IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

LEO SHUMACHER, individually and on behalf of all others similarly situated,	:	
Plaintiff,	:	
v	:	C. A. No. 2022-0051-NAC
BRIAN MARIOTTI, KEN BROTMAN, GINO DELLOMO, ADAM KRIGER, RUSSELL NICKEL, FUNDAMENTAL CAPITAL, LLC, ACON INVESTMENTS and FUNKO, INC.,	:	
Defendants.	:	

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Chancery Court Chambers
Leonard L. Williams Justice Center
500 North King Street
Wilmington, Delaware
Monday, December 18, 2023
9:15 a.m.

- - -

BEFORE: HON. NATHAN A. COOK, Vice Chancellor

- - -

RULINGS OF THE COURT ON DEFENDANTS' TWO MOTIONS TO DISMISS AND PLAINTIFF'S APPLICATION FOR INTERIM ATTORNEYS' FEES AND EXPENSES
HELD VIA TELEPHONE

CHANCERY COURT REPORTERS
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THE COURT: Good morning. This is Vice Chancellor Cook. Can I get appearances, please?

MR. FOULDS: Good morning, Your Honor. It's Chris Foulds and Jeff Gorris from Friedlander & Gorris. And we're joined by Randy Baron from Robbins Geller Rudman & Dowd.

ATTORNEY DICAMILLO: Good morning, Your Honor. It's Ray DiCamillo for the Funko Defendants. Also on the line with us this morning from my office, John O'Toole. And from Latham & Watkins, Kevin McDonough and Thomas Giblin.

ATTORNEY KELLY: Good morning, Your Honor. Shaun Michael Kelly with Connolly Gallagher LLP on behalf of Defendant ACON Investments. On the line with me is Jarrett Horowitz from my firm, and Thomas Shakow and Mike Ross and Sean Roberts from the Aegis Law Group.

ATTORNEY SANDERS: Good morning, Your Honor. James Sanders on behalf of the Defendant Fundamental.

THE COURT: All right. Good morning to you all, and thank you very much for joining me on this teleconference for me to deliver my bench ruling on defendants' two motions to dismiss, and the

plaintiff's application for interim award of attorneys' fees and expenses.

If folks would like to place their phones on mute, I will provide my ruling on the two motions to dismiss and the application for interim fee award now.

For the reasons I will explain in a moment, I am going to deny both motions to dismiss and the fee application.

I turn now to the relevant background, beginning with the parties. And I will note this is going to be a long bench ruling, so I'm going to ask folks just to bear with me.

Plaintiff Leo Shumacher owns ten shares of Class A common stock in defendant Funko Inc., which I will refer to as "Funko" or the "Company." He purchased those shares on January 28, 2019.

Defendant Funko is a publicly traded Delaware corporation that adopted an "Up-C" structure when it went public via a 2017 initial public offering (or "IPO"). Funko, along with its subsidiaries, is a "pop culture consumer products company," although, as I will explain shortly, Funko itself serves

essentially as a holding company for an operational pass-through entity.

Plaintiff brings this class action against Funko, certain current and former members of Funko's board, which I will refer to as the "Board," and those individuals I'll refer to as the "Director Defendants," as well as certain persons and entities alleged to comprise a control group under our law.

The director defendants include Brian Mariotti, Ken Brotman, Gino Dellomo, Adam Kriger, and Andrew Perlmutter. Collectively, with Russel Nickel who served as an officer of the company, I will refer to these defendants as the "Individual Defendants." I will also refer to the individual defendants, together with Funko, as the "Funko Defendants."

The alleged control group is comprised of three defendants, Mariotti, ACON Investments, and Fundamental Capital, LLC. The members of the alleged control group were parties to what I will refer to as the "Stockholders Agreement," which I will discuss more in a moment.

Collectively, the individual defendants, Funko, and the alleged control group will be referred to as "Defendants."

To understand plaintiff's claims, it is helpful first to understand some background principles of Up-C structures and Funko's 2017 IPO.

As noted, Funko went public using an Up-C structure in 2017. Plaintiff's amended complaint describes in a fair amount of detail, for a pleading, the background structure and philosophy behind the Up-C form.

Over the years, the Up-C structure has become an increasingly common means of making pass-through entities available to the public, while still maintaining many of the benefits offered by a pass-through entity, especially for its pre-IPO owners. This is because Up-Cs utilize essentially two levels of ownership to preserve and to create certain tax benefits.

In this case, Funko LLC is the operating entity and is, in turn, wholly owned by another LLC, Funko Acquisition Holdings, L.L.C. (or "FAH"). Plaintiff's amended complaint alleges that, for tax purposes, the operating entity Funko LLC is treated as a disregarded entity and FAH is treated as a partnership — in other words, as a pass-through entity with tax obligations flowing to its

unitholders. As a result of the Up-C IPO transaction, FAH is partially owned by the pre-IPO owners, which include the members of the alleged control group. The remainder of FAH's units are owned by the company, which is also FAH's sole manager.

The company's Class A common stock is publicly traded on the NASDAQ, while the company's Class B stock is owned by the pre-IPO owners. The company's Class A shares have both economic and voting rights, while the Class B shares have only voting rights. In its prospectus, Funko identified itself as being a "holding company" and explained that it "will have no material assets other than our ownership of [FAH units] representing approximately 48.3% of the economic interest in FAH ...."

In laying the groundwork, there are three additional features of the Up-C structure that are relevant here.

First is the obligation to maintain a "one-to-one" ratio of shares to units. Funko is required to own the same number of FAH units as it has Class A shares outstanding. Indeed, Section 6.1 of Funko's charter provides "[Funko] shall, to the fullest extent permitted by law, undertake all actions

... with respect to: ... the shares of Class A Common stock necessary to maintain at all times a one-to-one ratio between the number of Common Units owned by [Funko] and the number of outstanding shares of Class A Common stock ...."

Likewise, the governing documents address the relationship between shares of Class B stock and ownership of FAH units. Turning again to Section 6.1 of Funko's charter, it provides that "[Funko] shall, to the fullest extent permitted by law, undertake all actions ... with respect to: ... the shares of Class B Common Stock necessary to maintain at all times a one-to-one ratio between the number of Common Units ... owned by all Permitted Class B Owners and the number of outstanding shares of Class B Common Stock owned by all Permitted Class B Owners."

I note that FAH's LLC agreement also references the one-to-one ratio obligation.

A second key feature concerns the exchangeability of the pre-IPO owners' LLC units; namely, the ability of the pre-IPO owners to exchange their FAH units for Class A stock on a one-for-one basis. Plaintiff cites, for example, Section 11.01 of

the FAH LLC agreement for this proposition. Without getting too deeply into the weeds of the mechanics here, when a pre-IPO owner exchanges an FAH unit for a Class A share, Funko ends up gaining an additional FAH unit and issues an additional Class A share to the pre-IPO owner while canceling the pre-IPO owner's corresponding Class B share.

A third feature concerns tax distributions from FAH to its unitholders for tax purposes, because FAH is treated as a pass-through entity and is not taxed at the entity level. Instead, certain tax obligations arising from FAH's income are passed on to its unitholders. The FAH LLC agreement in turn obligates FAH to provide cash distributions to its unitholders "on a *pro rata* basis in accordance with each Member's Percentage Interest" of FAH, to ensure the unitholders have sufficient cash to cover these tax obligations.

The amount of these tax distributions "is calculated based on the highest combined federal, state and local tax rate that may potentially apply to any one of FAH, LLC's members, regardless of the actual final tax liability of any such member." Thus, irrespective of a unitholder's actual tax liability,

the unitholders receive a distribution based on what plaintiff states is an "assumed combined rate of '52.9% of allocated taxable income.'" To the extent a unitholder's actual tax rate is less than the amount the unitholder receives in tax distributions, the unitholder gets to keep the difference.

In this case, FAH makes its tax distributions to the pre-IPO owners and to Funko, in amounts corresponding to their respective ownership percentages of FAH units. Plaintiff alleges that since Funko, as a corporation, has an actual corporate tax rate well below the assumed 52.9% rate, Funko is necessarily left with substantial cash surpluses as a result of FAH's tax distributions to Funko.

With this groundwork, I turn next to plaintiff's allegations regarding the obligation to maintain economic equivalence and the tax benefits of an Up-C structure. First, I note that reasons for pursuing an Up-C IPO include the ability of the pre-IPO owners to obtain the tax benefits of a pass-through entity while also accessing public capital markets via an IPO. As to the tax benefit, by employing the Up-C form, the distributions to the pre-IPO owners are not routed through Funko, and thus,

while they are subject to taxation at the pre-IPO owners' individual level, the distributions from FAH to the pre-IPO owners are not, for those pre-IPO owners, subject to double taxation at the entity level and the individual level. This stands in contrast to distributions for the benefit of the Class A stockholders, which pass through Funko first and are subject to Funko's corporate tax rate. Hence the double taxation.

At its core, economic equivalence seems to arise in large part out of the nature of the Up-C form, with the pre-IPO owners having voting rights via Class B shares and economic rights via their ownership of FAH units, while Class A shares have both of these rights collapsed into the single Class A share.

Plaintiff alleges that the requirement to maintain economic equivalence is a fundamental obligation of Funko and cites multiple sources for this understanding. Plaintiff cites, for example, public sources like numerous academic articles and, indeed, a November 1, 2016 SEC no-action letter, referencing and relying on the notion of economic equivalence. In issuing the no-action letter, the SEC

considered the relationship in the Up-C form between holding the LLC units and shares of the C corporation.

In finding equivalence for securities law purposes, the letter is based in primary part on the understanding that "the terms for the exchange of [the operating partnership units or] OP Units for Corporation Shares [were] such that the OP Unitholder had the same economic risk as if it were a holder of the Corporation Shares during the entire period it holds the OP Units[.]"

According to plaintiff, this highlights a key point that I must accept as true at this pleading stage — namely, that the substance of the rights associated with an FAH unit is to confer the quantitatively same economic interest in the same asset (*i.e.*, FAH), as a Class A share, despite the FAH unit and Class A share taking different forms. And this is to hold even notwithstanding differing tax treatments derived from the difference in form.

Importantly, internal company documents appear to support this premise, at least for pleading stage purposes, unequivocally. Plaintiff, in particular, cites and quotes an April 16, 2018, Funko Audit Committee presentation providing, in no

uncertain terms, that the "maintenance of 1:1 economic relationship between publicly traded shares and [the] partnership interest[s] is paramount[.]" This presentation highlights the need for the Class A shares to maintain an economically equivalent relationship to ownership of FAH units, not just a numerical equivalence. This pleading-stage understanding is further bolstered by multiple other presentations analyzing avenues for maintaining economic equivalence.

Before moving on, I note also that this may be, at least in some respects, a two-way street. The FAH LLC agreement provides that in the event of a tender offer, etc., for Class A stock, Funko will act "to enable and permit the [FAH] Unitholders to participate ... to the *same extent or on an economically equivalent basis as* the holders of shares of Class A Common Stock without discrimination[.]"

Turning to plaintiff's allegations of control: Plaintiff alleges that, in 2015, ACON acquired a controlling stake in Funko LLC from Fundamental. From 2017 to 2020, Funko identified itself as a "controlled company."

Plaintiff asserts that until 2020, the alleged control group owned over 50% of Funko's combined voting power, and that it held over 45% of Funko's voting power at the time plaintiff filed the initial complaint in this action.

Plaintiff also alleges that the members of the alleged control group have a nearly seven-year history of co-investment in and co-management of Funko.

Plaintiff alleges that, as of Funko's last proxy statement before plaintiff filed the January 2022 initial complaint, ACON owned 70.8% of Funko's Class B stock and held 39.7% of Funko's combined voting power. Plaintiff further alleges that, thereafter, as of Funko's April 8, 2022, proxy statement, ACON owned 32.5% of Funko's voting power.

Plaintiff alleges that, as of Funko's last proxy statement before plaintiff filed the January 2022 initial complaint, Fundamental owned 7.4% of Funko's Class B stock and 2.9% of Funko's combined voting power, and that, as of the April 2022 proxy statement, Fundamental owns 2.5% of the voting power.

Plaintiff alleges that Mariotti continues to serve on Funko's board and served as

Funko's CEO from Funko's formation until January 3, 2022. Plaintiff alleges that "[a]t the time ACON acquired its controlling interest in 2015, Mariotti was Funko, LLC's CEO."

Plaintiff further alleges that, as of Funko's last proxy statement before plaintiff filed the January 2022 initial complaint, Mariotti owned 20.2% of Funko's Class B stock and held 5.1% of its combined voting power. And plaintiff alleges that Mariotti held 3.1% of the voting power as of the April 2022 proxy statement.

Mariotti, Fundamental, and ACON were parties to a stockholders agreement that, among other things, included an agreement to vote for ACON's board designees and Mariotti as directors on Funko's board. This agreement also gave ACON various special rights, such as the right to appoint the chairperson of the board and the right to veto any of the following actions: (1) the purchase or sale of assets exceeding $10 million, (2) any sale of the company, (3) any issuance of new classes of stock or new shares of existing classes of stock, and (4) any amendments to the organizational documents of Funko or any of its subsidiaries. The stockholders agreement also

provided veto rights over the ability of Funko or any of its subsidiaries to reorganize or recapitalize.

On January 3, 2022, Perlmutter joined Funko's board and replaced Mariotti as CEO. Plaintiff alleges that Perlmutter had joined Funko at Mariotti's request almost a decade prior and served as president of both Funko and FAH alongside Mariotti from 2017 until 2022. Plaintiff quotes an article describing Perlmutter as working "hand-in-hand" with Mariotti and recounting Perlmutter's description that he and Mariotti are "kindred spirits in a lot of ways." Plaintiff also quotes Mariotti as describing Perlmutter as alluding to the Broadway musical Hamilton and, in an apparent reference to George Washington's view of Alexander Hamilton, Mariotti describing Perlmutter as his "right-hand man for many years." For his part, Perlmutter stated that in his role as CEO, he would be "maintaining the longstanding and fruitful partnership Brian [Mariotti] and I have enjoyed for many years." And, indeed, Perlmutter stood to receive "over $5 million in compensation in 2022[,]" after taking on the CEO role. Plaintiff further alleges that "from 2018-2020 alone, Funko paid Perlmutter more than $14 million."

Plaintiff's amended complaint alleges that Defendant Brotman is a founder and managing partner at ACON and served on Funko's board from its formation in April 2017 until May 20, 2022. Defendant Kriger is an executive partner at ACON and also served on Funko's board from April 2017 until May 20, 2022. Kriger additionally owns FAH units. Defendant Dellomo is a director at ACON and served on Funko's board from April 2017 until January 3, 2022.

Defendant Nickel served as Funko's CFO through 2019 and held Class B stock — all of which he converted to Class A stock by the end of his employment.

Plaintiff alleges that, in light of the alleged control group's control over Funko in these circumstances, defendants "double dipping" resulted in fiduciary duty breaches. I will return to these issues shortly.

At its core, double dipping refers to the notion that, although an FAH unit and Class A share are supposed to be economically equivalent, by controlling Funko in such a way as to let the excess cash from the tax distributions pile up, defendants are able to get more than the economically equivalent

value of a Class A share from a single FAH unit. Plaintiff alleges that defendants receive the benefit of more than the share of the economics they'd be entitled to if economic equivalence was maintained.

In conceptualizing plaintiff's claim of breach, it is perhaps useful to think of this in two parts. In part one, FAH makes tax distributions to all of its unitholders in an amount exceeding their actual tax liability. In this step, FAH makes a cash distribution to a pre-IPO owner who is holding Class B shares and corresponding FAH units. FAH also distributes cash to Funko, which Funko then holds onto. The market recognizes that Funko has this cash and the stock price of Class A shares adjusts accordingly.

In the second part, at some point after pocketing one or more direct cash distributions from FAH, the pre-IPO owner exchanges one of his FAH units for a share of Class A stock. Funko issues a new Class A stock to the pre-IPO owner and adds the exchanged FAH unit to its books. This maintains a numerical one-to-one ratio between the outstanding Class A stock and the FAH units it holds.

This is all fine so long as Funko has

done something with the distributions it previously received from FAH in order to maintain economic equivalence. According to plaintiff, the easiest and most obvious way to maintain economic equivalence — and the method often used — is to dividend the cash at the C corporation level out, rather than leaving it sitting there. However, if nothing is done with the prior distribution from FAH to Funko, then that's where economic equivalence goes awry. Now the cash becomes what both plaintiff and even the company in its internal presentations refers to as "trapped cash."

Thus, in the next quarter, when FAH allocates its tax distributions, Funko will receive a larger distribution because of the FAH unit that transferred ownership from the pre-IPO owner to Funko. However, once cash has piled up at the Funko level, the pre-IPO owner gets the benefit of that trapped cash too, even though that second helping of benefit is contrary to economic equivalence — hence the double dip.

Indeed, according to plaintiff, the pre-IPO owner gets a disproportionate economic benefit because he now owns a Class A share that is worth more

as a result of the "trapped cash" which, again, is derived from prior tax distributions in which the pre-IPO owner has already received his direct cash payment share via his directly owned units.

In this way, the pre-IPO owner is able to partake in the initial economic benefit of the direct tax distribution and then subsequently partake a second time in the economic benefit of the tax distributions made to Funko as a function of Funko's ownership of other FAH units and properly considered allocable to the Class A shares held by the public at the time of the distributions.

This destabilizes the idea that there is economic equivalence between a Class A share and an FAH unit, as the benefit is necessarily skewed toward the pre-IPO owner. This issue is compounded when the pre-IPO owner controls the corporation and causes it to continue amassing cash so that the owner is able to capture as much value as possible when he exchanges his FAH units. And, indeed, plaintiff's claim alleges that this is not merely happenstance, but instead a manipulatable and intentional skewing of the Up-C form by defendants for their own benefit.

Funko's internal documents show, at

least for pleading-stage purposes, that the company knew there are at least three ways to maintain economic equivalence in such circumstances. First, Funko could issue cash dividends before pre-IPO owners convert their FAH units so that the value of the tax distribution is captured only by the Class A stockholders whose shares correspond to the FAH units giving rise to the tax distribution. Second, Funko could issue a stock dividend exclusively to the Class A stockholders. Third, Funko could require pre-IPO owners to forfeit some of their FAH units and/or similarly dilute the pre-IPO owners' holdings in FAH.

The effect of this third option is explained another way in one of the articles plaintiff cites as essentially "adjust[ing] the exchange ratio so that pre-IPO owners receive fewer shares in the public company to reflect the additional value they receive per share."

These three mechanisms are designed to reestablish economic equivalence by diverting value away from the pre-IPO owners and to the Class A stockholders to the extent of the double dip.

As applied to this case, plaintiff alleges that tax distributions are made to pre-IPO

owners, including the alleged control group, and to Funko based on an assumed tax rate of 52.9%. These tax distributions substantially exceed Funko's corresponding tax obligation. Plaintiff asserts that Funko paid no federal income tax in 2017, that in 2018 Funko paid $4.2 million in taxes based on $23 million of taxable income (which plaintiff calculates to be 18.3%) and paid $2 million in taxes based on $16 million of taxable income in 2019 (which plaintiff calculates to be 12.3%).

Consistent with the company's disclosures concerning dividends, the board did not issue cash dividends that could have eliminated the opportunity to double dip. The board also did not issue stock dividends. Plaintiff alleges that, as cash from the tax distributions began to amass, Funko began to include disclosures concerning the conflict the double-dip presented in its Form 10-K and 10-Q filings. Commencing with Funko's August 10, 2018 10-Q, every subsequent 10-K and 10-Q included such a disclosure. One version of the disclosure that was used repeatedly in these filings provides:

"As a result of potential differences in the amount of net taxable income allocable to us

and to the Continuing Equity Holders, as well as the use of an assumed tax rate in calculating FAH, LLC's distribution obligations, we may receive distributions significantly in excess of our tax liabilities ... *To the extent we do not distribute such cash balances as dividends on our Class A common stock* and instead, for example, hold such cash balances or lend them to FAH, LLC, the Continuing Equity Owners would benefit from any value attributable to such accumulated cash balances as a result of their ownership of Class A common stock following an exchange of their common units for Class A common stock."

Plaintiff alleges that Defendant Nickel delivered presentations to the audit committee on this issue on multiple occasions with Perlmutter also in attendance. During these presentations, Nickel specifically discussed the cash that the board had "trapped" at Funko and the different options of how to use the accumulated funds. The audit committee purportedly discussed amending the FAH LLC agreement to allow Funko to use the trapped cash to repurchase shares. At a different audit committee meeting in July 2018, plaintiff asserts that the committee was informed of the continued accumulation of trapped cash

with trapped cash of $10 million accruing across just two quarters of 2018. Plaintiff alleges that the trapped cash quickly surpassed $50 million and reached as much as $74 million.

Plaintiff alleges that, at a November 2018 audit committee meeting, Nickel further suggested using the "trapped" cash at Funko to fund an intercompany loan to Funko LLC. The board adopted this suggestion of Nickel's and executed an intercompany loan the next month for $20 million. I note that defendants, for their part, assert that the loan was made at a "arms-length interest rate."

As I noted a few moments ago, according to plaintiff, it is the conversion and exchanges of FAH units for Class A shares without prior fixes of the trapped cash issue that then locks in at least some degree of breach and harm therefrom.

And, indeed, plaintiff alleges that since the IPO, the pre-IPO owners have converted a significant number of their FAH units into Class A shares. Plaintiff set forth a chart in the amended complaint that reflects defendants' diminishing Class B shares over time. According to plaintiff, between 2017 and 2021, ACON, Mariotti, and Fundamental each

exchanged millions of FAH units and Class B shares. Plaintiff also alleges that Nickel exchanged over 100,000 FAH units and Class B shares.

Plaintiff has asserted in briefing that following these exchanges the pre-IPO owners largely sold the new newly issued Class A stock to the public and realized the economic benefit of their alleged double dip with respect to such exchanged units and shares.

On January 18, 2022, plaintiff filed the initial complaint in this action. Within months thereafter, the board settled on reestablishing economic equivalence through a recapitalization transaction that took effect in early May 2022. The 2022 recapitalization involved a $74 million capital contribution by Funko to FAH in exchange for over 4.2 million newly issued FAH units. The FAH units were recapitalized through a reverse unit split. This reverse split reduced the number of units held by the pre-IPO owners and required a corresponding cancellation of approximately 900,000 shares of Class B stock held by the pre-IPO owners to maintain the required one-to-one ratio of shares to units.

On May 3, 2022, Funko disclosed that

ACON had agreed to sell over 12.5 million shares of its Class A stock to an affiliate of The Chernin Group. This sale included newly issued Class A shares resulting from an exchange of FAH units following the recapitalization, as well as previously held Class A shares. Plaintiff alleges that the sale appears to have closed on May 20, 2022. Defendants assert that, upon closing, this sale terminated the stockholders agreement and represented a sale of roughly 25% of the combined voting power of Funko stock.

On May 26, 2022, plaintiff filed the amended complaint. The amended complaint alleges three direct counts for breach of fiduciary duty. Count I asserts a breach by the alleged control group. Count II asserts a breach by the director defendants. And Count III asserts a breach by Mariotti, Perlmutter, and Nickel as officers.

The Funko defendants filed a motion to dismiss, which Fundamental and ACON both joined. Additionally, ACON filed a separate motion to dismiss. Thereafter, plaintiff filed the interim fee application.

Defendants have moved to dismiss under Rule 12(b)(6) and Rule 12(b)(1) on mootness grounds.

For the reasons I describe below, I turn first to the 12(b)(6) arguments.

"The standards governing a motion to dismiss for failure to state a claim are well settled: (i) all well-pleaded factual allegations are accepted as true; (ii) even vague allegations are 'well-pleaded' if they give the opposing party notice of the claim; (iii) the Court must draw all reasonable inferences in favor of the non-moving party; and (i[v]), dismissal is inappropriate unless the 'plaintiff' would not be entitled to recover under any reasonably conceivable set of circumstances susceptible of proof." That is from our high court's decision in *Savor, Inc. v. FMR Corp*.

Under Rule 12(b)(6), defendants have sought dismissal because (1) the relevant decisions were a matter of the board's business judgment, (2) Funko disclosed all relevant information, and (3) plaintiff has failed to allege sufficient facts implicating defendants Dellomo and Nickel. I address each of these arguments in turn.

First, the parties dispute whether the business judgment rule or entire fairness provides the applicable standard of review. This question was

front and center in the briefing and at oral argument. For purposes of resolving defendants' pleading-stage motions to dismiss, I conclude that it is reasonably conceivable that the entire fairness standard of review applies.

"The [business judgment] rule is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company...." That is from this Court's decision in *Orman v. Cullman*. In *In re Crimson Exploration Inc. Stockholder Litigation*, this court explained that "[i]f the challenger successfully rebuts the rule's presumptive applicability, the burden shifts to the defendants to prove the transaction's entire fairness."

Defendants assert that cash management decisions are a classic exercise of business judgment. Plaintiff argues that, applying the plaintiff-friendly pleading standards applicable on a Rule 12(b)(6) motion to dismiss, as I must, the amended complaint provides two reasons why I must conclude that it is at least reasonably conceivable that entire fairness

applies to defendants' claims.

First, plaintiff argues that its extensive allegations, based on internal company documents and public disclosures, among others, require the conclusion that it is reasonably conceivable that ACON, Fundamental, and Mariotti comprised, at least at this pleading stage, a conflicted control group.

Second, plaintiff argues that the amended complaint's allegations compel the pleading-stage conclusion that half of the board was either conflicted or lacked independence during the course of the many years when the board determined to allow trapped cash to pile up at Funko for defendants' benefit. I begin with the first argument.

In *Sheldon v. Pinto Technology Ventures*, our high court explained: "[O]ur law recognizes that multiple stockholders together can constitute a control group exercising majority or effective control, with each member subject to the fiduciary duties of a controller." That is to say, "[i]f such a control group exists, ... its members owe fiduciary duties to the minority shareholders of the corporation." That second quote is from this Court's

decision in *Frank v. Elgamal*.

In *Garfield v. BlackRock Mortgage Ventures, LLC*, this Court recognized that there are two relevant inquiries: Whether "the Amended Complaint ... contain[s] facts sufficient to form a reasonably conceivable inference that [the purported members of the control group], if treated as a group, exercised control sufficient to give rise to fiduciary obligations under Delaware law [and] ... that [the alleged members of the control group] indeed formed a group."

Relevant to the first inquiry, the Court in *Crimson* explained that: "Delaware law treats a majority stockholder as a controlling stockholder. Exceeding the 50% mark, however, is only one method of determining whether a stockholder controls the company. A stockholder who 'exercises control over the business affairs of the corporation' also qualifies as a controller." There, the Court also explained "triggering entire fairness review requires the controller or control group to engage in a conflicted transaction. That conflicted transaction could involve standing on both sides of the transaction ...." This can also involve the receipt

of a nonratable benefit.

Plaintiff first alleges that ACON, Fundamental, and Mariotti held over 50% of the combined voting power in Funko for years during the course of the alleged breaches until 2020, and that they held over 45% by the time plaintiff filed the initial complaint in this action in January of 2022.

Plaintiff has also sufficiently alleged that the members of the alleged group were all parties to a stockholders agreement that gave them the power to designate half the board's membership — power which they exercised up until the agreement's purported termination with the May 2022 transactions. According to plaintiff, the stockholders agreement also afforded veto power over a host of managerial and transaction-level decisions that would be relevant to reestablishing or otherwise maintaining economic equivalence.

From Funko's formation until January 3, 2022, three of the alleged control group's board designees were also dual fiduciaries of Funko and ACON, and alleged control group member Mariotti was the remaining designee. Mariotti, of course, is alleged to have served as Funko's CEO for most of the

time during which the trapped cash piled up at Funko, from its formation until January 3, 2022.

Plaintiff alleges Mariotti described himself as "partnering" with Fundamental and then "partnering" with ACON.

For many years covered by the allegations, the alleged control group again owned over 50% of Funko's voting power. And even after that dropped to 45%, taking the allegations together, it is reasonably conceivable that the alleged control group -- ACON, Fundamental, and Mariotti, Funko's CEO -- wielded significant control over Funko and could effectively control or otherwise influence Funko's day-to-day decision-making.

Indeed, for much of the period, the plaintiff has also adequately alleged, at least for pleading-stage purposes, that the members of the control group abused their control so as to enable and facilitate their own double dipping in contravention of economic equivalence, thereby standing on both sides of the transaction and acting to divert value away from Class A stockholders and receive a nonratable benefit.

And just to be clear, none of this is

in any way a finding of fact. This is the pleading stage, and I am simply applying the plaintiff-friendly standards that I am instructed to, and indeed required to, apply at this very early stage. I have no doubt that the defendants have a very different side of the story and will vigorously contest plaintiff's allegations as this matter proceeds.

Accordingly, it is at least reasonably conceivable that, if treated as a control group, ACON, Fundamental and Mariotti were capable of exercising and indeed did exercise sufficient control over Funko's business affairs to give rise to the fiduciary duties of a controller and shift the standard of review to entire fairness, at least for purposes of this pleading stage.

I turn now to the second question: That is, whether, for purposes of this pleading stage, it is reasonably conceivable that ACON, Fundamental, and Mariotti formed a control group.

In *Sheldon*, our high court explained that: "To demonstrate that a group of stockholders exercises 'control' collectively, the [plaintiffs] must establish that they are 'connected in some legally significant way' — such as 'by contract,

common ownership, agreement, or other arrangement — to work together toward a shared goal.' To show a 'legally significant' connection, the [plaintiffs] must allege that there was more than a 'mere concurrence of self-interest among certain stockholders.' Rather, 'there must be some indication of an actual agreement,' although it need not be formal or written.'"

In *Garfield*, this Court found that the purported control group satisfied the *Sheldon* standard by walking through the plaintiff's deployment of the "*Hansen* playbook," a reference to *In re Hansen Medical Shareholders Litigation*, which the *Sheldon* Court cited as a favorable example of an action where the plaintiffs adequately alleged facts sufficient to infer the existence of a control group. The Court in *Garfield* considered the control group members' alignment of interests in favoring their own interests and, "[a]s plus factors," the members' historical ties and transaction-specific ties.

The historical ties highlighted in *Garfield* included the alleged control group members' founding of the controlled company together, a "multi-year history of co-investment between the group

members that was identified and recognized by the Company in public disclosures," and references in the company's LLC agreements and offering documents that referred to the members as a collective group.

The transaction-specific ties in *Garfield* included management's joint meeting with the members of the control group to negotiate a reorganization and management's internal presentations depicting the members of the group as belonging to a collective unit. The *Garfield* Court noted that this was also the case in *Hansen*, where the company identified the group by a collective term and included a voting agreement regarding the specific transaction that was at issue.

Here, plaintiff alleges substantial historical ties. Plaintiff asserts that the members of the alleged control group owned and controlled Funko LLC before the IPO and orchestrated the IPO and the use of an Up-C structure. Their considerable ties, which Mariotti characterized as "partnering" with ACON and Fundamental, included an extensive seven-year history of co-investment and co-management of Funko entities.

Pre-IPO, the members controlled Funko

and exchanged units among themselves. After the IPO, they held over 50% of Funko's combined voting power and could essentially designate four of the eight board seats. As was the case in *Garfield*, the offering documents refer to Funko repeatedly as a "controlled company," including on the cover page of the prospectus.

Moreover, the prospectus itself states the following: "After the consummation of this offering, we will be considered a 'controlled company' for the purposes of the Nasdaq rules as ACON, Fundamental and Brian Mariotti, our chief Executive Officer, will, in aggregate, have more than 50% of the voting power for the election of directors."

In numerous other places throughout the SEC filings, this same list of three members: ACON, Fundamental, and Mariotti is referenced in conjunction with the assertion that Funko is a controlled company.

Plaintiff also alleges considerable transaction-specific ties. These include the stockholders agreement that effectively selected half the board's membership, gave the right to designate the board's chairperson, and provided veto rights over

a variety of managerial and transaction-level decisions, including stock issuances and recapitalizations. Defendants argue that stockholders agreement did not specifically cover the tax distributions. But, for a company that self-identified as only being a "holding company" and held substantially no assets other than its FAH units, plaintiff's allegations support the pleading-stage inference that the extensive bundle of rights and powers worked to, and were intended to work to, ensure control over, among other things, the use of the FAH units and the corresponding $50-74 million pile of cash Funko amassed in excess from the tax distributions.

Moreover, when considering the board designation rights, Funko's no-cash-dividends policy in light of the stock issuance and recapitalization veto rights contained in the stockholders agreement, the constraints would seem to essentially place the ability to maintain economic equivalence wholly within the group's control.

Additionally, pre-IPO ACON, Fundamental, and Mariotti held a controlling interest in Funko LLC, and, as plaintiff asserts, it is

reasonably conceivable that they were involved in the process of taking Funko public and in the use of the Up-C structure which provided them with the positioning they needed to engage in the double-dipping.

Indeed, in light of all the powers and veto rights I've noted, one inference to which plaintiff is entitled at this pleading stage is that the agreement I am looking for here to work together, particularly concerning treatment of the cash at Funko, was in place from the outset of Funko's Up-C form, given the prospectus disclosure concerning cash dividends.

Here, the confluence of voting power, mutual self-interest, historical ties, and transaction-specific or related ties gives rise to a reasonably conceivable inference that the purported control group had more than what the *Sheldon* Court described as a "mere concurrence of self-interest" and instead had some type of "actual agreement" to work together to cause Funko to treat the tax distributions in a way that maximized the alleged control group's benefit.

As this court previously did in

Garfield, I acknowledge that "[b]ecause the analysis for whether a control group exists is fact intensive, it is particularly difficult to ascertain at the motion to dismiss stage." However, here "the sum-total of the facts alleged and inferences therefrom make it at least reasonably conceivable that [ACON, Fundamental, and Mariotti] formed a control group that exercised effective control over [Funko] in connection with the [double dipping]." That is a modified quotation from *Garfield*. Accordingly, on the limited pleading-stage record before me, I conclude that it is appropriate, at least for purposes of this pleading stage, to review the relevant actions under the entire fairness standard.

I note that this conclusion also addresses ACON's motion to dismiss, which asserts that ACON is not connected to the other members of the alleged control group in some legally significant way. And for the same reason, the argument contained in Fundamental's notice of joinder to the Funko defendants' motion to dismiss fails.

I turn now to the question of board conflict.

In *Frederick Hsu Living Trust v. ODN*

Holding Corp., this Court explained: "At the pleading stage, to change the standard of review from the business judgment rule to entire fairness, the complaint must allege facts supporting a reasonable inference that there were not enough sufficiently informed, disinterested individuals who acted in good faith when taking the challenged actions to comprise a board majority .... If a board is evenly divided between compromised and non-compromised directors, then the plaintiff has succeeded in rebutting the business judgment rule. Consequently, to determine whether to intensify the standard of review ... to entire fairness, a court counts heads. If a director-by-director analysis leaves insufficient directors to make up a board majority, then the court will review the board's decision for entire fairness."

In *ODN*, the Court explained that a director is interested where he "received 'a personal financial benefit from a transaction that is not equally shared by the stockholders.' Or ... [where the] director was a dual fiduciary and owed a competing duty of loyalty to an entity that itself stood on the other side of the transaction or received a unique benefit not shared with the stockholders."

Similarly, a director lacks independence if the "director is sufficiently loyal to, beholden to, or otherwise influenced by an interested party to undermine the director's ability to judge the matter on its merits." That is also from *ODN*.

As explained in *ODN*, the next step in the analysis, then, requires head counting. Here, the board consisted of eight members. It is reasonably conceivable that Brotman, Kriger, Dellomo, Perlmutter, and Mariotti were, for pleading-stage purposes, compromised during their tenure on the board.

Brotman and Kriger were both ACON partners and also served on Funko's board from April 2017 until May 2022. Brotman co-founded ACON in 1996, and Kriger joined ACON in August 2017. Dellomo joined ACON as a director in 2006 and served on Funko's board from April 2017 until January 3, 2022. It is reasonably conceivable that each was a dual fiduciary who, while owing duties of loyalty to Funko, also owed a "competing duty of loyalty to an entity that itself stood on the other side of the transaction or received a unique benefit not shared with the stockholders." That is from *ODN*.

Plaintiff's primary argument is that

the board and other Funko fiduciaries chose to maintain and indeed facilitated the diversion of value from the public Class A stockholders to the alleged control group and pre-IPO owners by causing Funko to retain the excess tax distributions so that the alleged control group members could capture extra value when they exchange their FAH units for Class A stock.

Here, plaintiff's allegations support the reasonable inference that ACON's interests as an FAH unitholder diverged from Funko and Class A stockholders' interests. It is reasonably conceivable that ACON was incentivized to cause Funko to simply accumulate funds to maximize the amount of value it could capture when it exchanged its FAH units for Class A stock. In this way, ACON had a clear interest in Funko's failure to maintain economic equivalence. As I will discuss more in a moment, it is reasonably conceivable that Funko understood itself obligated to maintain economic equivalence, and the public Class A stockholder had a clear interest in such equivalence because failing to maintain parity would lead the pre-IPO owners to receive a nonratable benefit out of the value allocated to the public Class A shares.

Accordingly, I conclude that it's reasonably conceivable that Brotman, Kriger, and Dellomo, each loyal and beholden to ACON, were not disinterested and independent for purposes of determining the appropriate standard of review. And, again, this is a pleading-stage conclusion only.

Likewise, as a member of the control group, Mariotti cannot be considered disinterested. Indeed, plaintiff adequately alleges that both Mariotti and Kriger held exchangeable FAH units and engaged directly in the double dipping. In that capacity, it is reasonably conceivable that they were directly conflicted at the time they participated in the relevant cash-management decisions. Here, I note that it is not until their reply brief that the Funko defendants assert that Brotman and Kriger are uncompromised. In the Funko defendants' opening brief, they simply assumed that Mariotti, Brotman, and Kriger are all conflicted and only raise issues with the notion that Perlmutter is conflicted.

Defendants' argument as to Perlmutter is based on their unsupported assertion that, in this context, the time to count heads is at the time the suit is filed. According to defendants, a majority of

the board was not compromised at the time the initial complaint was filed, since Perlmutter replaced Dellomo on January 3, 2022, and the initial complaint was not filed until January 18, 2022.

This argument fails for two reasons: First, because it is reasonably conceivable that Perlmutter lacked sufficient independence from the alleged control group. In *ODN*, the Court concluded that a director was not independent "because she was a highly compensated senior officer in a Company controlled by [a controlling stockholder]." There, the Court further explained that "[u]nder the great weight of Delaware precedent, senior corporate officers generally lack independence for purposes of evaluating matters that implicate the interests of the controller."

Here, plaintiff has adequately alleged that there is a control group that controlled Funko, that Perlmutter was Funko's CEO and was a highly compensated corporate officer (receiving upwards of $14 million between 2018 and 2020 and $5 million in 2022, during his tenure as CEO and board member.) It is thus also reasonably conceivable that Perlmutter lacked independence from the alleged control group.

This conclusion is further supported by Perlmutter's significant personal and professional ties to Mariotti, which I discussed earlier.

Thus, even accepting defendants' reading of the head-counting requirements, in other words as applying at the time the initial complaint was filed, I conclude that it is reasonably conceivable that four of the eight — Brotman, Kriger, Mariotti, and Perlmutter — were compromised for purposes of this analysis. It is appropriate, then, to conclude that entire fairness provides the applicable standard of review for pleading-stage purposes.

The second basis on which I reject defendants' argument as to Perlmutter relates to the point in time when the court counts heads to determine the proper standard of review. Of the numerous cases that address the issue, none of them seem to count heads only at the time the complaint is filed. That may be appropriate for demand futility purposes, but that is a very different context and, to be clear, defendants have not raised this particular argument in that capacity.

Instead, the cases compel the

conclusion that head counting occurs during the time of the alleged wrongdoing. For example, in *New Enterprise Associates 14, L.P. v. Rich*, this Court concluded that entire fairness applied "[b]ecause there were not disinterested and independent directors to approve the [disputed transaction.]"

Thus, the proper time to count heads here is at the times of the alleged wrongdoing. Plaintiff has alleged that since Funko's 2017 IPO, the board has maintained, at its discretion, a self-imposed no-cash-dividend policy and has otherwise intentionally failed to maintain economic equivalence, instead choosing to take a course of action that benefited the control group and pre-IPO owners at the expense of the public Class A stockholders.

Accordingly, for these two reasons, I conclude that the facts asserted in plaintiff's amended complaint make it reasonably conceivable that at all relevant times at least half the board was compromised. This too makes applicable, at least for pleading-stage purposes, the entire fairness standard of review.

In a footnote in their opening brief, the Funko defendants raised the issue of whether the

claims are direct or derivative. Given the way in which this was raised, plaintiff has argued that I should not entertain the argument, and indeed in *In re Tesla Motors, Inc. Stockholder Litigation*, this Court explained that the "failure to raise a legal issue in the above-the-line text of a brief generally constitutes waiver of that issue." Although I think defendants might be on to something with their argument, I am presently inclined to agree with plaintiff for purposes of the parties' pleading-stage arguments.

But even if I were to consider the issue, I would likely find it to not change the outcome at the pleading stage. As I have already explained, the facts alleged in the amended complaint make it reasonably conceivable that at least half of the board lacked independence or was otherwise interested, irrespective of when the Court counts heads amongst the board members. Thus, and as I will explain shortly, plaintiff seems to state a claim regardless. As this Court explained in *In re CBS Corp. Stockholder Class Action & Derivative Litigation*, "[w]here the nature of a claim is disputed, and the plaintiff has met its pleading

burden under both Chancery Rules 12(b)(6) and 23.1, it is proper to defer the final determination of whether the claim is direct or derivative under *Tooley* until after the factual record on the point is better developed."

Setting this issue aside, I also acknowledge that plaintiff has alleged sufficient facts from which it is reasonably conceivable that defendants breached their duty of loyalty. As a brief aside, I note that, although the standard of review was hotly disputed in the briefing and at oral argument, defendants did not spend much effort on arguing whether there were sufficient allegations on whether they breached their fiduciary duties.

Defendants devote a paragraph to arguing that they fulfilled their duties because Funko carried out the 2022 recapitalization after plaintiff had initiated this suit. Similarly, defendants do not seem to argue, for purposes of their dismissal motions, that the piling up of cash at Funko while the pre-IPO owners exchanged units for Class A stock was entirely fair. To be clear, I will get to defendants' mootness arguments in a few moments.

"[T]he duty of loyalty mandates that

the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally.' ... Corporate fiduciaries — both officers and directors — 'are not permitted to use their position of trust and confidence to further their private interests.'" That is from this Court's decision in *Metro Storage International LLC v. Harron*.

At oral argument, I certainly had questions about the purported genesis of what plaintiff refers to as an obligation to maintain economic equivalence, from which plaintiff asserts that the failure to do so constitutes a breach of fiduciary duty. But defendants' papers do not really contest the origin of this obligation.

Based on plaintiff's allegations, and considering the standards applicable at this stage and the limited pleading-stage record before me, I conclude that, at least for purposes of this pleading stage, it is reasonably conceivable that the defendants had a duty to maintain economic equivalence. This is supported both by Funko's own internal documents and by the way that, at least as

alleged by plaintiff, failure to maintain economic equivalence foreseeably diverts value from the Class A stockholders for the benefit of the alleged control group and pre-IPO owners.

Based on the facts alleged, it is reasonably conceivable that the individual defendants, as directors and officers, understood that they were required to maintain economic equivalence. Even ignoring the asserted academic and market expectations, Funko's internal management presentations compel this pleading-stage conclusion. One such presentation recognizes that "maintenance of 1:1 economic relationship between publicly traded shares and [the] partnership interest[s] is paramount[.]" This statement goes beyond the obligation to maintain a purely numerical equivalence between shares and units and seems to extend to qualitative and quantitative economic equivalence. Indeed, another of Funko's internal slide decks, which appears to have been assembled by JPMorgan, is entirely dedicated to assessing four solutions to reestablish "the 1-to-1 conversion ratio." Multiple simulated solutions therein expressly include steps to "return to 1-1." Recall that adjusting the conversion

ratio is one of the methods through which economic equivalence can be reestablished.

Indeed, it is this foundational understanding that one FAH unit is, in its substance, the economic equivalent of a Class A Share and holds the same level of economic risk that appears to have led the SEC to issue its 2016 no-action letter that, for the purposes discussed therein, ownership of the two should be treated synonymously.

At bottom, and as their own documents suggest, it is reasonably conceivable that the individual defendants understood the obligation to maintain a one-to-one ratio as applying to both the numerical equivalence of the units held and also the economic equivalence between the FAH units and Class A shares. Further bolstering this conclusion is the very obvious point that defendants carried out the 2022 recapitalization, one of the very acts they believed would reestablish economic equivalence.

The implications of failing to maintain economic equivalence would seem to further support the notion that there is a duty to maintain such equivalence. As I described in the factual background, where tax distributions are simply

retained by the company, as Funko has done here, it is reasonably conceivable that this accumulation, when coupled with a pre-IPO owners' exchange of an FAH unit for Class A stock results in the alleged "double dipping" which diverts value away from the public holders of Class A stock and to the control group and pre-IPO owners.

Thus, it is reasonably conceivable that what defendants refer to as this "cash management decision[]" — that is, the board's determination to let the cash amass at Funko, which created the "trapped cash," functions to increase the amount the alleged control group and pre-IPO owners are able to capture at the time they exchange their FAH units.

I acknowledge that this seems like a somewhat novel action derived from a somewhat unique and arguably emerging corporate structure. I also acknowledge the limited record before me at this pleading stage.

Accordingly, while I conclude that it is reasonably conceivable that Funko's board and officers had a fiduciary duty to maintain economic equivalence, I place considerable emphasis on the low bar that a plaintiff must meet to get past a motion to

dismiss.

Defendants do not argue that they maintained economic equivalence. Indeed, even if they had, their undertaking of the 2022 recapitalization would seem to belie such a position. Thus, I need not address this issue much further today. Suffice it to say, plaintiff has, for pleading-stage purposes, alleged facts making it reasonably conceivable that the individual defendants used their positions of trust to divert value to the alleged control group, and indeed themselves, and away from the public Class A stockholders. Moreover, it is reasonably conceivable that they did so by causing Funko to amass cash so that the members of the alleged control group and pre-IPO owners were able to capture as much value as possible when they exchanged their FAH units.

Thus, I conclude that it is reasonably conceivable that the individual defendants facilitated the double dipping by maintaining a self-imposed no-cash-dividends policy and choosing to take no other action to correct the economic inequivalence until the May 2022 recapitalization, to the detriment of the Class A common stockholders.

I turn now to defendants' second

asserted basis for dismissal, the adequacy of Funko's disclosures.

Defendants argue that the claims against them must be dismissed because Funko disclosed the risk of double dipping in its prospectus and various SEC filings. They rely on this Court's decision in *In re SmileDirect Club, Inc. Derivative Litigation*, where the Court quoted *7547 Partners v. Beck* in stating that "it would seem to follow that plaintiff would be barred from suing by reason of its knowledge of the alleged wrong when it purchased the stock." Defendants cite the same language in *In re MultiPlan Corp. Stockholders Litigation*, quoting *SmileDirect*.

Defendants' reliance on these cases is incorrect for three reasons. First, the alleged facts at issue in *SmileDirect* are materially dissimilar, and the Court's decision in *MultiPlan* does not support defendants' argument on the issue. Second, a more recent decision of this Court counsels against the reading that defendants have proposed. Lastly, the disclosures were stated as related primarily to issuing "cash dividends." I address these each in turn.

The disclosures referred to in *SmileDirect* are meaningfully distinct from those at issue in this action. The prospectus at issue there "disclosed and described at length how the IPO proceeds would finance the Insider Transactions; the exact number of LLC Units and Class A shares the Company would purchase from the pre-IPO investors upon closing; and the price at which the Company would purchase those LLC Units and Class A shares." Moreover, "[t]he Prospectus explained those transactions would occur automatically if the IPO raised sufficient funds."

There, the Court highlighted that: "Plaintiffs do not allege the Board made a conscious decision, modified any terms, or delayed in carrying out their disclosed plans to complete the Insider Transactions after the IPO closed and the market price dropped. Plaintiffs do not allege, for example, that the Board learned the price was too high only upon the market's unfavorable response to the IPO."

Here, the facts alleged are different. The disclosures defendants point to are the August 2018 10-K disclosure that I quoted previously and the no-cash dividends policy set forth in Funko's

prospectus, which in relevant part states the following:

"We currently intend to retain all available funds and any future earnings to fund the development and growth of our business and to repay indebtedness, and therefore we do not anticipate declaring or paying any cash dividends on our Class A common stock in the foreseeable future ... [and] [a]ny future determination as to the declaration and payment of dividends, if any, will be at the discretion of our board of directors ...."

Here, the hypothetical harm contemplated in Funko's 2018 10-K stands in stark contrast to the granular description of the transactions that were set to occur "automatically" in *SmileDirect*. Also, unlike in *SmileDirect*, the dividend policy here was left wholly to the board's discretion, and plaintiff alleges that the board's refusal to maintain economic parity was deliberate and made in the face of its own recognition of an obligation to do so. For these reasons, I conclude that the Court's statement in *SmileDirect* does not apply here.

In *MultiPlan*, this Court quoted

SmileDirect where it quoted *Beck* but did not find it applicable to the facts there. There, the Court only stated that "[t]he defendants' argument might be persuasive if it had been made about the Proxy and the plaintiffs had opted not to redeem despite adequate disclosures — but that is not the universe alleged in the Complaint." This is far afield from defendants' characterization that "no claim can stand where there are 'adequate disclosures.'"

These major distinctions clarify why defendants' reading of the language in *SmileDirect* is inapplicable. Next, I turn to this Court's recent decision in *Delman v. GigAcquisitions3, LLC*.

In *Gig3*, Vice Chancellor Will addressed a defendants' assertion that the language used in SmileDirect, quoting Beck, should be read as "estopp[ing plaintiff] from invoking the duty of loyalty and a heightened standard of review because he implicitly assented to the conflicts [disclosed in the prospectus and proxy]." Vice Chancellor Will explained why this interpretation of *SmileDirect* is incorrect, stating:

"Nothing in *SmileDirect* indicates that the plaintiff waived loyalty claims by tacitly

consenting to a conflicted arrangement when investing. Nor does it suggest that this court is barred from applying entire fairness if the conflicts triggering that standard of review were disclosed. *Such an approach would be inconsistent with the fundamental principles of our law*. Delaware corporate law 'does not allow for a waiver of the directors' duty of loyalty.' .... The Delaware General Assembly alone 'has the authority to eliminate or modify fiduciary duties and the standards that are applied by this court, or to authorize their elimination or modification.' Whether it is wise to 'create a business entity in which the managers owe the investors no duties at all except as set forth' by statute or the entity's governing documents is a 'policy judgment' left to that legislative body. Unless and until that occurs, [an entity] taking the Delaware corporate form 'promises investors that equity will provide the important default protections it always has.' It is not for this court to grant an exemption."

I agree and cannot say it better myself. I accordingly turn now to the third basis for rejecting defendant's argument on the disclosure

issue.

I add a note here only to recognize what plaintiff has already pointed out — that is, the most definitive language which defendants assert to be an "adequate disclosure," suggests only that Funko does not foresee distributing "cash dividends." This language never suggests that Funko will not maintain economic equivalence, which Funko itself believed it was obligated to do, at least for purposes of this pleading stage. Even if I were to read the language in *SmileDirect* as defendants suggest (which, to be clear, I do not, but even if I did) it would seem that the substance of what defendants claim to have been disclosed is actually considerably less than defendants argue it to be. Indeed, as defendants recognize in the briefing and as Funko's internal documents seem to demonstrate, there are a number of ways for Funko to maintain economic equivalence that do not require Funko to distribute cash dividends.

Finally, and perhaps as a fourth reason, I have questions about the premise on which defendants' disclosure argument rests. Defendants suggest that I should treat plaintiff differently from other stockholders because he purchased his shares in

2019 and they say that, by that time, they'd made various evolving disclosures. I have already described why I conclude that, for pleading stage purposes, those arguments fail. However, I note further that defendants' argument, if adopted, would seem to suggest a new regime for analyzing fiduciary duties, one that perhaps more resembles federal securities law and is not an approach that I believe Delaware law has adopted. In merger litigation, for example, we generally view direct claims as traveling with the shares, particularly after an IPO. Defendants' argument, if adopted, would seem to open up, for example, seller classes and so forth. This consideration suggests to me yet another reason why defendants' argument, which basically amounts to an argument that simple disclosure precludes fiduciary liability even for the duty of loyalty, seems to have little foundation in our law.

My analysis, then, compels me to reject defendants' argument that the disclosures somehow bar plaintiff's suit for breach of fiduciary duties in these circumstances.

I turn now to defendants' arguments for dismissing the claims against Dellomo and Nickel.

First, defendants argue that the claim against Dellomo must be dismissed because he was not a member of the board at the time the initial action was brought. I have already explained why this argument fails.

During his tenure on the board, Dellomo was a dual fiduciary of ACON and Funko. Plaintiff has alleged that the failure to maintain economic equivalence, for the pre-IPO owners' benefit, was a discretionary and intentional approach maintained for years while Dellomo was on the board as a dual fiduciary. It is reasonably conceivable that Dellomo participated in the cash management decision-making and helped facilitate ACON and the alleged control group's ability to capture more value from the public Class A stockholders through the double dipping.

Indeed, it can alternatively be said that, at least at this pleadings stage, plaintiff is entitled to the inference that each of the four conflicted directors, including Dellomo, was key in ensuring that half the board would be available to block any effort to fix the failure to maintain economic equivalence. This would indeed be consistent with the numerous other veto rights set forth in the

stockholders agreement that I discussed earlier. Indeed, one might describe it as an interlocking approach that, itself, suggests the validity of plaintiff's allegations, at least at the pleading stage.

Moreover, considering the board's decisions under entire fairness at this pleading stage, defendants have failed to demonstrate or even argue that the "cash management decisions" made while Dellomo was on the board, were entirely fair.

Next, defendants argue that plaintiff failed to state a claim against Nickel since he was not on the board and simply acquiesced to the board's decisions. But plaintiff has alleged that Nickel was directly interested and held interests adverse to the Class A stockholders. Plaintiff sufficiently alleges that Nickel held FAH units and sold those units while he was Funko's CFO. Plaintiff sufficiently alleges that Nickel participated in the purported double dipping and, while serving as Funko's CFO, presented the very issue of how to use the "trapped cash" to the audit committee on multiple occasions.

Indeed, plaintiff's allegations indicate the board even adopted one of Nickel's

proposals when it entered into the $20 million intercompany loan agreement with Funko LLC, a loan that plaintiff alleges itself favored the pre-IPO owners using the trapped cash that was properly allocable to the public Class A stockholders. I conclude that, applying the plaintiff-friendly standards that I must at this stage, plaintiff's allegations are sufficient to meet the low threshold for stating a claim against Nickel in his capacity as a former officer.

Accordingly, I conclude that I must reject defendants' arguments for dismissal of the claims against Dellomo and Nickel.

I turn now to the mootness argument made under Rule 12(b)(1). Despite understanding that the arguments are made in the alternative, it is difficult to ignore entirely that there is at least some small degree of curiousness in arguing simultaneously that plaintiffs' claims are moot while also arguing that no claim ever existed.

Nonetheless, I have given great consideration to this issue and have carefully reviewed the parties' arguments. Here, defendants argue that by undertaking the 2022 recapitalization,

they have mooted plaintiff's claims and that, in doing so, the board has fulfilled its fiduciary duties and thus the amended complaint fails to state a claim.

"'Mootness arises when controversy between the parties no longer exists such that a court can no longer grant relief in the matter.' 'A proceeding may become moot in one of two ways: if the legal issue in dispute is no longer amenable to a judicial resolution; or, if a party has been divested of standing.' '[A] controversy that has become moot normally will be dismissed.' '[But] [i]f the alleged injury still exists despite the occurrence of intervening events, a justiciable controversy remains, and the mootness doctrine will not operate to deprive a court of jurisdiction to hear the case.'"

That is from this Court's decision in *OTK Associates v. Friedman*.

Here, plaintiff alleged several ways that Funko could reestablish economic equivalence. One of these methods included requiring pre-IPO owners to forfeit some of their FAH units to the extent of the double dip. If done at the correct scale and ratio, this could theoretically have the effect of diluting the pre-IPO owners' holdings of FAH and

function to shift value back to the public Class A stockholders to the extent of the double dip.

As I explained earlier, Funko carried out a recapitalization in May 2022 that aimed to effectuate this outcome. The recapitalization had two primary steps. In step one, Funko made a $74 million capital contribution to FAH in exchange for over 4 million newly issued FAH units.

In step two, the FAH units were recapitalized through a reverse unit split. This decreased the number of FAH units held by pre-IPO owners. Thus, in order to maintain the one-to-one ratio of Class B shares to FAH units held by the pre-IPO owners, over 900,000 Class B shares were canceled.

This recapitalization reduced the pre-IPO owners' holdings of FAH by what plaintiff approximates to be around 10% and increased the percentage of FAH units held by Funko, since the reverse split was offset as to its holdings, by the 4 million newly issued units.

Defendants argue that this brought Funko's Class A shares and FAH units back into economic equivalence and thus moots plaintiff's claims

because "'the substance of the dispute' has 'disappear[ed].'" Plaintiff disputes this. And indeed, as plaintiff's explanation made clear at the outset, whether reducing the pre-IPO owners' holdings of FAH actually brings the shares and units back into economic equivalence is a question of the scale on which it is done. Accordingly, the question of whether the 2022 recapitalization actually mooted plaintiff's claims is fact-intensive. It is a question of scale and degree.

I, for one, am not an investment banker. But even if I were, I'm not sure that the record that the defendants have presented at this stage would be sufficient to conclude that actual economic equivalence has been restored.

As part of this action, plaintiff seeks damages, which, in itself, is a highly factual issue. Plaintiff argues that the recapitalization diluted the FAH units still held by pre-IPO owners by an amount equal to the benefit that they would have received from double dipping into the $74 million of trapped cash.

It seems that this can properly be read as plaintiff agreeing that the recapitalization

functioned to shift a certain amount of value to public Class A stockholders and away from the pre-IPO owners. But it is unclear whether the amount of value shifted is sufficient to account for prior exchanges of FAH units into Class A shares — in other words, for the alleged unique double-dip benefit the defendants received and did not share with the rest of the stockholders when they exchanged their FAH units and, particularly, when they sold their new Class A shares into the market.

As plaintiff's counsel explained at oral argument, to effectively give back the excess value captured by pre-IPO owners from double dipping that took place prior to the 2022 recapitalization "[i]t would ultimately result in a question of whether the cancellation was large enough[.]"

While it seems entirely possible that defendants did carry out the recapitalization at the requisite scale, it is not at all clear from the briefing or record that has been presented to me that they did so in a way that accounted for these alleged unique benefits.

The defendants have not explained, certainly not in a way that I can conclude this action

must now be dismissed, how the board determined at what scale to conduct the cancellation or what multiplier to use for the reverse split. Instead, the Court is essentially left to rely on the defendants' say-so for the proposition that no damages or other remedy remains. That is not something I am willing to do, or frankly can do, at this stage.

Here, it seems that controversy remains over the recapitalization's mooting effect and the extent of any remedy remaining, including possible disgorgement. The presence of this controversy means that the recapitalization "will not operate to deprive [this] court of jurisdiction ...." As the record develops, defendants are welcome to raise this issue again, and I will gladly revisit it, but without more, I cannot presently conclude that dismissal is appropriate.

For these same reasons, I must also reject defendants' single-paragraph argument that the board completely fulfilled its fiduciary duties by undertaking the recapitalization, and thus the claim brought against defendants remains justiciable.

This notwithstanding, I also recognize that at least some portion -- and indeed likely a very

substantial portion -- of plaintiff's claim is mooted by the recapitalization, but, again, it is not clear whether the entire basis for a remedy has been. Thus, as I will explain more in a moment, consistent with my rationale for not dismissing this action on mootness grounds, I am also unable at this time to quantify the benefit of this action with any degree of reasonable precision and thus will decline plaintiff's application for an award of interim attorneys' fees.

Before I move on from this mootness issue, I want to briefly address a couple of ancillary arguments that the Funko defendants raise in their briefs.

Defendants argue that no unique benefit was captured by pre-IPO owners because they did not receive some dividend or otherwise share in the trapped cash directly before selling their exchanged Class A shares. This misses the point. The trapped cash can, among other things, affect share price, and it is reasonably conceivable defendants took advantage of and benefited from that when they sold their Class A shares, despite having already received a direct tax distribution from FAH before it exchanged its FAH unit. In this way, plaintiff argues

defendants received an unjust benefit by receiving more than the pure economically equivalent value of an FAH unit when the value should have already been allocated to the direct and sole benefit of the public Class A stockholders.

Second, defendants argue that plaintiff failed to allege that the cash accumulation affected the price of Class A stock. But the disclosures that Funko has asked me to consider to dismiss this action expressly recognize that the impact of accumulated cash from the tax distributions could foreseeably benefit the pre-IPO owners once they exchange their FAH units for Class A stock. Likewise, Funko's internal documents, which defendants have asked me to consider in this matter, repeatedly show the accumulated cash as having a direct relationship to share price. This is, in any event, fairly inferrable at the pleading stage given the well-pled allegations that Funko is a company with substantially no operational assets, only its ownership of the FAH units and, of course, the trapped cash.

Accordingly, I conclude that neither of these ancillary arguments are sufficient grounds to justify dismissing this action.

For the reasons I have discussed, I conclude that I must deny defendants' motions to dismiss.

I now turn briefly to plaintiff's application for an interim fee award. Plaintiff asserts that counsel has caused a significant corporate benefit and has submitted an application for an award of interim attorneys' fees. However, it is well established that "[t]he determination of any award is a matter within the sound judicial discretion of the Court of Chancery." That is from our high court's decision in *In Re Infinity Broadcasting Corp*. Indeed, in its *Novell* decision, this court explained, in the context of an interim fee request, that it may exercise its discretion to "defer ruling on the ... Plaintiff's fee request until [the plaintiffs] have fully litigated the remaining damages claims."

I note first that, despite some minimal references, defendants have not really put forward any meaningful dispute over causation for purposes of considering the interim fee application.

That said, even if I were otherwise inclined to grant a fee award here, given what appears to be a quite substantial result already, there

remains a very substantial question of setting an appropriate award amount.

As I have noted, I have given defendants' mootness arguments very careful and long consideration, and I believe the arguments are, in large part, very good ones. Although I can't conclude that this matter is entirely mooted such that the action can be dismissed, it seems that defendants more or less did what the plaintiff had asked in its initial complaint with the trapped cash.

Defendants have raised very good points that while, as I have discussed, there is a question about any harm or improper benefit that might have accrued as a result of exchanges that occurred before the recapitalization, it seems as though there was a large, arguably hypothetical harm that could have accrued but ultimately never did. Other than the loan, the cash remained unspent, and then it was used to effectuate the recapitalization.

As to alleged harms, it also seems that the double dip, even at best, arguably did not involve the entire amount of the trapped cash but instead involved some as-yet unquantified slice that the pre-IPO owners were not entitled to. So, when you

factor in the fact that some substantial portion of the harm remained hypothetical, we're now potentially talking about a slice of a slice.

The upshot of all of this is that, with the questions I've already identified concerning the ratios involved in the recapitalization, plus these questions I just discussed about quantifying the slice of harm, it becomes clear to me that, if I am accepting plaintiff's arguments against mootness on grounds that fact-intensive questions remain, I must also conclude that I cannot grant the interim fee application for the same or similar reasons. This is essentially just application of the goose/gander rule.

In sum, I deny defendants' motions to dismiss and also deny plaintiff's interim fee application.

This concludes my ruling. Thank you very much for bearing with me for a very long ruling. I'm not looking for reargument at this time, but I'm happy to take any questions. I will start with plaintiff's counsel. Mr. Foulds?

MR. FOULDS: Your Honor, Chris Foulds. We do not have any questions at this time. Thank you.

THE COURT: Mr. DiCamillo?

ATTORNEY DICAMILLO: Thank you, Your Honor, no questions.

THE COURT: Mr. Kelly?

ATTORNEY KELLY: Thank you, Your Honor, no questions.

THE COURT: And Mr. Sanders?

ATTORNEY SANDERS: Thank you, Your Honor. No questions.

THE COURT: All right. Well, again, thank you all very much for bearing with me through that very lengthy ruling. And with that, we're adjourned.

(Proceedings concluded at 10:41 a.m.)

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CERTIFICATE

I, LORENA J. HARTNETT, Official Court Reporter for the Court of Chancery for the State of Delaware, Registered Professional Reporter, Certified Realtime Reporter, and Delaware Notary Public, do hereby certify that the foregoing pages numbered 3 through 74 contain a true and correct transcription of the rulings as stenographically reported by me at the hearing in the above cause before the Vice Chancellor of the State of Delaware, on the date therein indicated, except as revised by the Vice Chancellor.

IN WITNESS WHEREOF I hereunto set my hand at Wilmington, this 19th day of December, 2023.

/s/ Lorena J. Hartnett

Lorena J. Hartnett
Official Court Reporter
Registered Professional Reporter
Certified Realtime Reporter
Delaware Notary Public