

Ninth Circuit issues split decision under Exchange Act on toy company's inventory-related warnings

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On February 4, 2026, a Ninth Circuit panel affirmed in part and reversed in part the dismissal of a securities fraud action alleging that a toy company misled investors about inventory management. The panel found that while some of the defendants' statements were inactionable puffery or forward-looking, certain risk warnings were actionable because they misrepresented risks that had already materialized, and scienter could be inferred as to facts critical to the company's core operations.

Funko is a manufacturer of toys based on famous characters from films, television, and comic books. The popularity of certain toy figurines can change quickly. As a result, critical to Funko's business model is the ability to manage its inventory and go from "design to shelf" as quickly as possible. (Op. at 7.) The company seeks to avoid "dead inventory"—unsellable figurines that take up Funko's limited warehouse space." (Op. at 7.)

Funko experienced a boom in popularity in 2020. In 2021, the company began planning for the opening of a new logistics facility, and migration to a new information technology system.

Throughout 2022, the company experienced logistics issues at its new facility and challenges integrating the new technology platform. Plaintiffs alleged that workers at the facility conducted up to 50 investigations per day to find lost inventory, with many resorting to Excel spreadsheets or handwritten notes to track inventory when Funko's technology systems failed; that by August 2022, the facility was 50 days behind on fulfillment; that by September, the facility was shipping partial orders with some customers cancelling; and that by October, Funko had rented a second warehouse to store excess inventory. Plaintiffs also alleged that storage racks were filled with inventory and that inventory was stacked in haphazard fashion on warehouse floors and, moreover, that two years of dead inventory had piled up as well.

During this time, Funko and its officers made public statements touting the company's inventory as "generally high quality" and in a "healthy position," and looking forward to "more distribution capabilities ... down the road." (Op. at 19, 25.) They also issued robust risk warnings concerning Funko's inventory and its technology systems. For example, they warned that:

- Funko must "avoid accumulating excess inventory" (Op. at 34.);
- there is a risk of holding "excess inventory ... for a long period of time," and that "[i]f [it is] not successful in managing [its] inventory, [its] business, financial condition and results of operations could be adversely affected" (Op. at 34.);
- the "[f]ailure to successfully operate [Funko's] information systems ... could disrupt [its] business or reduce [its] sales or profitability," and that it "rel[ie]d extensively on various information technology systems and software applications" (Op. at 37.); and
- "[t]he failure of these information systems to perform as designed, [or its] failure to operate them effectively ... could disrupt [its] business, require significant capital investments to remediate a problem or subject [it] to liability." (Op. at 37.)

On November 3, 2022, Funko announced during an earnings call that delays with the technology migration were causing “higher-than-expected short-term operating expenses” and that inventory levels were high. (Op. at 19.) Following these announcements, Funko’s stock price dropped 59%. In March 2023, Funko announced that it would abandon the still-incomplete technology migration entirely and write off \$32.5 million in associated costs, as well as about \$30 to \$36 million in inventory.

Plaintiffs alleged that the company and certain officers misrepresented Funko’s inventory management and use of technology systems in violation of §§ 10(b) and 20(a) of the Securities Exchange Act of 1934 and SEC Rule 10b-5. The district court dismissed the complaint in May 2024 and plaintiffs appealed, challenging the district court’s determinations as to falsity and scienter. (Op. at 20-21, 23.)

Writing for the panel, Circuit Judge Salvador Mendoza, Jr. [affirmed in part and reversed in part](#). The panel affirmed dismissal as to a number of the challenged statements. The panel found that statements touting the strength of Funko’s inventory were inactionable puffery because they did not “rise to the level of ‘concrete description of the past and present’ that affirmatively create a misleading impression of a ‘state of affairs that differed in a material way from the one that actually existed.’” (Op. at 28.) The panel further found that the Private Securities Litigation Reform Act (PSLRA) safe harbor protected certain forward-looking statements regarding Funko’s future distribution capabilities. (Op. at 39-40.)

On the other hand, the panel found that defendants’ risk warnings regarding potential inventory management and technology systems issues were actionable and *not* protected by the PSLRA safe harbor because the plaintiffs had alleged that these risks had already materialized and were affecting Funko at the time the statements in question were made. (Op. at 35, 38.) The panel credited plaintiff’s specific factual allegations that at the time of the warnings, excess inventory was visible and piling up and Funko was having a number of identifiable malfunctions with its inventory management system. (Op. at 35, 38.) The panel concluded that a rational trier of fact could find that from the risk warnings, investors might have incorrectly concluded that the company was “handily operating its information technology systems; or at least that its business was not disrupted.” (Op. at 37.)

Lastly, the panel found that plaintiffs adequately pled scienter. (Op. at 43.) The panel credited plaintiffs’ allegations that under the “core operations” doctrine, Funko’s senior leadership *must have been aware* of the relevant issues because the company’s inventory management and technology systems were so central to Funko’s business that it would be implausible or “absurd to suggest” otherwise. (Op. at 43, 48.)

This decision reaffirms that vague, optimistic statements of puffery and forward-looking projections are not actionable under the PSLRA. However, it is also a reminder that a court may determine that even robust warnings about future potential risks can be actionable if a plaintiff is able to allege with specific and detailed factual information (i.e., with the necessary particularity) that those risks have already materialized and the warnings imply that they are hypothetical future risks only. Finally, it illustrates the Ninth Circuit’s approach to the core operations doctrine and its greater willingness than other circuits to infer the knowledge of senior leadership, at least in some instances, as to matters that are critical to a business’s operations.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Brian M. Burnovski

+1 212 450 4666
brian.burnovski@davispolk.com

Michael S. Flynn

+1 212 450 4766
michael.flynn@davispolk.com

Edmund Polubinski

+1 212 450 4695
edmund.polubinski@davispolk.com

Neal Potischman

+1 650 752 2021
neal.potischman@davispolk.com

Vincent Barredo

+1 650 752 2099
vincent.barredo@davispolk.com

Jonathan K. Chang

+1 650 752 2043
jonathan.chang@davispolk.com

Elazar Chertow

+1 650 752 2037
elazar.chertow@davispolk.com

Will Reynolds

+1 650 752 2146
will.reynolds@davispolk.com

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