



IN THE SUPREME COURT OF THE STATE OF DELAWARE

MICHAEL ROBERT MARCHNER, JR.,
derivatively on behalf of B. RILEY
FINANCIAL, INC., a Delaware Corporation,
Plaintiff-Below, Appellant

v.

BRYANT R. RILEY, ROBERT L. ANTIN,
TAMARA "TAMMY" BRANDT, ROBERT
D. D'AGOSTINO, THOMAS J.
KELLEHER, RENÉE E. LABRAN,
RANDALL E. PAULSON, MICHAEL J.
SHELDON, and MIRIAM "MIMI" K.
WALTERS,
Defendants-Below, Appellees

-and-

B.RILEY FINANCIAL, INC.,
Nominal Defendant Below,
Appellee.

Case No. 175,2026

Court Below:
Court of Chancery of the
State of Delaware
C.A. No. 2025-0164-LWW

PUBLIC VERSION

APPELLANT'S OPENING BRIEF

June 15, 2026

OF COUNSEL:

WOLF POPPER LLP
Robert C. Finkel*
845 Third Avenue, 12th Floor
New York, NY 10022
(212) 759-4600
rfinkel@wolfdpopper.com
*(*pro hac vice* motion forthcoming)

PUBLIC VERSION:

FILED July 1, 2026

Carmella P. Keener (#2810)
COOCH AND TAYLOR, P.A.
1000 North West Street, Suite 1500
Wilmington, Delaware 19801
(302) 984-3816
ckeener@coochtaylor.com

*Counsel for Plaintiff Below, Appellant
Michael Robert Marchner, Jr.*

TABLE OF CONTENTS

	<u>Page</u>
TABLE OF AUTHORITIES.....	iv
NATURE OF PROCEEDINGS	1
SUMMARY OF THE ARGUMENT	3
STATEMENT OF FACTS	6
A. B.Riley’s Relationship with Kahn.....	6
B. B.Riley Evaluates Purchases of Badcock Receivables	6
C. B.Riley’s Undisclosed \$200.5 Million Loan to Vintage	8
D. B.Riley’s Diligence of the Take-Private Transaction.....	8
E. The 5-8-23 Board Meeting.....	11
F. FRG Announces the Take-Private Transaction and Releases 1Q23 Results	12
G. FRG Issues the Definitive Proxy Statement for the Take- Private Transaction.....	13
H. FRG’s 2Q23 Operating Results.....	14
I. The Take-Private Transaction Closes.....	14
J. B.Riley Discloses the \$200.5 Million Loan and the \$64.6 Million IAA	15
K. The Sale of Badcock to Conn’s.....	16
L. Kahn is Implicated in a Securities Fraud Conspiracy at Prophecy	16
M. The Audit Committee’s “Actions” Following Disclosure of the Prophecy Fraud	17
N. FRG’s and B.Riley’s Financial Performance Worsens	19

O.	Defendants’ Breaches Exposed Them and the Company to Securities Liability	20
P.	Plaintiff Sought Books and Records and Then Filed this Action.....	21
	ARGUMENT	23
I.	THE COURT OF CHANCERY ERRED IN HOLDING THAT THE OUTSIDE DIRECTORS DID NOT FACE A SUBSTANTIAL LIKELIHOOD OF LIABILITY UNDER CAREMARK PRONG I.	23
A.	Question Presented.....	23
B.	Scope of Review	23
C.	Merits of the Argument.....	23
II.	THE CHANCERY COURT ERRED IN FINDING THAT THE AUDIT COMMITTEE DIRECTORS DID NOT FACE A SUBSTANTIAL LIKELIHOOD OF LIABILITY UNDER CAREMARK PRONG II.	36
A.	Question Presented.....	36
B.	Scope of Review	36
C.	Merits of the Argument.....	36
1.	The Audit Committee Ignored Red Flags at the Time of the 5-8-23, Board Meeting	38
2.	The Audit Committee Ignored Red Flags that Followed the 5-8-23 Board Meeting	39
3.	The Audit Committee Ignored Red Flags Presented After the Close of the Take-Private Transaction	40

III.	THE CHANCERY COURT ERRED IN FAILING TO CONSIDER THE ALLEGATIONS HOLISTICALLY AND FINDING THAT THE OUTSIDE DIRECTORS COULD IMPARTIALLY CONSIDER A DEMAND AGAINST RILEY.	45
A.	Question Presented.....	45
B.	Scope of Review	45
C.	Merits of the Argument.....	45
CONCLUSION		50

TABLE OF AUTHORITIES

Cases

<i>Beam v. Stewart</i> , 845 A.2d 1040 (Del. 2004)	48
<i>Benefore v. Jung Woong Cha</i> , C.A. No. 14614, 1998 Del. Ch. LEXIS 28 (Del. Ch. Feb. 20, 1998)	48
<i>Brehm v. Eisner</i> , 746 A.2d 244 (Del. 2000)	23
<i>Cal. Pub. Emples. Ret. Sys. v. Coulter</i> , No. 19191, 2002 Del. Ch. LEXIS 144 (Del. Ch. Dec. 18, 2002)	48
<i>City of Detroit Police & Fire Ret. Sys. v. Hamrock</i> , 2021-0370-KSJM, 2022 Del. Ch. LEXIS 159 (Del. Ch. June 30, 2022)	41
<i>Crescent/Mach I Partners, L.P. v. Turner</i> , 846 A.2d 963 (Del. Ch. 2000)	48
<i>Fisher v. Sanborn</i> , No. 2019-0631-AGB, 2021 Del. Ch. LEXIS 61 (Del. Ch. Mar. 30, 2021)	34
<i>Giuliano v. Grenfell-Gardner</i> , No. 2021-0452-KSJM, 2025 LEXIS 342509 (Del. Ch. Sep. 2, 2025)	25, 31, 33, 34
<i>Guttman v. Jen-Hsun Huang</i> , 823 A.2d 492 (Del. Ch. 2003)	34
<i>Highland Legacy Ltd. v. Singer</i> , No. 1566-N, 2006 Del. Ch. LEXIS 55 (Del. Ch. Mar. 17, 2006)	48
<i>IBEW Local Union 481 Defined Contribution Plan & Tr. v. Winborne</i> , 301 A.3d 596 (Del. Ch. 2023) (“Winborne”)	24, 43, 44
<i>In re Caremark Int’l</i> , 698 A.2d 959 (Del. Ch. 1996)	<i>passim</i>
<i>In re BGC Partners, Inc. Deriv. Litig.</i> , CONSOLIDATED C.A. No. 2018-0722-LWW, 2021 Del. Ch. LEXIS 213 (Del. Ch. Sep. 20, 2021)	46
<i>In re Boeing Co. Deriv. Litig.</i> , No. 2019-0907-MTZ, 2021 Del. Ch. LEXIS 197 (Del. Ch. Sep. 7, 2021)	24, 25, 27

<i>In re Citigroup Inc. S’holder Deriv. Litig.</i> , 964 A.2d 106 (Del. Ch. 2009)	27
<i>In re Dell Techs. Inc. Class V Stockholders Litig.</i> , Consol. C.A. No. 2018-0816-JTL, 2020 Del. Ch. LEXIS 211 (Del. Ch. June 11, 2020).....	47
<i>In re MetLife Deriv. Litig.</i> , C.A., No. 2019, 0452-SG, 2020 Del. Ch. LEXIS 265 (Del. Ch. Aug. 17, 2020)	34, 35
<i>In re Oracle Corp. Deriv. Litig.</i> , Consol. C.A. No. 2017-0337-SG, 2022 Del. Ch. LEXIS 118 (Del. Ch. May 20, 2022).....	47
<i>In re ProAssurance Corp. Stockholder Deriv. Litig.</i> , Consol. C.A. No. 2022-0034-LWW, 2023 Del. Ch. LEXIS 385 (Del. Ch. Oct. 2, 2023)	27-28
<i>In re Walt Disney Co. Deriv. Litig.</i> , 825 A.2d 275 (Del Ch. 2003)	25
<i>Leb. Cty. Employees’ Ret. Fund v. Amerisourcebergen Corp.</i> , No. 2019-0527-JTL, 2020 Del. Ch. LEXIS 17 (Del. Ch. Jan. 13, 2020)	37
<i>Lebanon Cnty. Employees’ Ret. Fund v. Collis</i> , 311 A.3d 773 (Del. 2023) (“Collis”)	23, 25
<i>Marchand v. Barnhill</i> , 212 A.3d 805 (Del. 2019).....	3, 24, 25, 33, 34
<i>Okla. Firefighters Pension & Ret. Sys. v. Corbat</i> , No. 12151-VCG, 2017 Del. Ch. LEXIS 848 (Del. Ch. Dec. 18, 2017).....	34
<i>Ont. Provincial Council of Carpenters' Pension Tr. Fund v. Walton</i> , No. 2021-0827-JTL, 2023 Del. Ch. LEXIS 92 (Del. Ch. Apr. 26, 2023)	31
<i>Sandys v. Pincus</i> , 152 A.3d 124 (Del. 2016).....	48
<i>Stone v. Ritter</i> , 911 A.2d 362 (Del. 2006)	25
<i>Teamsters Local 443 Health Servs. & Ins. Plan v. Chou</i> , No. 2019-0816-SG, 2020 Del. Ch. LEXIS 274 (Del. Ch. Aug. 24, 2020) ...	36, 37

<i>United Food and Com. Workers Union and Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg,</i> 262 A.3d 1034 (Del. 2021) (“Zuckerberg”)	24, 46
---	--------

Rules

Court of Chancery Rule 23.1	2, 23
-----------------------------	-------

NATURE OF PROCEEDINGS

This derivative action asserts fiduciary duty claims on behalf of nominal Defendant B. Riley Financial, Inc. (“B.Riley”), against Bryant Riley (“Riley”) and Thomas Kelleher (the “Management Directors”), and Robert Antin, Tamara Brandt, Robert D’Agostino, Renée LaBran, Randall Paulson, Michael Sheldon, and Miriam Walters (the “Outside Directors”) in connection with B.Riley’s \$589.5 million funding of Brian Kahn and his affiliates, consisting of (i) B.Riley’s \$216.5 million participation in the Take-Private Transaction of Franchise Group, Inc. (“FRG”), (ii) \$200.5 million in loans outstanding to Kahn and his affiliate Vintage Capital Management, LLC, (iii) a \$64.6 million equity interest in FRG arising out of an Investment Advisory Agreement (“IAA”), and (iv) a \$108 million loan to Conn’s Inc. to facilitate Conn’s acquisition of a Kahn-related entity, W.S. Badcock LLC. That concentration exceeded B.Riley’s entire book value. Each of these Kahn-related entities, and Kahn himself, ultimately filed for bankruptcy, resulting in a corporate trauma to B.Riley occasioned by a complete loss exceeding \$500,000,000.

Plaintiff Michael Robert Marchner, Jr. has owned B.Riley common stock since November 2022. Plaintiff’s Complaint,¹ is supported by documents obtained pursuant to Plaintiff’s books and records demand. Plaintiff alleges [REDACTED]

¹ Verified Complaint A20-A169 (“¶”).

[REDACTED]
[REDACTED], and that
B.Riley's indolent Board breached its fiduciary duties by [REDACTED]
[REDACTED]

[REDACTED] *Caremark* prong one ("*Caremark I*") and
prong two ("*Caremark II*"). Plaintiff also asserts claims for disclosure violations
and excessive compensation.

On 3-30-26, Vice Chancellor Lori Will issued a Memorandum Opinion
("Op.") granting Defendants' motions to dismiss the Complaint for failure to make
a pre-suit demand pursuant to Ct. Ch. R. 23.1. Of the nine Directors, Defendants
had conceded that demand was futile as to Riley, Kelleher, and Antin. Because the
Chancery Court concluded that no fourth director could not impartially consider a
demand, the Court did not consider whether director Paulson lacks independence or
faces a substantial likelihood of liability.

SUMMARY OF THE ARGUMENT

1. The Court erred in holding that the remaining five directors (excluding Paulson) were impartial when at least two members of the Audit Committee (D’Agostino and LaBran) face a substantial likelihood of liability under *Caremark*

I. The Court failed to draw reasonable inferences from the Complaint’s particularized allegations that the Board and its Audit Committee “made no good faith effort to ensure that the Company had in place any ‘system of controls’”² necessary to make to make the Board aware of the severe risk of the \$589.5 million exposure to Kahn. Though the Audit Committee (consisting of Paulson, D’Agostino, and LaBran) was tasked with oversight, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] All six of the remaining directors (including Paulson), especially the three Audit Committee members, face a substantial likelihood of liability under *Caremark*

I.

2. The Court erred in holding that the remaining directors were impartial because the Audit Committee members face a substantial likelihood of liability under *Caremark* II. The Complaint asserted claims under *Caremark* II in the

² *Marchand v. Barnhill*, 212 A.3d 805, 822 (Del. 2019).

alternative, alleging that the Audit Committee members were aware of the red flags ignored under *Caremark* I. The Complaint makes particularized allegations that the

[REDACTED]
[REDACTED] would have had knowledge of material information related to its oversight. The Audit Committee, for example,

[REDACTED]
[REDACTED], the Audit Committee [REDACTED]

[REDACTED]
[REDACTED]
[REDACTED] The Complaint makes additional particularized allegations that the Audit Committee consciously ignored red flags of Riley's misconduct, [REDACTED]

[REDACTED] Thus, the Audit Committee members Paulson, D'Agostino and LaBran face a substantial likelihood of liability under *Caremark* II.

3. The Court erred in failing to consider the facts holistically when determining whether the Outside Directors could impartially consider a demand, including the *Caremark* allegations coupled with each of the Outside Director's personal and professional relationships with Riley. Among other things, Riley and D'Agostino were fraternity brothers at Lehigh and engaged in business transactions

together. Moreover, five of the seven Outside Directors—including Paulson, D’Agostino, Antin, Sheldon, and Walters—face personal liability in pending litigation under the Securities Act of 1933 for signing offering documents relating to Kahn. Given the Directors’ indolence related to the Kahn transactions, and Riley’s gross misconduct, the Court should have concluded on these facts that there is reasonable doubt that two or more Directors could independently respond to a demand.

STATEMENT OF FACTS

A. B.Riley's Relationship with Kahn

B.Riley is a financial services company co-founded by Riley and Kelleher. A22,¶1. Riley serves as Chair of the Board and owns 23.8% of B.Riley's common stock. A35,¶50.

Since at least 2018, B.Riley has had a longstanding financial relationship with Kahn, former CEO and controlling shareholder of FRG and founder and managing partner of Vintage, a private equity firm. A40-41,¶¶69-70,73-77.³

B. B.Riley Evaluates Purchases of Badcock Receivables

Beginning in December 2021, a subsidiary of B.Riley entered into a series of multi-hundred-million-dollar purchase agreements with Badcock, a division of FRG, to acquire Badcock's consumer credit receivables. A47,¶¶86-88.

In February 2023, due to concern with Badcock's deterioration, B.Riley discontinued purchasing Badcock receivables, and FRG's efforts to obtain financing for Badcock's receivables from alternative third parties similarly failed. A49-50,¶¶95-99. The feedback from B.Riley and others, in combination with the worsening of negative trends in economic conditions facing FRG and its industry,

³ The trial court described the "years-long" relationship between B.Riley and FRG/Kahn/Vintage as "lucrative" (Op.4), [REDACTED]

[REDACTED] See A1046-1047, Plaintiff's Answering Brief in Opposition to Defendants' Motions to Dismiss ("Opp.") at 6-7.

caused FRG to grow concerned that a failure to continue to sell Badcock receivables could result in the inability to continue to pay quarterly dividends and a default under the FRG First Lien Credit Agreement.⁴ A50,¶¶99.

As part of ongoing discussions, FRG management shared non-public financial projections with B.Riley prepared prior to the release of FRG’s 4Q22 financial statements (the “January Projections”) (A50,¶¶100-102):

<i>January Projections</i>				
The following table summarizes the January Projections for the fiscal years 2023 through 2026 (\$ in millions, unless otherwise stated):				
<u>Dollars in millions, unless otherwise stated</u>	<u>2023F</u>	<u>2024F</u>	<u>2025F</u>	<u>2026F</u>
Revenue				
Vitamin Shoppe	\$1,223	\$1,261	\$1,317	\$1,399
Pet Supplies Plus	\$1,393	\$1,475	\$1,648	\$1,859
American Freight	\$ 945	\$1,058	\$1,162	\$1,242
Badcock	\$ 808	\$ 794	\$ 845	\$ 916
Buddy’s	\$ 56	\$ 60	\$ 67	\$ 73
Sylvan	\$ 43	\$ 45	\$ 48	\$ 51
Total Revenue	\$4,468	\$4,693	\$5,087	\$5,540
EBITDA⁽¹⁾	\$ 370	\$ 444	\$ 527	\$ 613
Less: D&A	\$ (80)	\$ (90)	\$ (88)	\$ (87)
EBIT⁽²⁾	\$ 290	\$ 354	\$ 439	\$ 526

After further discussions, B.Riley indicated that it would be willing to fund Badcock receivables only for 1Q23, advising FRG “that it would prefer to explore

⁴ The trial court overlooked the anticipated adverse consequences to FRG’s stock price if those facts became publicly known. *See* Op.5. The trial court also failed to consider the illogic of B.Riley acquiring the outstanding equity of FRG in spite of FRG and Badcock’s deteriorating financial condition, and the evident motive for Riley to engage in the Take-Private Transaction to shore up the collateral for Kahn’s outstanding \$200.5 million debt. *Id.*

the acquisition of all the outstanding equity of FRG, rather than expose itself to continued balance sheet risk without any equity or similar upside.” A51,¶104.

C. B.Riley’s Undisclosed \$200.5 Million Loan to Vintage

B.Riley already faced significant Kahn-related risk from a \$200.5 million loan to Vintage. A76-77,¶219. The loan was secured by 7.57 million shares of FRG common stock, bearing payment-in-kind (“PIK”) interest of 12%, which added debt onto the loan, and did not mature until 2027. A77,¶220. By 3-17-23, the collateral was valued at \$172.4 million (based on the closing price of FRG’s stock), significantly below the \$200.5 million loan. A53,¶115; A1049,Opp.9. B.Riley did not publicly acknowledge this loan until 12-13-23. A76-77,¶219. At the same time, B.Riley also had an undisclosed \$64.6 million equity interest in FRG through a Kahn-related IAA. A73,¶¶204-206.

D. B.Riley’s Diligence of the Take-Private Transaction

On 3-19-23, B.Riley delivered a letter to FRG setting forth B.Riley’s potential interest in acquiring FRG for \$30 per share in cash. A53,¶109. The following morning, on 3-20-23, FRG announced that it had received an unsolicited non-binding proposal from an unnamed third party (B.Riley) to acquire FRG at \$30 per share. A53,¶111. [REDACTED]

[REDACTED] A53,¶¶112-114. FRG common stock had last traded on 3-17-23 at \$22.75 a share. A53,¶115.

After receiving B.Riley's non-binding offer, FRG formed a Special Committee, which retained Jefferies LLC as a financial advisor. A54,¶¶119-120.

FRG management updated certain of the assumptions underlying the January Projections to reflect the most current information available, including "the worsening of certain negative trends in economic conditions facing the Company and its industry more generally, such as persistent high inflation and the impact of weaker consumer trends on the Company's customer segments." A54,¶121. FRG's Special Committee held discussions with Jefferies on 4-14-23, concerning "headwinds affecting the Company" including FRG's "ability to meet certain thresholds and covenants in its existing indebtedness agreements." A54-55,¶122.

On 4-14-23, upon review of additional FRG diligence materials, B.Riley communicated to FRG its belief that FRG's "estimated cash flows for 2023 and 2024 would be lower than in the recent prior fiscal quarters." A55,¶123. Moreover, B.Riley communicated its belief that "the value of [FRG] was lower than B.Riley perceived when it made its Original Proposal of \$30.00 per share." A55,¶125. Indeed, FRG had experienced a "downward trend in the actual results of operations of certain key business segments in March and April 2023." A71,¶198. Despite this, B.Riley "indicated that it would nevertheless be willing to maintain its offer at \$30.00, but that it was unwilling to increase its offer price under any circumstances." A55,¶126.

B.Riley further communicated B.Riley’s “willingness to proceed with the proposed transaction...on an expedited timeline to facilitate a deal announcement prior to, or contemporaneous with, the Company’s planned earnings announcement on [5-10-23].” A56,¶127.

On 5-5-23, as part of due diligence, FRG shared with B.Riley the following management projections (the “Management Projections”) (A57,¶131):

<i>The Management Projections</i>				
The following table summarizes the Management Projections for the fiscal years 2023 through 2026 (\$ in millions, unless otherwise stated):				
Dollars in millions, unless otherwise stated	2023F ⁽¹⁾	2024F	2025F	2026F
Revenue				
Vitamin Shoppe	\$1,248	\$1,272	\$1,309	\$1,359
Pet Supplies Plus	\$1,372	\$1,475	\$1,648	\$1,859
American Freight	\$ 912	\$ 985	\$1,145	\$1,262
Badcock	\$ 592	\$ 591	\$ 660	\$ 730
Dollars in millions, unless otherwise stated	2023F⁽¹⁾	2024F	2025F	2026F
Buddy’s	\$ 57	\$ 60	\$ 67	\$ 73
Sylvan	\$ 42	\$ 45	\$ 48	\$ 51
Total Revenue	\$4,223	\$4,428	\$4,876	\$5,334
EBITDA⁽¹⁾	\$ 242	\$ 281	\$ 366	\$ 440
Less: D&A	\$ (80)	\$ (82)	\$ (78)	\$ (78)
EBIT⁽²⁾	\$ 162	\$ 199	\$ 288	\$ 363

The Management Projections reflected a significant decline, among other things, in EBITDA from FRG’s 4Q22 results and the previously shared January Projections. In particular, the Management Projections forecasted a 34.6% decline in 2023 EBITDA from the January Projections of \$370 million to the Management Projections of \$242 million. A58,¶134.⁵

⁵ See also A58-60,¶¶137-145

Defense counsel misstated at oral argument that the January Projections were only overstated by 5%, presumably referencing revenue rather than

E. The 5-8-23 Board Meeting

On 5-8-23, B.Riley’s Board met telephonically and for the first time to consider the Take-Private Transaction. A58,¶¶135-136; A681. Two days prior, the Board received a set of materials [REDACTED]
[REDACTED] A58,¶136. [REDACTED]
[REDACTED] A577;
A1053,Opp.13.

[REDACTED]
[REDACTED]
[REDACTED] A59,¶140. [REDACTED]
[REDACTED] A58-60,¶¶134-
144.

During the 5-8-23 meeting, [REDACTED]
[REDACTED]
[REDACTED].”
A63-64,¶¶164,169.

[REDACTED]
[REDACTED]

profitability metrics. *See* A1370, Transcript of 12-29-25 Oral Argument (“Tr.”) at 19.

[REDACTED] A573-592; A858-862. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] A63,¶166. The next day, on 5-9-23, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] A62,¶¶157-158; A863-867. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] A62,¶¶157-158.

F. FRG Announces the Take-Private Transaction and Releases 1Q23 Results

On 5-10-23 at 7:08 a.m., FRG announced that it had entered into an agreement to take FRG private, pursuant to which FRG senior management, in partnership with B.Riley, would acquire 64% of FRG's common stock that the management team did not already own at \$30 per share. A65,¶172.

Immediately after the Take-Private announcement, at 7:09 a.m., FRG released its 1Q23 operating results. A66,¶176. FRG's 1Q23 results were significantly below

the prior year's 1Q22 results and analysts' expectations and the January Projections (on an annualized basis) [REDACTED]. A66-67, ¶¶177-182.

The release further reported that FRG would not declare a quarterly stock dividend due to restrictions in FRG's credit agreement. A67, ¶¶183-184. The contemporaneous conference call provided further negative news, including that in April 2023, FRG divisions Buddy's Home Furnishings LLC, Badcock, and American Freight were down "7.8%," "26.2%," and "12.9%," respectively, year-over-year and that FRG "took a \$75 million impairment charge to the goodwill of American Freight[.]" A68, ¶¶185-186.

The Vice Chancellor recognized that "the [May 10] announcements were allegedly coordinated to prevent FRG's stock price from 'plummet[ing].'" Op.7.

G. FRG Issues the Definitive Proxy Statement for the Take-Private Transaction

On 7-14-23, FRG filed its Definitive Proxy Statement for the Take-Private Transaction, which detailed B.Riley's unwillingness to continue financing the Badcock receivables, and FRG's deteriorating financial condition prior to the 5-8-23 Board meeting. The Proxy Statement acknowledged that FRG was experiencing "the worsening of certain negative trends in economic conditions...such as persistent high inflation and the impact of weaker consumer trends on the Company's customer

segments.” *See supra* 9; A54¶¶121; A69-70¶¶194,198; A623-624,Proxy Statement.24,25; A652,Proxy Statement.53.

The Friendly Bear, in its 11-3-23 research report, concluded: “One has to therefore wonder whether B.Riley made a [\$200,500,000] margin loan to Brian Kahn that was upside down and did not want to recognize the loss, deciding it might be better to just take the company private at an inflated mark.” A72,¶200.⁶

H. FRG’s 2Q23 Operating Results

On 8-8-23, FRG announced its 2Q23 operating results, which were significantly lower than the January Projections on an annualized basis. A74,¶¶207-208.

I. The Take-Private Transaction Closes

On 8-21-23, FRG issued a press release stating that the Take-Private Transaction had closed. A72,¶201.

On 8-25-23, B.Riley stated in a Form 8-K that it had “made a new cash Equity Investment of \$216.5 million in FRG’s new parent entity, bringing the Company’s entire equity investment in the parent entity to approximately \$280 million.” A73,¶204. Reporting by *The Wall Street Journal* on 2-12-24 traced \$64.6 million of

⁶ The trial court again accepted defendants’ interpretation of the facts when it concluded that “B.Riley’s investment in FRG...was an arms-length negotiation with a third-party.” Op.27 n.132. It was a negotiation under duress with a third party (Kahn) that had an outstanding debt exceeding \$200 million.

B.Riley's \$280,000,000 equity investment to rollover shares that had been reported by FRG as controlled by Kahn. A73,¶205. The article stated that B.Riley's separate acquisition of these shares had not been publicly disclosed. A73,¶206. According to the Management Directors, the \$64.6 million in equity is "FRG stock returned from Kahn's investment account." A192,MB11.⁷ The Directors provided no explanation why those shares were transferred to B.Riley (A1061,Opp.21), but it was presumably done in satisfaction of some undisclosed debt from Kahn to B.Riley.

Shortly following the close of the Take-Private Transaction, public rating agencies began to downgrade FRG due to its poor operating results and the added debt from the Transaction. A74-75,¶¶209-216. In turn, B.Riley experienced a significant decline in its stock price given its ownership of FRG stock. A75-76,¶¶211,214-217.⁸

J. B.Riley Discloses the \$200.5 Million Loan and the \$64.6 Million IAA

On 12-13-23, B.Riley acknowledged publicly for the first time that it had loaned \$200,500,000 to Vintage, which pledged its FRG shares as collateral. A76-77,¶¶219-221. Accordingly, B.Riley's exposure to FRG was \$481,600,000, which exceeded the \$467,731,000 in stockholders' equity reported on B.Riley's 3Q23 Form

⁷ Opening Brief in Support of the Management Directors' Motion to Dismiss.

⁸ That stock price decline was muted by B.Riley's failure to disclose the \$200.5 million loan and the separate \$64.6 million investment derived from the IAA.

10-Q, and the [REDACTED]

telephonically on 5-8-23. A79,¶231; A577.

On 4-24-24, B.Riley filed its Form 10-K (signed by all Directors) acknowledging the \$64.6 million IAA (A106-107,¶¶330-331,337,340) and stated that the collateralized shares in FRG supporting the \$200,500,000 loan were valued at \$227,000,000 based on the \$30 per share (*i.e.*, 7.57 million shares) Take-Private Transaction (A107,¶340; A1072,Opp.32; A192,MB11).

K. The Sale of Badcock to Conn's

On 12-18-23, Freedom VCM (the successor to FRG) sold Badcock to Conn's for Conn's preferred stock valued at \$70 million. A93,¶¶286-288. [REDACTED]

[REDACTED] A94,¶291. B.Riley provided Conn's a \$108 million loan to facilitate the acquisition. Conn's subsequently filed for bankruptcy on 7-23-24, resulting in a loss to B.Riley due to Conn's \$167,568,000 indebtedness. A94,¶292.

L. Kahn is Implicated in a Securities Fraud Conspiracy at Prophecy

On 11-2-23, Kahn was implicated in a securities fraud conspiracy when John Hughes, the co-founder of Prophecy Asset Management LP pled guilty to charges for hiding approximately \$294 million in losses from investors and was separately sued by the SEC. A79-81,¶¶232-237. Kahn was soon described as a co-conspirator by the media. A81,¶¶238-239. According to the SEC complaint, Kahn's securities

fraud scheme touched several of Kahn’s transactions with B.Riley. A82-83,¶¶243-247. Subsequently, *Bloomberg News* and *Reuters* reported that the SEC was investigating B.Riley’s transactions with Kahn. A84-85,¶¶254-255.⁹

On 1-22-24, Kahn resigned as CEO of FRG. A85,¶256.¹⁰

On 2-12-24, *The Wall Street Journal* reported that “[n]ew details of loans by B.Riley to [Kahn] show a longer and closer relationship than previously known...[that] also raise questions about whether FRG should have disclosed more details about some of the loans years ago, when its Board included two B.Riley executives [including Riley].” A85-86,¶257.

M. The Audit Committee’s “Actions” Following Disclosure of the Prophecy Fraud

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

⁹ Kahn’s association with Prophecy and the substance of the eventual allegations made against Hughes and Kahn had been previously reported in the press and in court dockets accessible to the B.Riley Board as early as June 2020. A39-40,¶¶67-68; A83,¶248; A86-89,¶¶258-273.

¹⁰ Before briefing closed, Kahn was indicted in *United States of America v. Kahn*, 25-700-01-MAS (D.N.J.) and pled guilty for his participation in the fraud. See A1264-1268, 12-17-2025 Letter.

[REDACTED]

[REDACTED]

[REDACTED] A90-

91,¶280.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].”

A92,¶282.

[REDACTED]

[REDACTED]

[REDACTED] A92,¶¶282-283.

On 2-22-24, B.Riley issued a press release stating that S&C’s internal review “confirmed...that the Company and its executives, including Riley, had no involvement with, or knowledge of, any of the alleged misconduct concerning Prophecy.” A97,¶302. The press release was narrowly drafted and silent about the relationship between Riley and Kahn, nor did it reference B.Riley’s transactions with Kahn-related entities, including the Take-Private Transaction. A97-98,¶303.

[REDACTED]

[REDACTED]

[REDACTED] A98,¶306. Shortly thereafter, the Audit Committee retained Winston & Strawn LLP (“W&S”) to perform an investigation of B.Riley’s relationship with Kahn (and his affiliates). A99,¶¶308-309; A103,¶330. B.Riley stated in a Form 8-K dated 4-4-24 that the W&S investigation “confirmed that the Company and its executives had no involvement with, or knowledge of, any of the alleged misconduct concerning Mr. Kahn or any of his affiliates.” A103-104,¶331. Again, the press release was narrowly drafted and silent about the relationship between Riley and Kahn; nor did it discuss B.Riley’s transactions with Kahn-related entities, including the Take-Private Transaction. A103-104,¶¶331-332.

[REDACTED]

[REDACTED]

A116-117,¶¶370-371.

N. FRG’s and B.Riley’s Financial Performance Worsens

On 8-12-24, B.Riley issued its preliminary 2Q24 results, and announced the suspension of its dividend. A108,¶346. In a conference call, Riley disclosed that he received subpoenas from the SEC related to B.Riley’s dealings with Kahn. A108,¶¶346-347.

On 11-3-24, FRG filed for bankruptcy. A109,¶352. That same day, Riley acknowledged that he received additional SEC subpoenas seeking documents concerning FRG. A110,¶356.

On 2-21-25, B.Riley acknowledged on a Form 10-Q that for the first nine months of 2024, “the Company had incurred a net loss of \$769,333,000 which includes fair value adjustments totaling \$(509,761,000) related to the Company’s equity investment in Freedom VCM Holdings, LLC and the loan to Vintage.” A1074,Opp.34.

All told, B. Riley’s stock price plummeted 88.7% from its closing price on 5-10-23 to \$4.29 per share on 2-11-25—an astounding \$1.025 billion loss in equity value. A23,¶3.

Notwithstanding Riley’s overwhelming misconduct, B.Riley’s Compensation Committee approved a substantial compensation package for him (and Kelleher) in 2023. A141-142,¶443; A159,¶481; A161,¶485.

O. Defendants’ Breaches Exposed Them and the Company to Securities Liability

On 1-24-24, a class action complaint was filed against Defendants B.Riley, Riley, Kelleher, and Philip Ahn (B.Riley’s CFO) for federal securities violations. A111-112,¶¶359-362.¹¹ The complaint alleged that the Form 10-K signed by each director for 2022 misrepresented facts concerning B.Riley’s concentration of indebtedness with FRG. On 12-12-25, the Central District of California sustained certain claims against B.Riley, Riley, and Ahn. *See* A1269-1295,12-17-2025 Letter,

¹¹ *Coan v. B.Riley Financial, Inc.*, Case No. 2:24-cv-00662 (C.D. Cal.).

Ex. A.¹² The court found that plaintiffs alleged sufficient facts to support a strong inference that Riley was aware of Kahn's fraudulent activities with Prophecy: "Given Riley's abrupt resignation from the FRG board, his personal involvement in the FRG Buyout, the size of the FRG Buyout, and Kahn's importance to the Company's business, the Court infers for purposes of this Motion that Riley was at least aware of public allegations Kahn had engaged in fraud." *Id.* at 20.¹³

On 5-1-24, a complaint was filed against Defendants B.Riley, Riley, Kelleher, Paulson, D'Agostino, Antin, Sheldon, and Walters for signing a materially misleading Registration Statement that omitted reference to the Kahn debt.¹⁴ A1092,Opp.52. On 9-30-25, the Superior Court for L.A. County issued an order overruling the demurrers to the amended complaint in its entirety. *See* A1129-1263,10-7-25 Letter.¹⁵

P. Plaintiff Sought Books and Records and Then Filed This Action

On 7-16-24, Plaintiff made a demand on B.Riley for books and records pursuant to 8 *Del. C.* §220. A112-115,¶363. In response, on 10-11-24, [REDACTED]

[REDACTED]

¹² Plaintiff's 12-17-25 Letter Regarding Suppl. Authority.

¹³ Relying on disputed facts, VC Will came to the contrary conclusion. *See* Op.1.

¹⁴ *Donaldson v. B, Riley Financial, Inc. et al.*, Case No. 24STCV10992, (Sup. Ct. L.A. Co.) (the "Donaldson Action").

¹⁵ Plaintiff's 10-7-25 Letter Regarding Suppl. Authority.

[REDACTED]. A115,¶¶364-366; A573-592; A858-862. On 11-4-24, Plaintiff's counsel wrote to S&C, [REDACTED] [REDACTED] A115-116,¶367. On 1-24-25, after a series of promises to produce additional materials, Plaintiff advised S&C that Plaintiff considered the production complete. A119,¶388. B.Riley failed to subsequently produce additional materials. A116-121,¶¶371-389.

Thereafter, Plaintiff filed this action.

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN HOLDING THAT THE OUTSIDE DIRECTORS DID NOT FACE A SUBSTANTIAL LIKELIHOOD OF LIABILITY UNDER *CAREMARK* PRONG I

A. Question Presented

Does the Complaint sufficiently allege that the Outside Directors face a substantial likelihood of liability under *Caremark* I? A1079-1080,Opp.39-40; A1084-90,Opp.44-50; A1099-1103,Opp.59-63; A1107-1108,Opp.67-68; A1113-1114,Opp.73-74.

B. Scope of Review

This Court’s review of Chancery Court motion to dismiss decisions under Ch. Ct. R. 23.1 is de novo and plenary.¹⁶ The Court must accept as true the Complaint’s particularized and well-pleaded allegations and all reasonable factual inferences that logically flow from the particularized facts alleged.¹⁷

C. Merits of the Argument

The Chancery Court erred in holding that the Outside Directors did not face a substantial likelihood of liability. Op.21-23.

To allege demand futility under Rule 23.1, the stockholder must plead particularized facts creating “reason to doubt that the board could bring its impartial

¹⁶ See *Lebanon Cnty. Employees’ Ret. Fund v. Collis*, 311 A.3d 773, 794-95 (Del. 2023) (“*Collis*”); see also *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000).

¹⁷ See *Collis*, 311 A.3d at 794-95 (citation omitted).

business judgment to bear on a litigation demand.”¹⁸ Demand is excused where a majority of directors either: (1) “received a material personal benefit from the alleged misconduct;” (2) “face[] a substantial likelihood of liability;” or (3) “lack[] independence from someone who received a material personal benefit from the alleged misconduct...or who would face a substantial likelihood of liability.”¹⁹ “The touchstone ‘to survive a motion to dismiss is reasonable ‘conceivability.’ This standard is ‘minimal’ and plaintiff-friendly.”²⁰ Here, Plaintiff alleges that at least two Outside Directors either face a substantial likelihood of liability or lack independence from Riley, who faces a substantial likelihood of liability.

Under a so-called *Caremark* I claim, directors can face liability where the directors failed to make “a good faith effort...to put in place a reasonable board-level system of monitoring and reporting.”²¹ The existence of written policies and procedures for board-level systems of monitoring and reporting is insufficient if those policies and procedures are not followed. “[H]aving implemented such a system of controls, [directors] cannot consciously fail[] to monitor or oversee its

¹⁸ *IBEW Local Union 481 Defined Contribution Plan & Tr. v. Winborne*, 301 A.3d 596, 617 (Del. Ch. 2023) (“*Winborne*”) (citing *United Food and Com. Workers Union and Participating Food Indus. Emps. Tri-State Pension Fund v. Zuckerberg*, 262 A.3d 1034, 1049 (Del. 2021) (“*Zuckerberg*”)) (quotations omitted).

¹⁹ *Zuckerberg*, 262 A.3d at 1059.

²⁰ *In re Boeing Co. Deriv. Litig.*, 2021 Del. Ch. LEXIS 197, at *64 (Del. Ch. Sep. 7, 2021) (internal quotation marks and citations omitted).

²¹ *Marchand*, 212 A.3d at 820-22.

operations.”²² “The court must evaluate whether the system was ‘reasonably designed to provide to senior management and to the board itself *timely, accurate information* sufficient to allow management and the board...to reach informed judgments concerning both the corporation’s compliance with law and its business performance.’”²³ “[O]nly a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability.”²⁴

A *Caremark* claim does not, as suggested by the Chancery Court, require a violation of “positive law.” Op.1,23,27. Rather any indolence with respect to a “mission critical” aspect of a corporation’s business is sufficient to establish bad faith liability under *Caremark*.²⁵ In any event, the Outside Directors violated “positive law” codified in SEC statutes and regulations with respect to SEC filings, such as Form 10-Ks. *See, e.g.,* A1092,Opp.52, *citing the Donaldson Action.*

²² *Collis*, 311 A.3d at 795 (citing *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006)).

²³ *Giuliano v. Grenfell-Gardner*, 2025 LEXIS 342509, at *19 (Del. Ch. Sep. 2, 2025) (quoting *In re Caremark Int’l*, 698 A.2d 959, 970 (Del. Ch. 1996)).

²⁴ *Boeing*, 2021 Del. Ch. LEXIS 197, at *69 (internal quotation marks and citation omitted); *see also Marchand*, 212 A.3d at 820 (failing to make a good faith effort to establish and follow an oversight system breaches the duty of loyalty).

²⁵ *See, e.g., In re Walt Disney Co. Deriv. Litig.*, 825 A.2d 275 (Del Ch. 2003) (sustaining *Caremark* claim on a motion to dismiss relating to employment contract); *see also Boeing*, 2021 Del. Ch. LEXIS 197, at *71 (“Like food safety in *Marchand*, airplane safety ‘was essential and mission critical’ to Boeing’s business[.]”) (citing *Marchand*, 212 A.3d at 824).

The Complaint chronicles multiple oversight failures at multiple stages, drawing reasonable inferences that the Board and Board Committees utterly failed to reasonably institute and maintain a functioning system of oversight. Plaintiff's allegations go much further than alleging simply that "the board did not uncover fraud at an outside company before the federal government did." Op.1. Plaintiff alleges that B.Riley, *a financial services company*, committed over \$500,000,000 of assets to a plainly uncreditworthy borrower without any Board oversight, based on *false* financial projections presented by its controlling shareholder.

Prior to the 5-8-23 meeting, for example, there was no reporting system in place to inform the Board of the "continued balance sheet risk" from ongoing purchases of Badcock receivables (A51,¶104) or that the Take-Private Transaction arose only after B.Riley management determined that it was unwilling to continue funding Badcock receivables after 1Q23 (A50-51,¶¶101-103).

There was no effective information system to inform the Board about the Company's \$200.5 million loan to Vintage, which was inadequately collateralized by FRG common stock. [REDACTED]

[REDACTED]."

A79,¶228. [REDACTED]

[REDACTED]

[REDACTED]

The \$200.5 million loan comprised approximately *one-third* of B.Riley’s entire loan portfolio. A1086,Opp.46. The loan was issued on risky “PIK” terms, which did not pay cash interest but only accrued additional debt to the outstanding principal.²⁶ Prior to the 5-8-23 Board meeting, the collateral for the loan based on FRG’s unaffected 3-17-23 stock price was significantly underwater and there was no process in place that reported this risk to the Board.²⁷

The Complaint’s allegations surrounding the Transaction also demonstrate the absence of effective oversight. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].²⁸ Together the outstanding loan and additional Take-Private commitment reflected a concentration of over \$500 million [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] See Op.25.

²⁶ See A1372,Tr.21:19-21.

²⁷ See *id.*; A1049,Opp.9 n.9.

²⁸ *Boeing*, 2021 Del. Ch. LEXIS 197, at *69-89 (finding *Caremark* I liability where the Board and Audit Committee failed to establish oversight over airplane safety, which was “mission critical” to the company).

²⁹ Each of *In re Citigroup Inc. S’holder Deriv. Litig.*, 964 A.2d 106, 125, 131 (Del. Ch. 2009) and *In re ProAssurance Corp. Stockholder Deriv. Litig.*, 2023 Del. Ch.

[REDACTED]

[REDACTED]

[REDACTED]. Indeed, the Complaint's particularized allegations demonstrate that Riley, as Chair of the Board, Co-CEO, Co-Founder who named the Company after himself, and a 23.8% beneficial owner of B.Riley,

[REDACTED]

[REDACTED]. A35,¶50. For example, the facts demonstrate that [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] As the facts have borne out, the lack of any system of oversight of Riley presented a significant business risk and allowed Riley to cause B.Riley to engage in a major transaction that led to significant corporate trauma without clear Board approval.

The following further demonstrates the lack of any functioning oversight mechanisms. Two days after the 5-8-23 meeting, FRG announced its 1Q23

LEXIS 385, at *27-33 (Del. Ch. Oct. 2, 2023), (cited Op.25 n.123) relate to good faith business judgments made in a "risky commercial" environment. That is entirely different than the deception perpetrated by Riley.

operating results, which were significantly below the prior year's first quarter results and analysts' expectations. A25,¶13; A66-67,¶¶176-177,179-182. Additionally, on 7-14-23, FRG disseminated its Proxy Statement, which detailed FRG's deteriorating operating condition, and the Management Projections received by B.Riley's deal team on 5-5-23 that contradicted Riley's April Presentation. A54¶¶121; A69-70¶¶194,198. Despite the Audit Committee's duty of oversight and risk assessment, which included monitoring B.Riley's loans and investments, [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].

The Complaint further alleges the absence of Board oversight after the Transaction's close. On 12-13-23, more than seven months after the 5-8-23 meeting, Riley acknowledged the \$200.5 million loan for the first time publicly. A76-77,¶219. [REDACTED]

[REDACTED]

Indeed, rather than take any remedial measures to reduce its risk exposure, the Board allowed B.Riley to make another *Kahn*-related loan, of \$108 million to Conn's in connection with its purchase of Badcock from Freedom VCM. A93-94,¶¶286-291.

Later, on 4-24-24, B.Riley acknowledged the additional \$64.6 million equity investment in FRG as part of the IAA. A106,¶339. [REDACTED]

[REDACTED]

[REDACTED]

Perhaps most significantly, [REDACTED]

[REDACTED] If performed, the Board would have learned of Kahn’s fraudulent activities. *See* A39-40,¶¶67-68; A83,¶248, A86-89,¶¶258-274.

There is nothing wrong, in the abstract, with the thesis defendants presented at oral argument (A1367,Tr.16:2-23) that “there was weakness in the consumer sector that we recognized in 2022 when inflation started to get bad, a lot of these businesses started to suffer because they are all consumer facing,” and that B.Riley could restructure FRG. *See also* Tr.19:14-17 (“We had our own view of what the company was going to do, and our projections incorporated all sorts of other stuff that was not incorporated by FRG management.”). But this is a post-hoc rationalization: [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] The January Projections provided to the Board on 5-8-23

³⁰ There is zero defense for Riley withholding FRG’s actual projections and using stale ones instead. Riley could have advocated for his contrarian position while accurately conveying to the Board the conflicting views of FRG management.

dramatically conflicted with the first quarter FRG operating results [REDACTED]

[REDACTED] That Riley had a different view of FRG's operations *after* the Transaction is irrelevant to [REDACTED]

[REDACTED]

The Court summarily dismissed *Caremark* I liability, pointing to the existence of some technical oversight mechanisms. Op.21. Without providing analysis, the Chancery Court characterized these oversight mechanisms as “functioning.” These oversight policies and mechanisms plainly were not functioning. *Id.* The “court must look beyond the mere existence of a system to some indicia of effectiveness when determining whether a board made the required good faith effort.”³¹

The Court described the Audit Committee as “active” and credited it for [REDACTED].” Op.21-22. The facts, however, demonstrate that the Committee was not active and failed to engage in reasonable risk assessment. [REDACTED]

[REDACTED].

A90-91, ¶280. The Court points to the Audit Committee's actions in response to Kahn's implication at Prophecy. This proves nothing. First, the Audit Committee

³¹ *Giuliano*, 2025 LEXIS 342509, at *18-19; *see also Ont. Provincial Council of Carpenters' Pension Tr. Fund v. Walton*, 2023 Del. Ch. LEXIS 92, at *146 (Del. Ch. Apr. 26, 2023) (“Delaware courts would not merely sign off on the existence of an information system, but would look to whether the information system reflected a good faith effort to achieve that goal.”).

should not be credited for belatedly responding to an extraordinary event extensively covered by the news and short sellers (A83,¶248), which put pressure on the Company's stock price (A84,¶249), and a pending SEC investigation into B.Riley's relationship with Kahn (A84-85,¶254). The Audit Committee's response to potential criminal liability says nothing about how reasonable the Committee's oversight systems functioned in the ordinary course, nor can it refute [REDACTED]

[REDACTED] 32

[REDACTED]. A90-92,¶¶280-283. [REDACTED]

[REDACTED] A98,¶306. [REDACTED]

³² The Court of Chancery credited B.Riley's auditor and "the retention of outside counsel to assist and report to the committee," as evidence of functioning oversight mechanisms. Op.21-22. However, this activity was only after the "barn door closed" and does not refute the overwhelming weight of evidence suggesting that the Audit Committee failed to flag other instances of misconduct.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].

The Complaint does not, as the Chancery Court suggested, merely plead that the compliance system was flawed or ineffective. Op.23. [REDACTED]

[REDACTED]

[REDACTED] *Id.*³³

These allegations here are not, as the Court concluded, a mere “hindsight critique of a business decision gone awry.” Op.1. Failing to implement a reasonable information and reporting system that informs the Board of mission critical issues does not fall under the protection of the business judgment rule.³⁴ This is unlike *Corbat*, wherein the board took affirmative action to improve its systems and

³³ *Quoting Marchand*, 212 A.3d at 821.

³⁴ *See Giuliano*, 2025 LEXIS 342509, at *18-23 (finding *Caremark* I liability where the Board had information-systems deficiencies, including the “lack[] [of] a board committee responsible for overseeing any central compliance risk, or aspect of regulatory compliance[,]” the “lack[] [of] processes and protocols requiring management to keep the board apprised of central compliance risks, or any regulatory compliance risks[,]” and the “lack[] [of] training protocols designed to inform employees of central compliance risks.”).

controls.³⁵ Rather, the Board had not even satisfied *Caremark*'s "bottom-line requirement."³⁶

This case is readily distinguishable from the Court's cited cases. Op.22-23. In *Fisher v. Sanborn*, the complaint contained specific allegations that the risk committee was routinely updated on consumer complaints and an FTC investigation into the company's internal controls, received related presentations on those risks, and discussed such risks, including in its "quarterly [r]isk [c]ommittee presentations." 2021 Del. Ch. LEXIS 61, at *23-25 (Del. Ch. Mar. 30, 2021). In *Guttman v. Jen-Hsun Huang*, the court dismissed the *Caremark* I claim because the complaint failed to allege *any* facts about the board's oversight. 823 A.2d 492, 506-07 (Del. Ch. 2003) (stating, "it is impossible to tell anything about the financial compliance systems in place.... This is a void that could have been filled had the plaintiffs procured pertinent books and records. For all I know, the audit committee met six times a year for half-day sessions...[and] was comprised entirely of independent directors[.]"). In *In re MetLife Deriv. Litig.*, the court found "an extensive network of internal controls," where the complaint "allege[d] that [the company] ha[d] an Audit Committee, as well as a Finance and Risk Committee, and further allege[d] that th[o]se committees meet regularly (indeed, frequently), that

³⁵ See *Okla. Firefighters Pension & Ret. Sys. v. Corbat*, No. 12151-VCG, 2017 Del. Ch. LEXIS 848, at *53 (Del. Ch. Dec. 18, 2017).

³⁶ *Giuliano*, 2025 LEXIS 342509, at *21 (quoting *Marchand*, 212 A.3d at 821).

they have internal codes of conduct, and that the Audit Committee receives reports from [the company's] internal auditor.” 2020 Del. Ch. LEXIS 265, at *32-34 n.188 (Del. Ch. Aug. 17, 2020).

II. THE CHANCERY COURT ERRED IN FINDING THAT THE AUDIT COMMITTEE DIRECTORS DID NOT FACE A SUBSTANTIAL LIKELIHOOD OF LIABILITY UNDER CAREMARK PRONG II.

A. Question Presented

Does the Complaint sufficiently allege that the Audit Committee Directors face a substantial likelihood of liability under *Caremark* II? A1079-1080,Opp.39-40; A1084-1090,Opp.44-50; A1093-1098,Opp.53-58; A1106-1108,Opp.66-68; A1113-1115,Opp.73-75.

B. Scope of Review

This Court’s review is de novo and plenary. *See supra* 23.

C. Merits of the Argument

The Chancery Court erred in holding that the Audit Committee members did not face a substantial likelihood of liability under *Caremark* II.

Under *Caremark* II, Plaintiff may state a claim by pleading “[particularized facts] that the board knew of evidence of corporate misconduct—the proverbial red flag—yet acted in bad faith by consciously disregarding its duty to address that misconduct.”³⁷ “In this context, bad faith means ‘the directors were conscious of the fact that they were not doing their jobs, and that they ignored red flags indicating

³⁷ *Teamsters Local 443 Health Servs. & Ins. Plan v. Chou*, 2020 Del. Ch. LEXIS 274, at *47 (Del. Ch. Aug. 24, 2020) (internal quotation marks and citation omitted).

misconduct in defiance of their duties.’”³⁸ “A board that fails to act in the face of such information makes a conscious decision, and the decision not to act is just as much of a decision as a decision to act.”³⁹ Whereas Plaintiff’s *Caremark* I claims allege that the Board and its Audit Committee were unaware of material risks to its financial condition and weaknesses in Riley’s SEC reporting requirements, Plaintiff’s *Caremark* II claims allege in the alternative that the Board and its Audit Committee were aware of those red flags and failed in bad faith to act.

The Outside Directors cannot have it both ways. They either lacked functioning oversight and thus did not have knowledge of red flags; or had functioning oversight and had knowledge of red flags.

As members of the Audit Committee, Paulson, D’Agostino, and LaBran were directly responsible for [REDACTED]

[REDACTED]

[REDACTED].” A1086,Opp.46; A979-989; A132,¶426. [REDACTED]

[REDACTED]”

A132,¶426. There are a litany of particularized allegations showing that despite its

³⁸ *Id.* at *49 (internal quotation marks and citation omitted).

³⁹ *Leb. Cty. Employees’ Ret. Fund v. Amerisourcebergen Corp.*, 2020 Del. Ch. LEXIS 17, at *51 (Del. Ch. Jan. 13, 2020).

duty of oversight the Audit Committee consciously ignored red flags of Riley’s misconduct.

1. The Audit Committee Ignored Red Flags at the Time of the 5-8-23 Board Meeting

[REDACTED],” the Audit Committee had knowledge of the “balance sheet risk” from ongoing purchases of Badcock receivables and B.Riley’s unwillingness to fund Badcock receivables after its review of financial information from Badcock and FRG. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].⁴⁰ A79, ¶228. Since the loan comprised approximately one-third of B. Riley’s entire loan portfolio, there is a reasonable inference that the Audit Committee—if it were functioning—monitored the loan and, at least on a quarterly basis, FRG’s financial statements, including FRG’s 4Q22 results. Thus, [REDACTED]

[REDACTED]

[REDACTED]. Finally, had the Audit

⁴⁰ Despite the lack of books and records, there is a bare minimum inference that the Audit Committee would have received information about the loan given its oversight responsibilities. Any opposing inference only supports *Caremark I*.

Committee been functioning, [REDACTED]

Despite the Audit Committee's knowledge, they did not respond to the red flags presented [REDACTED]

[REDACTED]. The Audit Committee [REDACTED]

2. The Audit Committee Ignored Red Flags that Followed the 5-8-23 Board Meeting

[REDACTED] the Audit Committee would have been aware of FRG's disastrous 1Q23 operating results, which were announced one minute after the Take-Private Transaction on 5-10-23. A66,¶176. The results, which were significantly lower than the January Projections (on an annualized basis) [REDACTED]

[REDACTED] A66,¶178. The timing of FRG's announcements raised another red flag [REDACTED]

[REDACTED]

[REDACTED]. The Audit Committee did not respond to these red flags.

Moreover, the Audit Committee ignored the red flags raised in the 7-14-23 Proxy Statement issued by FRG in connection with the Take-Private Transaction. Given the Audit Committee's presumptive awareness of the \$200.5 million loan and the Transaction, there is a strong inference that the Audit Committee reviewed the Proxy Statement as part of their duty of oversight. A135-136,¶435. [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] (A70-71,¶198) [REDACTED]

[REDACTED] (A57,¶131). Again, the Audit Committee took no action.

3. The Audit Committee Ignored Red Flags Presented After the Close of the Take-Private Transaction

The Audit Committee ignored red flags presented by the public disclosures of the \$200.5 million loan to Vintage on 12-13-23, and the disclosure of the \$64.6 million IAA on 4-24-24 in a Form 10-K signed by all directors. A76-77,¶¶219-221; A106,¶339. Even though these disclosures placed the entire Board on notice, the

[REDACTED]

[REDACTED].⁴¹

The Complaint does not rely on a theory of constructive knowledge. Op.24. There are reasonable inferences that the Audit Committee had knowledge of and monitored the \$200.5 million loan and the Take-Private Transaction. *See supra* 38-39. [REDACTED]

[REDACTED]. This is not the type of constructive knowledge that Delaware courts routinely reject. In *City of Detroit Police & Fire Ret. Sys. v. Hamrock*, for example, the plaintiff sought to impose onto the Board knowledge of over-pressurization risks detailed in an operational notice. 2022 Del. Ch. LEXIS 159, at *57-61 (Del. Ch. June 30, 2022). The court declined to charge the board with knowledge given the lack of evidence (*i.e.* board materials) that the operational notice was discussed at the board level and because the operational notice was not prepared for the board but rather for company and contractor employees. *Id.* The Complaint here does not

⁴¹ [REDACTED]

seek to impose constructive knowledge of red flags outside the Audit Committee's domain but ones the Committee would have reasonably encountered had it been functioning according to its charter.

The red flags presented here are not “quintessential business risks.” Op.25. This is not a situation, as the Chancery Court suggests, where the Board weighed its options before deciding to act and thereafter pursued a risky transaction. Op.25-26. Riley lied to his Board. The red flags presented warning signs of Riley's misconduct to the Audit Committee, which were consciously disregarded. Misconduct of this nature does not fall under the protection of the business judgment rule.

The Chancery Court found that the Board did not ignore these red flags. Op.26. This is wrong. It is not clear what the Court was considering when it wrote that “the Board's alleged reliance on stale projections was addressed by April 2023 when it used newer projections to decide how to respond to FRG's counteroffer.” Op.26. The Board was *never advised* of FRG's true financial condition and only Riley and Paulson took part in the Take-Private negotiations. Had the Board been aware of FRG's rapidly declining operations, it would have recognized that the \$30 Take-Private price was clearly excessive compared to FRG's unaffected \$22.75 stock price. Moreover, the Board's response to potential illegality at Prophecy does not negate their lack of response to the red flags asserted here. *See supra* 31-32; Op.26.

Finally, there is no “fundamental doctrinal mismatch” in Plaintiff’s claim. Op.27. “[T]he purported ‘red flags’ and corporate trauma” occurred at B.Riley—not at Prophecy. Op.27. The alleged corporate trauma—B.Riley’s loss of its \$481.6 million investment in FRG and B.Riley’s 88.7% stock price decline—were cast based on B.Riley’s commitments and FRG’s financial performance, as of 5-10-23. This is not a situation where a board made an investment decision that later went awry because of circumstances unforeseen.⁴² Op.27 n.132. FRG’s deteriorating condition was caused by forces independent of Kahn’s implication in the Prophecy fraud, including FRG’s inability to finance Badcock receivables, its operating performance, the discontinuation of its dividend, and the default on its loan agreement. *See supra* 6-7; A50,¶¶99. These losses were not caused by Kahn’s resignation as FRG’s CEO. Indeed, according to B.Riley’s counsel at oral argument, B.Riley’s investment thesis was that FRG would be better managed by B.Riley than it had been under Kahn. *See* A1367, Tr.16:9-14 (“So the thinking [was] that B.Riley Financial could do a better job taking it private...realize more value.”).

To distinguish this case from *Winborne*, the Chancery Court contrasted the “internal, related-party transaction purportedly fraught with conflicts of interest[,]” in *Winborne* with the supposed “arms-length negotiation with a third-party[,]” here.

⁴² This also leaves aside that B.Riley failed to engage in sufficient, or any, due diligence on known public information concerning Kahn prior to committing almost \$500 million in assets. *See* A86-89,¶¶258-274.

Op.27. First, as detailed above, the Take-Private Transaction was riddled with issues, [REDACTED] Moreover, the distinction is without a difference. In *Winborne*, the voting directors approved the company paying \$850 million for something that was worth \$175.3 million. Although, there were “additional factors which bolster[ed] the inference...[of] an improper purpose[,]” the court found that the “valuation disparity” “alone establishe[d] an inference of bad faith sufficient to render demand futile.”⁴³ As in *Winborne*, [REDACTED]
[REDACTED]
[REDACTED] as “to suggest bad faith” when the Board approved the transaction.⁴⁴

Accordingly, liability was established on *Caremark II*.

⁴³ *Winborne*, 301 A.3d at 627.

⁴⁴ *Id.*

III. THE CHANCERY COURT ERRED IN FAILING TO CONSIDER THE ALLEGATIONS HOLISTICALLY AND FINDING THAT THE OUTSIDE DIRECTORS COULD IMPARTIALLY CONSIDER A DEMAND AGAINST RILEY

A. Question Presented

Does the Complaint sufficiently allege facts that when viewed holistically create a reasonable doubt that the Outside Directors could act impartially? A1091-1092,Opp.51-52; A1103-1106,Opp.63-66; A1113,Opp.73; A1116,Opp.76.

B. Scope of Review

This Court's review is de novo and plenary. *See supra* 23.

C. Merits of the Argument

The Chancery Court erred in failing to consider the facts holistically when determining that the Outside Directors could impartially consider a demand. A1079-1081,Opp.39-41; A1090,Opp.50.

The Chancery Court failed to consider that Outside Directors Paulson, D'Agostino, Sheldon⁴⁵, Antin, and Walters⁴⁶ are named in the *Donaldson* Action alleging claims under the Securities Act for signing a materially misleading registration statement that omitted reference to the Kahn debt and made other false statements concerning B.Riley's inadequate risk control, especially when dealing

⁴⁵ There is also a reasonable doubt as to Sheldon's independence based on his actions as a Compensation Committee member. *See infra* 48-49.

⁴⁶ On September 30, 2025, the California Supreme Court denied defendants' demurrer in its entirety. *See* A1229-1263,10-7-25 Letter.

with FRG and Kahn. A1092,Opp.52; A1227-1228,10-7-25 Letter. As part of its holistic demand futility analysis, the Chancery Court was required to consider that pursuing a demand based on the facts alleged in the Complaint would require these Directors to implicate themselves.⁴⁷

Moreover, the Chancery Court failed to consider in its holistic analysis that Director D’Agostino lacks independence from Riley.⁴⁸ Op.39-41.

A director cannot impartially consider a demand when “the director lacks independence from someone...who would face a substantial likelihood of liability on any of the claims that are subject of the litigation demand.”⁴⁹ “The plaintiff must allege that ‘the director in question had [material] ties to the person whose proposal or actions he or she is evaluating that are sufficiently substantial that he or she could not objectively discharge his or her fiduciary duties.’”⁵⁰ “The independence inquiry

⁴⁷ See *In re BGC Partners, Inc. Deriv. Litig.*, 2021 Del. Ch. LEXIS 213, at *15 (Del. Ch. Sep. 20, 2021) (“This court in analyzing demand futility will consider factors that may affect a director’s disinterestedness and independence in their totality.”) (citing cases).

⁴⁸ The Court similarly failed to consider in its holistic analysis that Brandt (A145-152,¶¶453-466), Walters (A152-157,¶¶467-478), Sheldon (A158-159,¶¶479-482), and LaBran (A142-145,¶¶445-452) lacked independence. Although not considered, the same arguments apply to Paulson (A134-A135,¶¶431-432).

⁴⁹ *Zuckerberg*, 262 A.3d at 1059.

⁵⁰ *Id.* at 1061 (citation omitted).

is fact-specific, and allegations levied against a director’s independence ‘must be viewed holistically.’”⁵¹

The Complaint alleges a personal friendship between D’Agostino and Riley that dates back 35 years when the two, along with Kelleher (who lacks independence from Riley), were fraternity brothers at Lehigh University, a friendship they all have maintained to this day as they continue to “meet socially.” A137,¶438. The Complaint also alleges a professional relationship that extends back more than 20 years when Riley, through shareholder activism, nominated (and once appointed) D’Agostino to serve on company boards through proxy contests—further evidence of their *personal* relationship. A137-141,¶¶439-442. The pair have served together on the B.Riley Board for more than ten years, for which D’Agostino has been well compensated. A38,¶60. B.Riley has also served as a financial advisor to D’Agostino’s company, Q-Mation, Inc. A140-141,¶441.

The Chancery Court discredited these allegations by discounting the personal friendship that is alleged with particularity and by attacking these allegations individually, rather than holistically. Op.39-41. The alleged friendship between D’Agostino and Riley stemming from their fraternity membership that has existed for the *majority* of their lives and has withstood the test of time, his liability in

⁵¹ *In re Oracle Corp. Deriv. Litig.*, 2022 Del. Ch. LEXIS 118, at *19 (Del. Ch. May 20, 2022) (quoting *In re Dell Techs. Inc. Class V Stockholders Litig.*, 2020 Del. Ch. LEXIS 211, at *103 (Del. Ch. June 11, 2020)).

Donaldson, coupled with the allegations under *Caremark* I and II, simply cannot be compared to the cases cited by the Chancery Court where the court rejected thin, conclusory social allegations.⁵² The facts here are further distinguishable from the Chancery Court's cited case *Singer*, wherein there were no allegations of a personal relationship between the directors and the interested party.⁵³ D'Agostino and Riley did not simply serve together on an outside board, Riley was directly responsible for D'Agostino's appointment through his shareholder activism, which he had attempted on multiple occasions. A137-140, ¶¶439-440. Finally, the Chancery Court failed to credit allegations that D'Agostino, as Chair of B. Riley's Compensation Committee, and Sheldon, as a member, continued to award Riley (and Kelleher) with annual executive compensation in excess of \$5 million despite their alleged

⁵² See *Crescent/Mach I Partners, L.P. v. Turner*, 846 A.2d 963, 980-81 (Del. Ch. 2000) (rejecting allegation of a "long-standing 15-year professional and personal relationship" as without "specific factual predicate."); *Benefore v. Jung Woong Cha*, 1998 Del. Ch. LEXIS 28, at *9-10 (Del. Ch. Feb. 20, 1998) (emphasis added) (stating that an "allegation that [a director] is a friend of the [interested party], *without more*, fails to raise a reasonable doubt," but concluding that additional allegations, including shared board membership and board appointment and employment caused by the interested party's company, "raise[d] a reasonable doubt" of independence); *Beam v. Stewart*, 845 A.2d 1040, 1051-52 (Del. 2004) (holding that "[m]ere allegations that they move in the same business and social circles, or a *characterization* that they are close friends, is not enough to negate independence[.]") (emphasis added); *Cal. Pub. Emples. Ret. Sys. v. Coulter*, 2002 Del. Ch. LEXIS 144 (Del. Ch. Dec. 18, 2002); *but see Sandys v. Pincus*, 152 A.3d 124, 130 (Del. 2016) (holding that co-ownership of a plane was in fact "indicative of a continuing, close personal friendship.").

⁵³ *Highland Legacy Ltd. v. Singer*, 2006 Del. Ch. LEXIS 55, at *19-25 (Del. Ch. Mar. 17, 2006).

misconduct, evidencing their loyalty and beholdenness to Riley. A32,¶¶40; A141-142,¶¶443.

Instead of viewing the Outside Director allegations in isolation, the Chancery Court was required to conduct a holistic analysis as to whether the allegations taken together raise a reasonable doubt. The Chancery Court failed to do so here.

CONCLUSION

The Chancery Court's decision should be reversed.

June 15, 2026

OF COUNSEL:

WOLF POPPER LLP

Robert C. Finkel*

845 Third Avenue, 12th Floor

New York, NY 10022

(212) 759-4600

rfinkel@wolfdpopper.com

Carmella P. Keener (#2810)

COOCH AND TAYLOR, P.A.

1000 North West Street, Suite 1500

Wilmington, Delaware 19801

(302) 984-3816

ckeener@coochtaylor.com

Counsel for Plaintiff Below, Appellant

Michael Robert Marchner, Jr.

*(*pro hac vice* motion forthcoming)

PUBLIC VERSION

FILED: July 1, 2026