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Sales projections not misleading, judge says, tossing securities action

By Gina Kim
Daily Journal Staff Writer

A federal judge has dismissed a securities action filed against Funko Inc., finding that its sales projections in 2019 were not misleading and did not rise to fraud, applying a circuit opinion that said Tesla's executives did not mislead investors about its Model 3 vehicle's production timeline.

Both the 9th U.S. Circuit Court of Appeals in Tesla and U.S. District Judge Virginia A. Phillips of the Central District of California in the Funko decision reasoned that the pessimistic viewpoints of former employees about a company's sales goals are not enough to indicate executives had the intent to commit securities fraud.

"We're very pleased with the court's decision," said Kevin McDonough, partner at Latham & Watkins, lead counsel for Funko.

The case before Phillips was filed last year by investors who accused Funko of making eight misleading statements reaffirming the company's sales guidance. Funko manufactures and sells licensed pop culture collectibles, apparel and other products. The investors bought Funko securities between August 2019 and March 5, 2020. The basis for the consolidated action is the statements made

by former Funko workers — confidential witnesses — who said the company amassed millions of dollars of obsolete inventory in warehouses due to its inability to predict consumer demand. *Gilberto Ferreira, et al v. Funko, Inc.*, 2:20-CV-02319 (C.D. Cal., filed March 10, 2020).

Phillips compared the Funko case to the 9th Circuit decision in *Kurt Friedman et al v. Tesla Inc.* 2021DJ DAR812 (9th Cir. 2021), where the panel affirmed a trial court's dismissal of Tesla investors' securities action over alleged statements made in 2017 by executives about achieving the company's goal of making 5,000 cars per week. Former Tesla employees told the executives that goal was impossible to meet, investors alleged. The panel's opinion, written by Circuit Judge Daniel P. Collins, reasoned that any schedule about how future production would play out on the way toward the goal is simply a set of assumptions about future events. The statements were protected by 'safe harbor' in the Private Securities Litigation Reform Act, according to the opinion.

Phillips went through the Tesla opinion at length in her ruling, stating that similar forward-looking statements made by Funko's executives were simply projections and were accompanied by cautionary language that protected the

statements about future sales.

Counsel from Glancy Prongay, Pomerantz LLP and Bernstein Liebhard, who represent the investors, could not be reached for comment Monday.

Two out of the eight allegedly misleading statements made to investors in 2019 rose to an actionable securities claim, the judge decided. Both of those statements involved excess inventory the company ordered. Funko wrote in its 2nd quarter 10-Q filing that its success depended on, in part, its ability to manage its inventory. Funko said if sales don't reach predicted levels, it could have excess inventory it must either hold onto for a while, write down, sell at a lower price or toss out.

Citing *Friedman*, Phillips found the risk disclosures in both inventory-related statements were 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." Unlike Funko's executives, Tesla's disclosed specific challenges it had to overcome when bolstering its Model 3 production, the judge found.

The six other statements which had to do with sales projections weren't misleading, the judge found. Funko's executives never guaranteed future performance, and expressed general

optimism, Phillips found. Nor did the investors allege specific facts that the executives knew their fiscal year guidance was impossible to meet, the judge reasoned.

Just because a former employee has a subjective opinion and pessimistic view of the company's ability to deliver on its goal doesn't necessarily mean any of the defendants lied to the public or planned to defraud investors, the judge wrote. The majority of Funko's employees who didn't have faith in the company weren't shown to have deep familiarity or direct knowledge of the company's global business operations, or full comprehension of inventory operations, the judge wrote.

Only one confidential witness who raised red flags over the company's statements came close to having direct knowledge, Phillips said, but none of his statements indicated the executives had the intent to defraud investors.

"Plaintiffs fail to allege sufficient particularized facts to show defendants shared CW1's pessimism or gloomy view that Funko could not meet its FY2019 guidance or sales projections for the 4th quarter of 2019," Phillips wrote.

Plaintiffs were given until March 29 to file an amended complaint.

gina_kim@dailyjournal.com