' Opposition to Funko Defendants' Motion to Dismiss, Dkt. No. 44;
- Funko Defendants' Reply in Further Support of their Motion to Dismiss, Dkt. No. 50;
- The records and pleadings on file in this action; and

The court finds as follows:

1. Funko, Inc. ("Funko") was founded in 2005, is headquartered in Everett, Washington, and its shares trade on NASDAQ under ticker symbol "FNKO". Funko is engaged in selling a broad range of pop culture consumer products.
2. Funko conducted its initial public offering of common stock ("IPO") in November 2017.
3. Funko filed a Registration Statement on Form S-1 on October 6, 2017 with two amendments later in the same month. The Registration Statement was signed by the individual defendants or the individual defendants authorized the signing of the Registration Statement.
4. On November 3, 2017, Funko filed its Prospectus with Securities and Exchange Commission ("SEC") which incorporated the Registration Statement (collectively, the "Registration Statement").
5. Funko's Form S-1 was declared effective on November 1, 2017. Funko's shares were priced at $12 and began trading the following day.
6. On November 2, 2017, Funko's share price dropped to close at $7.07.
7. On November 2, 2017, the Bloomberg Gadfly posted an article (Blogpost) titled "*Funko Extends Playtime to Its Accounting*". In this article, the author, Gandel, in analyzing Funko's Corporate filings, gave critical opinion as to Funko's performance, prospectus and "*adjusted Ebitda*[1]" measure of earnings.
8. Plaintiffs brought the current law suit against a number of defendants. The cases have been consolidated under one cause number. Plaintiffs make the following claims:

[1] EBITDA: Earnings Before Interest, Tax, Depreciation and Amortization

a. That all defendants violated Section 11of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. § 77k, by issuing a registration statement for the initial public offering that was materially misleading and omitted to state material facts required to be stated therein;

b. That Funko and the underwriters violated Section 12(a)(2) of the Securities Act, 15 U.S.C. § 77*l*(a)(2), by selling common shares of Funko in the initial public offering for their personal financial gain based on the Prospectus dated November 3, 2017 that created materially misleading impression and omitted to state other facts necessary to make the statements made not misleading;

c. That the individual defendants by virtue of their offices, directorship and specific acts, were, controlling persons of Funko and violated Section 15 of the Securities Act, 15 U.S.C. § 77o, by having power and influence and exercising the same to cause Funko to engage in the wrongful acts.

- ANALYSIS

1. In a motion to dismiss pursuant to CR 12(b)(6), the court accepts the allegations in the complaint and any reasonable inferences therein as true. *Tabingo v. American Triumph LLC,* 188 Wash. 2d 41, 391 P.3d 434, 437, 2017 A.M.C. 1139 (2017), *as amended*, (May 2, 2017) and cert. denied, 138 S. Ct. 648, 199 L. Ed. 2d 530 (2018); *J.S. v. Village Voice Media Holdings, LLC,* 184 Wash. 2d 95, 359 P.3d 714 (2015); *Hipple v. McFadden,* 161 Wash. App. 550, 255 P.3d 730 (Div. 2 2011), *review denied*, 172 Wash. 2d 1009, 259 P.3d 1108 (2011).

2. Dismissal pursuant to a CR 12 (b)(6) motion is only appropriate if the court concludes that the plaintiff cannot prove any set of facts which could justify recovery. *Tabingo,* supra at 45-46; *Kinney v. Cook,* 159 Wn.2d 837, 154 P.3d 206 (2007).

3. Prior to a public securities offering, a company must file certain documents, generally a

registration statement[2] and prospectus[3], with the SEC in order to provide relevant information to investors about the company and the securities. *"Registration statements as a class are formal documents, filed with the SEC as a legal prerequisite for selling securities to the public." Omnicare, Inc. v. Laborers Dist. Council Const. Indus. Pension Fund,* 135 S. Ct. 1318, 1330, 191 L. Ed. 2d 253 (2015).

9. Section 11 of the Securities Act contains a private right of action for purchasers of a security if the issuer publishes a registration statement in connection with that security that *"contain[s] an untrue statement of a material fact or omit[s] to state a material fact required to be stated therein or necessary to make the statements therein not misleading."* 15 U.S.C. § 77k(a).
10. Section 12(a)(2) of the Securities Act imposed liability where a prospectus or communication *"includes an untrue statement of a material fact"* or *"omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading"*. 15 U.S.C.A. § 77***l***.
11. Section 15 of the Securities Act provides a cause of action against persons who control other persons liable under Section 11. 15 U.S.C. § 77(o).
12. The Plaintiffs allege that all Defendants violated Section 11 and that Funko and the Underwriters violated Section 12(a)(2) of the Securities Act, both of which create liability for untrue statements of material fact in connection with the sale of securities.
13. Plaintiffs further claim that Funko violated Sections 11, 12 and 15 of the Securities Act by making false or misleading statements or omitting material facts in the Registration

[2] The term "registration statement" means the statement provided for in section 77f of this title, and includes any amendment thereto and any report, document, or memorandum filed as part of such statement or incorporated therein by reference. 15 U.S.C.A. § 77b

[3] The term "prospectus" means any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television, which offers any security for sale… 15 U.S.C.A. § 77b

Statement in connection with its November 2017 IPO. Plaintiffs allege that they purchased or acquired the common stock of Funko pursuant to its Registration Statement and that they were damaged.

14. In support of their claims the Plaintiffs point to certain statements in the Prospectus regarding Funko's historical growth; Funko's net income and profitability; and the intangible assets subject to amortization. Plaintiffs claim that the following statement and information in the Prospectus created materially misleading impressions that Funko's earning growth trends were stronger than they actually were and that the EBITDA growth trend was representative of the Funko's prospects:
    a. Our financial performance reflects the strong growth of our business. From 2014 to 2016, we expanded our net sales, net income and Adjusted EBITDA at a 100%, a 17% and an 86% compound annual growth rate, or CAGR, respectively. We achieved this growth without reliance on a singular "hit" property as no single property accounted for more than 15% of annual net sales during this period. We believe our strong growth and profitability reflect our pop culture consumer products leadership. P.3
    b. The graphic display that followed the above statement showing an upward arrow of the Adjusted EBITDA and the net income information side-by-side.
    c. The information at p.27 regarding Funko's net income and profitability.
    d. The information on p.F-19 regarding Funko's intangible assets subject to amortization created misleading impressions.
15. Plaintiffs' further claim that Funko did not disclose that it largely relied upon third-party intellectual property.

I. **Standing:**

16. Funko in its motion argues that the Plaintiffs lack standing to bring this lawsuit as they have failed to show an "injury in fact" and that the Plaintiffs in their complaint point to no losses

by any of the six named Plaintiffs.

17. On the issue of standing the Plaintiffs argue that the IPO was on November 2, 2017 and the shares were offered at $12; that each of Plaintiffs acquired their shares before filing of one of the consolidated actions and that per Section 11 of the Securities Act: *"damages must be measured by the difference between the amount paid for the security and its price at either the time it was sold or the date the action was filed."* The first filing of the consolidated action was on November 16, 2017. The Plaintiffs therefore claim that they have standing because at the time of the initial action was filed, Funko's stock traded in the range of $6-$7 per share or approximately 50% below the Company's IPO price of $12 per share.

18. 15 U.S.C. 77k(e) provides: *"The suit under subsection (s) may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought.."*

19. Standing is a threshold issue. "*To have standing, one must have some protectable interest that has been invaded or is about to be invaded." Orion Corp. v. State,* 103 Wash.2d 441, 455, 693 P.2d 1369 (1985); *Alexander v. Sanford,* 181 Wash. App. 135, 149–50, 325 P.3d 341, 351 (2014).

20. The Plaintiffs assert their claim pursuant to Section 11 of the Securities Act and as such they have shown that at the time of the initial filing of the consolidated claims, the price per share of Funko's common stocks was lower than at the time of the IPO. The Court therefore finds that the Plaintiffs have standing.

1 II. **Section 11 and 12 Claims:**

2 21. For Plaintiffs to state a claim under Section 11 and 12 of the Securities Act, they must
3 plausibly allege that the statement in the Prospectus was both false and misleading to
4 investors, or that there was an omission in the Prospectus that created an impression of a
5 state of affairs that differed in a material way form the one that actually existed. See *Brody*
6 *v. Transitional Hospitals Corp.,* 280 F.3d 997, 1006 (9th Cir 2002); *Greenberg v. Sunrun*
7 *Inc.*, 233 F. Supp. 3d 764, 771–72 (N.D. Cal. 2017); see also *Rubke v. Capitol Bancorp Ltd.*,
8 551 F.3d 1156, 2009 WL 69278 *3 (9th Cir. Jan.13, 2009).

9 22. Plaintiffs in their opposition to the motion rely on the Bloomberg Gadfly article and argue
10 that the article demonstrated that Funko's Registration Statement, as presented, gave a
11 misleading impression of Funko's business and financial condition.

12 23. Plaintiffs argue that their claim under Section 11[4] should be considered in the context of
13 Funko's entire Registration Statement and that the graphic chart and the upward arrow were
14 materially misleading because the financial metric used by Funko left out most of the
15 expenses from the Adjusted EBITDA.

16 24. The Plaintiffs further argue that even if the information in the Registration Statement were
17 literally true, their claim should survive because a misleading *"gloss and emphasis"* in the
18 registration material could violate the Securities Act. Plaintiffs point out that taking Funko's
19 Registration Statement in context, a reasonable investor could get the impression of a
20 company that was growing much faster than Funko was and believe that Funko had a high
21 growth rate that was expected to continue.

22 25. The court finds that Funko's Registration Statement included and explained the basis for
23 and the limitations of the financial metrics presented. It also included the disclosure that
24 Funko excluded certain costs from its EBITDA, Adjusted EBITDA and Adjusted EBITDA
25

26 [4] Plaintiffs' apply their argument also to Section 12

margin calculations. The Registration Statement includes the following warning: *EBITDA Adjusted EBITDA, and Adjusted EBITDA margin are not measurements of our financial performance under GAAP and should not be considered as an alternative to net income (loss), net income (loss) margin or any other performance measure derived in accordance with GAAP*[5]*, or as an alternative to cash flow from operating activities as a measure of our liquidity.* It also goes on to explain how Funko defines "EBITDA", "Adjusted EBITDA" and "Adjusted EBITDA margin" and explains that these are non-GAAP financial measures provided as supplemental measures together with reconciliations to enhance the investor's understanding of Funko's business and operations. Funko further provides that: "EBITDA, Adjusted EBITDA and Adjusted EBITDA margin have limitations as analytical tools, and should not be considered in isolations, or an alternative to, or a substitute for net income (loss) margin or other financial statement data presented... it goes on to state some of such limitations such as: *"do not reflect our cash expenditures"* ; *"do not reflect the interest expense or cash requirements necessary to service interest or principal payments on our debts"*; *"do not reflect our tax expenses"*.(Prospectus at 86).

26. Plaintiffs rely on the November 2, 2017 article /blogpost by Gandel to support their claims. Gandel in his article provided his personal opinion/ interpretation of the information in Funko's Registration Statement. Gandel's article cited to "Funko's corporate filings" as his only source of information. Gandel's article did not reveal any new information which had not been disclosed by Funko. Gandel in his article did not question the accuracy of the information disclosed by Funko; he provided his interpretation and opinion using Funko's disclosed information. Gandel's article did not reveal any corrective disclosure revealing the falsity in the Registration Statement by Funko.

27. Plaintiffs have not shown that any new information about Funko was revealed on November

[5] Generally Accepted Accounting Principles

1 2, 2017 to cause the price decline.

2 28. The upward arrow in the graphic included in the Registration Statement did not improperly
3 emphasized Funko's Adjusted EBITDA over its net income. The graphic shows the
4 Adjusted EBITDA and the net income side-by side. The Prospectus' financial data also
5 defines the EBOTDA- related metrics and provides a table reconciling them to the net
6 income. This information appears in close proximity. Additionally, there are clear warnings
7 included in the Prospectus.

8 29. Plaintiffs' claim that Funko did not disclose that it largely relied upon third-party intellectual
9 property, however the Prospectus discloses that Funko generates substantially all of their
10 net sales under license agreements that allow them to use certain intellectual property in
11 products.

12 30. The court finds that Funko's statements regarding its financial disclosures were not
13 materially false or misleading.

14 31. The court further finds that the Plaintiffs have not shown that Funko's "opinion statements"
15 were false or that such statements were not simply corporate optimism or puffery. See
16 *Greenberg*, supra at 775 "*The securities laws do not exist to combat sales puffery of this*
17 *sort.*", and *Philco Investments, Ltd. v. Martin*, 2011 WL 500694 at *7 (N.D. Cal. 2011).
18 Furthermore, the Plaintiffs have not satisfied the *Omnicore* standard for alleging falsity of
19 opinion statements. "The investor must identify particular (and material) facts going to the
20 basis for the issuer's opinion—facts about the inquiry the issuer did or did not conduct or
21 the knowledge it did or did not have—whose omission makes the opinion statement at issue
22 misleading to a reasonable person reading the statement fairly and in context. See *supra,* at
23 1328 – 1330. That is no small task for an investor." *Omnicare, Inc. v. Laborers Dist. Council*
24 *Const. Indus. Pension Fund*, 135 S. Ct. 1318, 1332, 191 L. Ed. 2d 253 (2015).

25 32. The Court does not find that the defendants violated Section 11of the Securities Act, 15
26 U.S.C. § 77k, or Section 12(a)(2)of the Securities Act, 15 U.S.C.A. § 77***l*** by issuing a

1 registration statement for the initial public offering that was materially misleading and
2 omitted to state material facts required to be stated therein.
3 33. For the Plaintiffs to state a claim under Section 15 of the Securities Act, against a control
4 person, they must plausibly allege (1) an underlying violation of Section 11 or 12, and (2)
5 control. 15 U.S.C. § 77o; *Greenberg,* supra at 772. Because the Court has concluded that
6 the Plaintiffs have not shown a violation of Section 11 or 12 of the Securities Act, the
7 Plaintiffs claims under Section 15 of the Securities Act cannot stand.
8
9 It is hereby ORDERED that Funko Defendants' Motion to Dismiss is GRANTED.
10 Plaintiffs are allowed leave to amend the Complaint.
11
12 Dated this 2nd day of August 2, 2019.
13
14 Judge Susan Amini
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APPENDIX C

IN THE SUPERIOR COURT OF THE STATE OF WASHINGTON
IN AND FOR KING COUNTY

In re FUNKO, INC. SECURITIES LITIGATION This Document Relates to: ALL ACTIONS.	No. 17-2-29838-7 SEA (Consol. with Nos. 18-2-01264-3 SEA, 18-2-01582-1 SEA, 18-2-02535-4 SEA, 18-2-08153-0 SEA, and 18-2-12229-5 SEA) **ORDER GRANTING FUNKO DEFENDANTS' MOTION TO DISMISS FIRST AMENDED CONSOLIDATED COMPLAINT**

This matter came before the Court on Defendants Funko, Inc., Brian Mariotti, Russell Nickel, Ken Brotman, Gino Dellomo, Charles Denson, Diane Irvine, Adam Kriger, and Richard McNally's (collectively, the "Funko Defendants") Motion to Dismiss the First Amended Consolidated Complaint ("Motion to Dismiss the FACC"). The Court has considered the pleadings, declarations and exhibits submitted by all parties and in particular the following:

- Plaintiffs' Consolidated Complaint, Dkt. No. 18A;
- The Court's Order Granting the Funko Defendants' Motion to Dismiss the Consolidated Complaint, Dkt. No. 76;
- Plaintiffs' First Amended Consolidated Complaint, Dkt. No. 77;
- The Funko Defendants' Motion to Dismiss the FACC, Dkt. No. 86;
- The Declaration of Kevin M. McDonough in support of the Motion to Dismiss the FACC and its attached exhibits, Dkt. No. 87;

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- The Underwriter Defendants' Joinder in the Funko Defendants' Motion to Dismiss the FACC, Dkt. No. 84;
- Plaintiffs' Opposition to the Motion to Dismiss the FACC, Dkt. No. 92;
- The Funko Defendants' Reply in Further Support of the Motion to Dismiss the FACC, Dkt. No. 94;
- The records and pleadings on file in this action; and
- The oral argument of the parties.

It is hereby ORDERED that the Funko Defendants' Motion to Dismiss the FACC is GRANTED with prejudice.

Dated this 5th day of August, 2020.

____

Judge Susan Amini

DLA Piper LLP (US)
701 Fifth Avenue, Suite 6900
Seattle, WA 98104-7029 | Tel: 206.839.4800

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CERTIFICATE OF SERVICE

I declare that on May 13, 2020, I caused a true and correct copy of the foregoing document to be served on the following in the manner indicated:

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Stephen Willey, WSBA No. 24499 Duffy Graham, WSBA No. 33103 SAVITT BRUCE & WILLEY LLP 1425 Fourth Avenue, Suite 800 Seattle, Washington 98101-2272 Tel: 206.749.0500 Fax: 206.749.0600 E-mail: swilley@sbwllp.com E-mail: dgraham@sbwllp.com *Attorneys for Defendant Fundamental Capital, LLC and Fundamental Capital Partners, LLC*	☐ Hand Delivery ☐ Via U.S. Mail ☒ Via E-mail ☒ Via the Court's E-Service Device

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Dated this 13th day of May, 2020.

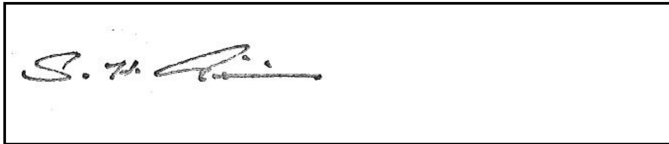
s/ Rachel Evans
Rachel Evans, Legal Practice Specialist

King County Superior Court
Judicial Electronic Signature Page

Case Number: 17-2-29838-7
Case Title: LOWINGER VS FUNKO INC ET AL

Document Title: ORDER

Signed by: Susan Amini
Date: 8/5/2020 1:37:02 PM



Judge/Commissioner: Susan Amini

This document is signed in accordance with the provisions in GR 30.
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APPENDIX D.1

AUTHENTICATED U.S. GOVERNMENT INFORMATION GPO

tus or can be furnished by such user without unreasonable effort or expense;

(4) there may be omitted from any prospectus any of the information required under this subsection which the Commission may by rules or regulations designate as not being necessary or appropriate in the public interest or for the protection of investors.

(b) Summarizations and omissions allowed by rules and regulations

In addition to the prospectus permitted or required in subsection (a), the Commission shall by rules or regulations deemed necessary or appropriate in the public interest or for the protection of investors permit the use of a prospectus for the purposes of subsection (b)(1) of section 77e of this title which omits in part or summarizes information in the prospectus specified in subsection (a). A prospectus permitted under this subsection shall, except to the extent the Commission by rules or regulations deemed necessary or appropriate in the public interest or for the protection of investors otherwise provides, be filed as part of the registration statement but shall not be deemed a part of such registration statement for the purposes of section 77k of this title. The Commission may at any time issue an order preventing or suspending the use of a prospectus permitted under this subsection, if it has reason to believe that such prospectus has not been filed (if required to be filed as part of the registration statement) or includes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which such prospectus is or is to be used, not misleading. Upon issuance of an order under this subsection, the Commission shall give notice of the issuance of such order and opportunity for hearing by personal service or the sending of confirmed telegraphic notice. The Commission shall vacate or modify the order at any time for good cause or if such prospectus has been filed or amended in accordance with such order.

(c) Additional information required by rules and regulations

Any prospectus shall contain such other information as the Commission may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors.

(d) Classification of prospectuses

In the exercise of its powers under subsections (a), (b), or (c), the Commission shall have authority to classify prospectuses according to the nature and circumstances of their use or the nature of the security, issue, issuer, or otherwise, and, by rules and regulations and subject to such terms and conditions as it shall specify therein, to prescribe as to each class the form and contents which it may find appropriate and consistent with the public interest and the protection of investors.

(e) Information in conspicuous part of prospectus

The statements or information required to be included in a prospectus by or under authority of subsections (a), (b), (c), or (d), when written, shall be placed in a conspicuous part of the prospectus and, except as otherwise permitted by rules or regulations, in type as large as that used generally in the body of the prospectus.

(f) Prospectus consisting of radio or television broadcast

In any case where a prospectus consists of a radio or television broadcast, copies thereof shall be filed with the Commission under such rules and regulations as it shall prescribe. The Commission may by rules and regulations require the filing with it of forms and prospectuses used in connection with the offer or sale of securities registered under this subchapter.

(May 27, 1933, ch. 38, title I, §10, 48 Stat. 81; June 6, 1934, ch. 404, title II, §205, 48 Stat. 906; Aug. 10, 1954, ch. 667, title I, §8, 68 Stat. 685.)

AMENDMENTS

1954—Act Aug. 10, 1954, complemented changes in section 77e of this title by act Aug. 10, 1954, permitted offering activities in the waiting period and in so doing rearranged the sequence of the subsections, added new text contained in subsec. (b), and renumbered subsecs. (c) and (d) as (e) and (f), respectively.

1934—Subsec. (b)(1). Act June 6, 1934, amended par. (1).

EFFECTIVE DATE OF 1954 AMENDMENT

Amendment by act Aug. 10, 1954, effective 60 days after Aug. 10, 1954, see note under section 77b of this title.

TRANSFER OF FUNCTIONS

For transfer of functions of Securities and Exchange Commission, with certain exceptions, to Chairman of such Commission, see Reorg. Plan No. 10 of 1950, §§1, 2, eff. May 24, 1950, 15 F.R. 3175, 64 Stat. 1265, set out under section 78d of this title.

§ 77k. Civil liabilities on account of false registration statement

(a) Persons possessing cause of action; persons liable

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or cer-

tified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

(b) Persons exempt from liability upon proof of issues

Notwithstanding the provisions of subsection (a) no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof—

(1) that before the effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1) of this subsection, and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and (B) as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert; and (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert; and (D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue, or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement made by the official person or was not a fair copy of or extract from the public official document.

(c) Standard of reasonableness

In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

(d) Effective date of registration statement with regard to underwriters

If any person becomes an underwriter with respect to the security after the part of the registration statement with respect to which his liability is asserted has become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration statement shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

(e) Measure of damages; undertaking for payment of costs

The suit authorized under subsection (a) may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security

shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: *Provided*, That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

(f) Joint and several liability; liability of outside director

(1) Except as provided in paragraph (2), all or any one or more of the persons specified in subsection (a) shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(2)(A) The liability of an outside director under subsection (e) shall be determined in accordance with section 78u–4(f) of this title.

(B) For purposes of this paragraph, the term ''outside director'' shall have the meaning given such term by rule or regulation of the Commission.

(g) Offering price to public as maximum amount recoverable

In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

(May 27, 1933, ch. 38, title I, § 11, 48 Stat. 82; June 6, 1934, ch. 404, title II, § 206, 48 Stat. 907; Pub. L. 104–67, title II, § 201(b), Dec. 22, 1995, 109 Stat. 762; Pub. L. 105–353, title III, § 301(a)(2), Nov. 3, 1998, 112 Stat. 3235.)

Amendments

1998—Subsec. (f)(2)(A). Pub. L. 105–353 made technical amendment to reference in original act which appears in text as reference to section 78u–4(f) of this title.

1995—Subsec. (f). Pub. L. 104–67 designated existing provisions as par. (1), substituted ''Except as provided in paragraph (2), all'' for ''All'', and added par. (2).

1934—Subsec. (a). Act June 6, 1934, inserted last par.

Subsecs. (b)(3), (c) to (e). Act June 6, 1934, amended subsecs. (b)(3) and (c) to (e).

Effective Date of 1995 Amendment

Pub. L. 104–67, title II, § 202, Dec. 22, 1995, 109 Stat. 762, provided that: ''The amendments made by this title [amending this section and section 78u–4 of this title] shall not affect or apply to any private action arising under the securities laws commenced before and pending on the date of enactment of this Act [Dec. 22, 1995].''

Construction of 1995 Amendment

Nothing in amendment by Pub. L. 104–67 to be deemed to create or ratify any implied right of action, or to prevent Commission, by rule or regulation, from restricting or otherwise regulating private actions under Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), see section 203 of Pub. L. 104–67, set out as a Construction note under section 78j–1 of this title.

Transfer of Functions

For transfer of functions of Securities and Exchange Commission, with certain exceptions, to Chairman of such Commission, see Reorg. Plan No. 10 of 1950, §§ 1, 2, eff. May 24, 1950, 15 F.R. 3175, 64 Stat. 1265, set out under section 78d of this title.

§ 77*l*. Civil liabilities arising in connection with prospectuses and communications

(a) In general

Any person who—

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraphs (2) and (14) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable, subject to subsection (b), to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

APPENDIX D.2

AUTHENTICATED U.S. GOVERNMENT INFORMATION GPO

shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: *Provided*, That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

(f) Joint and several liability; liability of outside director

(1) Except as provided in paragraph (2), all or any one or more of the persons specified in subsection (a) shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

(2)(A) The liability of an outside director under subsection (e) shall be determined in accordance with section 78u–4(f) of this title.

(B) For purposes of this paragraph, the term ''outside director'' shall have the meaning given such term by rule or regulation of the Commission.

(g) Offering price to public as maximum amount recoverable

In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

(May 27, 1933, ch. 38, title I, §11, 48 Stat. 82; June 6, 1934, ch. 404, title II, §206, 48 Stat. 907; Pub. L. 104–67, title II, §201(b), Dec. 22, 1995, 109 Stat. 762; Pub. L. 105–353, title III, §301(a)(2), Nov. 3, 1998, 112 Stat. 3235.)

AMENDMENTS

1998—Subsec. (f)(2)(A). Pub. L. 105–353 made technical amendment to reference in original act which appears in text as reference to section 78u–4(f) of this title.

1995—Subsec. (f). Pub. L. 104–67 designated existing provisions as par. (1), substituted ''Except as provided in paragraph (2), all'' for ''All'', and added par. (2).

1934—Subsec. (a). Act June 6, 1934, inserted last par.

Subsecs. (b)(3), (c) to (e). Act June 6, 1934, amended subsecs. (b)(3) and (c) to (e).

EFFECTIVE DATE OF 1995 AMENDMENT

Pub. L. 104–67, title II, §202, Dec. 22, 1995, 109 Stat. 762, provided that: ''The amendments made by this title [amending this section and section 78u–4 of this title] shall not affect or apply to any private action arising under the securities laws commenced before and pending on the date of enactment of this Act [Dec. 22, 1995].''

CONSTRUCTION OF 1995 AMENDMENT

Nothing in amendment by Pub. L. 104–67 to be deemed to create or ratify any implied right of action, or to prevent Commission, by rule or regulation, from restricting or otherwise regulating private actions under Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), see section 203 of Pub. L. 104–67, set out as a Construction note under section 78j–1 of this title.

TRANSFER OF FUNCTIONS

For transfer of functions of Securities and Exchange Commission, with certain exceptions, to Chairman of such Commission, see Reorg. Plan No. 10 of 1950, §§1, 2, eff. May 24, 1950, 15 F.R. 3175, 64 Stat. 1265, set out under section 78d of this title.

§ 77*l*. Civil liabilities arising in connection with prospectuses and communications

(a) In general

Any person who—

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraphs (2) and (14) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable, subject to subsection (b), to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

(b) Loss causation

In an action described in subsection (a)(2), if the person who offered or sold such security proves that any portion or all of the amount recoverable under subsection (a)(2) represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communication, with respect to which the liability of that person is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statement not misleading, then such portion or amount, as the case may be, shall not be recoverable.

(May 27, 1933, ch. 38, title I, § 12, 48 Stat. 84; Aug. 10, 1954, ch. 667, title I, § 9, 68 Stat. 686; Pub. L. 104–67, title I, § 105, Dec. 22, 1995, 109 Stat. 757; Pub. L. 106–554, § 1(a)(5) [title II, § 208(a)(3)], Dec. 21, 2000, 114 Stat. 2763, 2763A–435.)

AMENDMENTS

2000—Subsec. (a)(2). Pub. L. 106–554 substituted ''paragraphs (2) and (14)'' for ''paragraph (2)''.

1995—Pub. L. 104–67 designated existing provisions as subsec. (a), inserted heading, inserted '', subject to subsection (b),'' after ''shall be liable'' in concluding provisions, and added subsec. (b).

1954—Act Aug. 10, 1954, inserted ''offers or'' before ''sells'' in pars. (1) and (2).

EFFECTIVE DATE OF 1995 AMENDMENT

Pub. L. 104–67, title I, § 108, Dec. 22, 1995, 109 Stat. 758, provided that: ''The amendments made by this title [enacting sections 77z–1, 77z–2, 78u–4, and 78u–5 of this title and amending this section and sections 77t, 78*o*, 78t, and 78u of this title and section 1964 of Title 18, Crimes and Criminal Procedure] shall not affect or apply to any private action arising under title I of the Securities Exchange Act of 1934 [15 U.S.C. 78a et seq.] or title I of the Securities Act of 1933 [15 U.S.C. 77a et seq.], commenced before and pending on the date of enactment of this Act [Dec. 22, 1995].''

EFFECTIVE DATE OF 1954 AMENDMENT

Amendment by act Aug. 10, 1954, effective 60 days after Aug. 10, 1954, see note under section 77b of this title.

CONSTRUCTION OF 1995 AMENDMENT

Nothing in amendment by Pub. L. 104–67 to be deemed to create or ratify any implied right of action, or to prevent Commission, by rule or regulation, from restricting or otherwise regulating private actions under Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), see section 203 of Pub. L. 104–67, set out as a Construction note under section 78j–1 of this title.

§ 77m. Limitation of actions

No action shall be maintained to enforce any liability created under section 77k or 77*l*(a)(2) of this title unless brought within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 77*l*(a)(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or 77*l*(a)(1) of this title more than three years after the security was bona fide offered to the public, or under section 77*l*(a)(2) of this title more than three years after the sale.

(May 27, 1933, ch. 38, title I, § 13, 48 Stat. 84; June 6, 1934, ch. 404, title II, § 207, 48 Stat. 908; Pub. L. 105–353, title III, § 301(a)(3), Nov. 3, 1998, 112 Stat. 3235.)

AMENDMENTS

1998—Pub. L. 105–353 substituted ''77*l*(a)(2)'' for ''77*l*(2)'' in two places and ''77*l*(a)(1)'' for ''77*l*(1)'' in two places.

1934—Act June 6, 1934, substituted ''one year'' for ''two years'', ''three years'' for ''ten years'', and inserted ''or under section 77*l*(2) of this title more than three years after the sale''.

§ 77n. Contrary stipulations void

Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

(May 27, 1933, ch. 38, title I, § 14, 48 Stat. 84.)

TRANSFER OF FUNCTIONS

For transfer of functions of Securities and Exchange Commission, with certain exceptions, to Chairman of such Commission, see Reorg. Plan No. 10 of 1950, §§ 1, 2, eff. May 24, 1950, 15 F.R. 3175, 64 Stat. 1265, set out under section 78d of this title.

§ 77*o*. Liability of controlling persons

(a) Controlling persons

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 77*l* of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist.

(b) Prosecution of persons who aid and abet violations

For purposes of any action brought by the Commission under subparagraph (b) or (d) of section 77t of this title, any person that knowingly or recklessly provides substantial assistance to another person in violation of a provision of this subchapter, or of any rule or regulation issued under this subchapter, shall be deemed to be in violation of such provision to the same extent as the person to whom such assistance is provided.

(May 27, 1933, ch. 38, title I, § 15, 48 Stat. 84; June 6, 1934, ch. 404, title II, § 208, 48 Stat. 908; Pub. L. 111–203, title IX, § 929M(a), July 21, 2010, 124 Stat. 1861.)

AMENDMENTS

2010—Pub. L. 111–203 designated existing provisions as subsec. (a), inserted heading, and added subsec. (b).

1934—Act June 6, 1934, exempted from liability controlling persons having no knowledge or reasonable grounds for belief.

EFFECTIVE DATE OF 2010 AMENDMENT

Amendment by Pub. L. 111–203 effective 1 day after July 21, 2010, except as otherwise provided, see section

APPENDIX D.3

AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
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occurring items recognized in each full quarter within the two most recent fiscal years and any subsequent interim period for which financial statements are included or are required to be included by Article 3 of Regulation S-X, as well as the aggregate effect and the nature of year-end or other adjustments which are material to the results of that quarter.

(4) If the financial statements to which this information relates have been reported on by an accountant, appropriate professional standards and procedures, as enumerated in the Statements of Auditing Standards issued by the Auditing Standards Board of the American Institute of Certified Public Accountants, shall be followed by the reporting accountant with regard to the data required by this paragraph (a).

(5) This paragraph (a) applies to any registrant, except a foreign private issuer, that has securities registered pursuant to sections 12(b) (15 U.S.C. §78*l*(b)) (other than mutual life insurance companies) or 12(g) of the Exchange Act (15 U.S.C. §78*l*(g)).

(b) *Information about oil and gas producing activities*. Registrants engaged in oil and gas producing activities shall present the information about oil and gas producing activities (as those activities are defined in Regulation S-X, §210.4–10(a)) specified in FASB ASC Topic 932, *Extractive Activities—Oil and Gas*, if such oil and gas producing activities are regarded as significant under one or more of the tests set forth in FASB ASC Subtopic 932–235, *Extractive Activities—Oil and Gas—Notes to Financial Statements*, for 'Significant Activities.'

Instructions to paragraph (b): 1. (a) FASB ASC Subtopic 932–235 disclosures that relate to annual periods shall be presented for each annual period for which an income statement is required. (b) FASB ASC Subtopic 932–235 disclosures required as of the end of an annual period shall be presented as of the date of each audited balance sheet required, and (c) FASB ASC Subtopic 932–235 disclosures required as of the beginning of an annual period shall be presented as of the beginning of each annual period for which an income statement is required.

2. This paragraph, together with §210.4–10 of Regulation S-X, prescribes financial reporting standards for the preparation of accounts by persons engaged, in whole or in part, in the production of crude oil or natural gas in the United States, pursuant to Section 503 of the Energy Policy and Conservation Act of 1975 (42 U.S.C. 8383) (''EPCA'') and Section 11(c) of the Energy Supply and Environmental Coordination Act of 1974 (15 U.S.C. 796) (''ESECA'') as amended by Section 506 of EPCA. The application of the paragraph to those oil and gas producing operations of companies regulated for ratemaking purposes on an individual-company-cost-of-service basis may, however, give appropriate recognition to differences arising because of the effect of the ratemaking process.

3. Any person exempted by the Department of Energy from any record-keeping or reporting requirements pursuant to Section 11(c) of ESECA, as amended, is similarly exempted from the related provisions of this paragraph in the preparation of accounts pursuant to EPCA. This exemption does not affect the applicability of this paragraph to filings pursuant to the federal securities laws.

(c) *Smaller reporting companies*. A registrant that qualifies as a smaller reporting company, as defined by §229.10(f)(1), is not required to provide the information required by this Item.

[47 FR 11401, Mar. 16, 1982, as amended at 47 FR 57914, Dec. 29, 1982; 52 FR 30919, Aug. 18, 1987; 56 FR 30053, July 1, 1991; 64 FR 73402, Dec. 30, 1999; 73 FR 958, Jan. 4, 2008; 74 FR 18617, Apr. 23, 2009; 76 FR 50120, Aug. 12, 2011]

§ 229.303 (Item 303) Management's discussion and analysis of financial condition and results of operations.

(a) *Full fiscal years*. Discuss registrant's financial condition, changes in financial condition and results of operations. The discussion shall provide information as specified in paragraphs (a)(1) through (5) of this Item and also shall provide such other information that the registrant believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations. Discussions of liquidity and capital resources may be combined whenever the two topics are interrelated. Where in the registrant's judgment a discussion of segment information or of other subdivisions of the registrant's business would be appropriate to an understanding of such business, the discussion shall focus on each relevant, reportable segment or other subdivision of the business and on the registrant as a whole.

(1) *Liquidity*. Identify any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way. If a material deficiency is identified, indicate the course of action that the registrant has taken or proposes to take to remedy the deficiency. Also identify and separately describe internal and external sources of liquidity, and briefly discuss any material unused sources of liquid assets.

(2) *Capital resources*. (i) Describe the registrant's material commitments for capital expenditures as of the end of the latest fiscal period, and indicate the general purpose of such commitments and the anticipated source of funds needed to fulfill such commitments.

(ii) Describe any known material trends, favorable or unfavorable, in the registrant's capital resources. Indicate any expected material changes in the mix and relative cost of such resources. The discussion shall consider changes between equity, debt and any off-balance sheet financing arrangements.

(3) *Results of operations*. (i) Describe any unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported income from continuing operations and, in each case, indicate the extent to which income was so affected. In addition, describe any other significant components of revenues or expenses that, in the registrant's judgment, should be described in order to understand the registrant's results of operations.

(ii) Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship shall be disclosed.

(iii) To the extent that the financial statements disclose material increases in net sales or revenues, provide a narrative discussion of the extent to which such increases are attributable to increases in prices or to increases in the volume or amount of goods or services being sold or to the introduction of new products or services.

(iv) For the three most recent fiscal years of the registrant or for those fiscal years in which the registrant has been engaged in business, whichever period is shortest, discuss the impact of inflation and changing prices on the registrant's net sales and revenues and on income from continuing operations.

(4) *Off-balance sheet arrangements*. (i) In a separately-captioned section, discuss the registrant's off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the registrant's financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors. The disclosure shall include the items specified in paragraphs (a)(4)(i)(A), (B), (C) and (D) of this Item to the extent necessary to an understanding of such arrangements and effect and shall also include such other information that the registrant believes is necessary for such an understanding.

(A) The nature and business purpose to the registrant of such off-balance sheet arrangements;

(B) The importance to the registrant of such off-balance sheet arrangements in respect of its liquidity, capital resources, market risk support, credit risk support or other benefits;

(C) The amounts of revenues, expenses and cash flows of the registrant arising from such arrangements; the nature and amounts of any interests retained, securities issued and other indebtedness incurred by the registrant in connection with such arrangements; and the nature and amounts of any other obligations or liabilities (including contingent obligations or liabilities) of the registrant arising from such arrangements that are or are reasonably likely to become material and the triggering events or circumstances that could cause them to arise; and

(D) Any known event, demand, commitment, trend or uncertainty that will result in or is reasonably likely to

result in the termination, or material reduction in availability to the registrant, of its off-balance sheet arrangements that provide material benefits to it, and the course of action that the registrant has taken or proposes to take in response to any such circumstances.

(ii) As used in this paragraph (a)(4), the term *off-balance sheet arrangement* means any transaction, agreement or other contractual arrangement to which an entity unconsolidated with the registrant is a party, under which the registrant has:

(A) Any obligation under a guarantee contract that has any of the characteristics identified in FASB ASC paragraph 460–10–15–4 (Guarantees Topic), as may be modified or supplemented, and that is not excluded from the initial recognition and measurement provisions of FASB ASC paragraphs 460–10–15–7, 460–10–25–1, and 460–10–30–1.

(B) A retained or contingent interest in assets transferred to an unconsolidated entity or similar arrangement that serves as credit, liquidity or market risk support to such entity for such assets;

(C) Any obligation, including a contingent obligation, under a contract that would be accounted for as a derivative instrument, except that it is both indexed to the registrant's own stock and classified in stockholders' equity in the registrant's statement of financial position, and therefore excluded from the scope of FASB ASC Topic 815, *Derivatives and Hedging*, pursuant to FASB ASC subparagraph 815–10–15–74(a), as may be modified or supplemented; or

(D) Any obligation, including a contingent obligation, arising out of a variable interest (as defined in the FASB ASC Master Glossary), as may be modified or supplemented) in an unconsolidated entity that is held by, and material to, the registrant, where such entity provides financing, liquidity, market risk or credit risk support to, or engages in leasing, hedging or research and development services with, the registrant.

(5) *Tabular disclosure of contractual obligations*. (i) In a tabular format, provide the information specified in this paragraph (a)(5) as of the latest fiscal year end balance sheet date with respect to the registrant's known contractual obligations specified in the table that follows this paragraph (a)(5)(i). The registrant shall provide amounts, aggregated by type of contractual obligation. The registrant may disaggregate the specified categories of contractual obligations using other categories suitable to its business, but the presentation must include all of the obligations of the registrant that fall within the specified categories. A presentation covering at least the periods specified shall be included. The tabular presentation may be accompanied by footnotes to describe provisions that create, increase or accelerate obligations, or other pertinent data to the extent necessary for an understanding of the timing and amount of the registrant's specified contractual obligations.

Contractual obligations	Payments due by period				
	Total	Less than 1 year	1–3 years	3–5 years	More than 5 years
[Long-Term Debt Obligations].					
[Capital Lease Obligations].					
[Operating Lease Obligations].					
[Purchase Obligations].					
[Other Long-Term Liabilities Reflected on the Registrant's Balance Sheet under GAAP].					
Total.					

(ii) *Definitions:* The following definitions apply to this paragraph (a)(5):

(A) *Long-term debt obligation* means a payment obligation under long-term borrowings referenced in FASB ASC paragraph 470–10–50–1 (Debt Topic), as may be modified or supplemented.

(B) *Capital lease obligation* means a payment obligation under a lease classified as a capital lease pursuant to

FASB ASC Topic 840, *Leases*''., as may be modified or supplemented.

(C) *Operating lease obligation* means a payment obligation under a lease classified as an operating lease and disclosed pursuant to FASB ASC Topic 840, as may be modified or supplemented.

(D) *Purchase obligation* means an agreement to purchase goods or services that is enforceable and legally binding on the registrant that specifies all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction.

Instructions to paragraph 303(a): 1. The registrant's discussion and analysis shall be of the financial statements and other statistical data that the registrant believes will enhance a reader's understanding of its financial condition, changes in financial condition and results of operations. Generally, the discussion shall cover the three-year period covered by the financial statements and shall use year-to-year comparisons or any other formats that in the registrant's judgment enhance a reader's understanding. However, where trend information is relevant, reference to the five-year selected financial data appearing pursuant to Item 301 of Regulation S–K (§ 229.301) may be necessary. A smaller reporting company's discussion shall cover the two-year period required in Article 8 of Regulation S–X and shall use year-to-year comparisons or any other formats that in the registrant's judgment enhance a reader's understanding.

2. The purpose of the discussion and analysis shall be to provide to investors and other users information relevant to an assessment of the financial condition and results of operations of the registrant as determined by evaluating the amounts and certainty of cash flows from operations and from outside sources.

3. The discussion and analysis shall focus specifically on material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This would include descriptions and amounts of (A) matters that would have an impact on future operations and have not had an impact in the past, and (B) matters that have had an impact on reported operations and are not expected to have an impact upon future operations.

4. Where the consolidated financial statements reveal material changes from year to year in one or more line items, the causes for the changes shall be described to the extent necesary to an understanding of the registrant's businesses as a whole; *Provided, however*, That if the causes for a change in one line item also relate to other line items, no repetition is required and a line-by-line analysis of the financial statements as a whole is not required or generally appropriate. Registrants need not recite the amounts of changes from year to year which are readily computable from the financial statements. The discussion shall not merely repeat numerical data contained in the consolidated financial statements.

5. The term ''liquidity'' as used in this Item refers to the ability of an enterprise to generate adequate amounts of cash to meet the enterprise's needs for cash. Except where it is otherwise clear from the discussion, the registrant shall indicate those balance sheet conditions or income or cash flow items which the registrant believes may be indicators of its liquidity condition. Liquidity generally shall be discussed on both a long-term and short-term basis. The issue of liquidity shall be discussed in the context of the registrant's own business or businesses. For example a discussion of working capital may be appropriate for certain manufacturing, industrial or related operations but might be inappropriate for a bank or public utility.

6. Where financial statements presented or incorporated by reference in the registration statement are required by § 210.4–08(e)(3) of Regulation S-X [17 CFR part 210] to include disclosure of restrictions on the ability of both consolidated and unconsolidated subsidiaries to transfer funds to the registrant in the form of cash dividends, loans or advances, the discussion of liquidity shall include a discussion of the nature and extent of such restrictions and the impact such restrictions have had and are expected to have on the ability of the parent company to meet its cash obligations.

7. Any forward-looking information supplied is expressly covered by the safe harbor rule for projections. See Rule 175 under the Securities Act [17 CFR 230.175], Rule 3b–6 under the Exchange Act [17 CFR 240.3b–6] and Securities Act Release No. 6084 (June 25, 1979) (44 FR 38810).

8. Registrants are only required to discuss the effects of inflation and other changes in prices when considered material. This discussion may be made in whatever manner appears appropriate under the circumstances. All that is required is a brief textual presentation of management's views. No specific numerical financial data need be presented except as Rule 3–20(c) of Regulation S-X (§ 210.3–20(c) of this chapter) otherwise requires. However, registrants may elect to voluntarily disclose supplemental information on the effects of changing prices as provided for in FASB ASC Topic 255,

Changing Prices, or through other supplemental disclosures. The Commission encourages experimentation with these disclosures in order to provide the most meaningful presentation of the impact of price changes on the registrant's financial statements.

9. Registrants that elect to disclose supplementary information on the effects of changing prices as specified by FASB ASC Topic 255 may combine such explanations with the discussion and analysis required pursuant to this Item or may supply such information separately with appropriate cross reference.

10. All references to the registrant in the discussion and in this Item shall mean the registrant and its subsidiaries consolidated.

11. Foreign private registrants also shall discuss briefly any pertinent governmental economic, fiscal, monetary, or political policies or factors that have materially affected or could materially affect, directly or indirectly, their operations or investments by United States nationals.

12. If the registrant is a foreign private issuer, the discussion shall focus on the primary financial statements presented in the registration statement or report. There shall be a reference to the reconciliation to United States generally accepted accounting principles, and a discussion of any aspects of the difference between foreign and United States generally accepted accounting principles, not discussed in the reconciliation, that the registrant believes is necessary for an understanding of the financial statements as a whole.

13. The attention of bank holding companies is directed to the information called for in Guide 3 (§ 229.801(c) and § 229.802(c)).

14. The attention of property-casualty insurance companies is directed to the information called for in Guide 6 (§ 229.801(f)).

Instructions to paragraph 303(a)(4): 1. No obligation to make disclosure under paragraph (a)(4) of this Item shall arise in respect of an off-balance sheet arrangement until a definitive agreement that is unconditionally binding or subject only to customary closing conditions exists or, if there is no such agreement, when settlement of the transaction occurs.

2. Registrants should aggregate off-balance sheet arrangements in groups or categories that provide material information in an efficient and understandable manner and should avoid repetition and disclosure of immaterial information. Effects that are common or similar with respect to a number of off-balance sheet arrangements must be analyzed in the aggregate to the extent the aggregation increases understanding. Distinctions in arrangements and their effects must be discussed to the extent the information is material, but the discussion should avoid repetition and disclosure of immaterial information.

3. For purposes of paragraph (a)(4) of this Item only, contingent liabilities arising out of litigation, arbitration or regulatory actions are not considered to be off-balance sheet arrangements.

4. Generally, the disclosure required by paragraph (a)(4) shall cover the most recent fiscal year. However, the discussion should address changes from the previous year where such discussion is necessary to an understanding of the disclosure.

5. In satisfying the requirements of paragraph (a)(4) of this Item, the discussion of off-balance sheet arrangements need not repeat information provided in the footnotes to the financial statements, provided that such discussion clearly cross-references to specific information in the relevant footnotes and integrates the substance of the footnotes into such discussion in a manner designed to inform readers of the significance of the information that is not included within the body of such discussion.

(b) *Interim periods.* If interim period financial statements are included or are required to be included by Article 3 of Regulation S-X (17 CFR 210), a management's discussion and analysis of the financial condition and results of operations shall be provided so as to enable the reader to assess material changes in financial condition and results of operations between the periods specified in paragraphs (b) (1) and (2) of this Item. The discussion and analysis shall include a discussion of material changes in those items specifically listed in paragraph (a) of this Item, except that the impact of inflation and changing prices on operations for interim periods need not be addressed.

(1) *Material changes in financial condition.* Discuss any material changes in financial condition from the end of the preceding fiscal year to the date of the most recent interim balance sheet provided. If the interim financial statements include an interim balance sheet as of the corresponding interim date of the preceding fiscal year, any material changes in financial condition from that date to the date of the most recent interim balance sheet provided also shall be discussed. If discussions of changes from both the end and the corresponding interim date of the preceding fiscal year are required, the discussions may be combined at the discretion of the registrant.

(2) *Material changes in results of operations.* Discuss any material changes in

the registrant's results of operations with respect to the most recent fiscal year-to-date period for which an income statement is provided and the corresponding year-to-date period of the preceding fiscal year. If the registrant is required to or has elected to provide an income statement for the most recent fiscal quarter, such discussion also shall cover material changes with respect to that fiscal quarter and the corresponding fiscal quarter in the preceding fiscal year. In addition, if the registrant has elected to provide an income statement for the twelve-month period ended as of the date of the most recent interim balance sheet provided, the discussion also shall cover material changes with respect to that twelve-month period and the twelve-month period ended as of the corresponding interim balance sheet date of the preceding fiscal year. Notwithstanding the above, if for purposes of a registration statement a registrant subject to paragraph (b) of §210.3–03 of Regulation S-X provides a statement of income for the twelve-month period ended as of the date of the most recent interim balance sheet provided in lieu of the interim income statements otherwise required, the discussion of material changes in that twelve-month period will be in respect to the preceding fiscal year rather than the corresponding preceding period.

Instructions to paragraph (b) of Item 303: 1. If interim financial statements are presented together with financial statements for full fiscal years, the discussion of the interim financial information shall be prepared pursuant to this paragraph (b) and the discussion of the full fiscal year's information shall be prepared pursuant to paragraph (a) of this Item. Such discussions may be combined.

2. In preparing the discussion and analysis required by this paragraph (b), the registrant may presume that users of the interim financial information have read or have access to the discussion and analysis required by paragraph (a) for the preceding fiscal year.

3. The discussion and analysis required by this paragraph (b) is required to focus only on material changes. Where the interim financial statements reveal material changes from period to period in one or more significant line items, the causes for the changes shall be described if they have not already been disclosed: *Provided, however,* That if the causes for a change in one line item also relate to other line items, no repetition is required. Registrants need not recite the amounts of changes from period to period which are readily computable from the financial statements. The discussion shall not merely repeat numerical data contained in the financial statements. The information provided shall include that which is available to the registrant without undue effort or expense and which does not clearly appear in the registrant's condensed interim financial statements.

4. The registrant's discussion of material changes in results of operations shall identify any significant elements of the registrant's income or loss from continuing operations which do not arise from or are not necessarily representative of the registrant's ongoing business.

5. The registrant shall discuss any seasonal aspects of its business which have had a material effect upon its financial condition or results of operation.

6. Any forward-looking information supplied is expressly covered by the safe harbor rule for projections. See Rule 175 under the Securities Act [17 CFR 230. 175], Rule 3b–6 under the Exchange Act [17 CFR 249.3b–6] and Securities Act Release No. 6084 (June 25, 1979) (44 FR 38810).

7. The registrant is not required to include the table required by paragraph (a)(5) of this Item for interim periods. Instead, the registrant should disclose material changes outside the ordinary course of the registrant's business in the specified contractual obligations during the interim period.

(c) *Safe harbor*. (1) The safe harbor provided in section 27A of the Securities Act of 1933 (15 U.S.C. 77z–2) and section 21E of the Securities Exchange Act of 1934 (15 U.S.C. 78u–5) (''statutory safe harbors'') shall apply to forward-looking information provided pursuant to paragraphs (a)(4) and (5) of this Item, provided that the disclosure is made by: an issuer; a person acting on behalf of the issuer; an outside reviewer retained by the issuer making a statement on behalf of the issuer; or an underwriter, with respect to information provided by the issuer or information derived from information provided by the issuer.

(2) For purposes of paragraph (c) of this Item only:

(i) All information required by paragraphs (a)(4) and (5) of this Item is deemed to be a *forward looking statement* as that term is defined in the statutory safe harbors, except for historical facts.

(ii) With respect to paragraph (a)(4) of this Item, the meaningful cautionary statements element of the

statutory safe harbors will be satisfied if a registrant satisfies all requirements of that same paragraph (a)(4) of this Item.

(d) *Smaller reporting companies*. A smaller reporting company, as defined by §229.10(f)(1), may provide the information required in paragraph (a)(3)(iv) of this Item for the last two most recent fiscal years of the registrant if it provides financial information on net sales and revenues and on income from continuing operations for only two years. A smaller reporting company is not required to provide the information required by paragraph (a)(5) of this Item.

[47 FR 11401, Mar. 16, 1982, as amended at 47 FR 29839, July 9, 1982; 47 FR 54768, Dec. 6, 1982; 52 FR 30919, Aug. 18, 1987; 68 FR 5999, Feb. 5, 2003; 73 FR 958, Jan. 4, 2008; 76 FR 50120, Aug. 12, 2011]

§ 229.304 (Item 304) Changes in and disagreements with accountants on accounting and financial disclosure.

(a)(1) If during the registrant's two most recent fiscal years or any subsequent interim period, an independent accountant who was previously engaged as the principal accountant to audit the registrant's financial statements, or an independent accountant who was previously engaged to audit a significant subsidiary and on whom the principal accountant expressed reliance in its report, has resigned (or indicated it has declined to stand for reelection after the completion of the current audit) or was dismissed, then the registrant shall:

(i) State whether the former accountant resigned, declined to stand for reelection or was dismissed and the date thereof.

(ii) State whether the principal accountant's report on the financial statements for either of the past two years contained an adverse opinion or a disclaimer of opinion, or was qualified or modified as to uncertainty, audit scope, or accounting principles; and also describe the nature of each such adverse opinion, disclaimer of opinion, modification, or qualification.

(iii) State whether the decision to change accountants was recommended or approved by:

(A) Any audit or similar committee of the board of directors, if the issuer has such a committee; or

(B) The board of directors, if the issuer has no such committee.

(iv) State whether during the registrant's two most recent fiscal years and any subsequent interim period preceding such resignation, declination or dismissal there were any disagreements with the former accountant on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedure, which disagreement(s), if not resolved to the satisfaction of the former accountant, would have caused it to make reference to the subject matter of the disagreement(s) in connection with its report. Also, (A) describe each such disagreement; (B) state whether any audit or similar committee of the board of directors, or the board of directors, discussed the subject matter of each of such disagreements with the former accountant; and (C) state whether the registrant has authorized the former accountant to respond fully to the inquiries of the successor accountant concerning the subject matter of each of such disagreements and, if not, describe the nature of any limitation thereon and the reason therefore. The disagreements required to be reported in response to this Item include both those resolved to the former accountant's satisfaction and those not resolved to the former accountant's satisfaction. Disagreements contemplated by this Item are those that occur at the decision-making level, *i.e.*, between personnel of the registrant responsible for presentation of its financial statements and personnel of the accounting firm responsible for rendering its report.

(v) Provide the information required by paragraph (a)(1)(iv) of this Item for each of the kinds of events (even though the registrant and the former accountant did not express a difference of opinion regarding the event) listed in paragraphs (a)(1)(v) (A) through (D) of this section, that occurred within the registrant's two most recent fiscal years and any subsequent interim period preceding the former accountant's resignation, declination to stand for reelection, or dismissal (''reportable

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