



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

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NATURE OF PROCEEDINGS

This appeal is Plaintiff's latest attempt to recast hindsight criticism of an arm's-length business decision into a non-exculpated *Caremark* claim against directors protected by an exculpatory charter provision. B. Riley Financial, Inc. (n/k/a BRC Group Holdings, Inc.) ("B. Riley") invested in the management-led take-private acquisition of formerly public Franchise Group, Inc. ("FRG") (the "FRG Take-Private"). Following months of work, management presented the proposed transaction to the B. Riley Board, which approved it at \$30 per share. Months after the transaction closed, then-FRG CEO Brian Kahn was implicated in an unrelated fraud at Prophecy Asset Management—a different company altogether. The fallout from Kahn's alleged involvement in the Prophecy fraud eventually caused FRG to fail.

In late 2024, Plaintiff filed this derivative action without making a pre-suit demand, alleging that the B. Riley Board acted in bad faith by failing to uncover that unrelated misconduct before federal authorities did. The Complaint challenges a business judgment that later proved unsuccessful, not a non-exculpated breach of the duty of loyalty, and it does not plead particularized facts showing that a majority of B. Riley's Board could not consider a demand, as Delaware law requires.

Plaintiff advances three theories on appeal. None has merit. First, he contends that the Court of Chancery erred in holding that outside directors Tammy Brandt,

Robert D’Agostino, Renee LaBran, Michael Sheldon, and Miriam Walters (together with Robert Antin and Randall Paulson, the “Outside Directors”)¹ do not face a substantial likelihood of liability under *Caremark* prong I, arguing that they failed to implement Board-level oversight systems. Second, he contends that the Court of Chancery erred in holding that Audit Committee members Paulson, D’Agostino, and LaBran (the “Audit Committee Defendants”) do not face a substantial likelihood of liability under *Caremark* prong II, arguing that they knew of, and consciously disregarded, red flags concerning the FRG Take-Private. Third, Plaintiff contends that the Court erred by finding D’Agostino, Sheldon, and Walters independent—and for not reaching Paulson’s independence—relying on an unpled securities action that cannot be used to amend his Complaint on appeal.

The Court of Chancery rejected each of those theories because Plaintiff failed to plead particularized facts showing that a majority of the Board could not have considered a demand. Plaintiff’s own allegations acknowledge that B. Riley had Board-level oversight mechanisms, including an Audit Committee charged with risk oversight, outside auditors, and outside counsel. That concession defeats his *Caremark* prong I claim. Plaintiff also failed to plead particularized facts showing

¹ The Court limited its analysis to Brandt, D’Agostino, LaBran, Sheldon, and Walters (the “Demand Majority”), however Plaintiff’s Opening Brief argues that all of the Outside Directors face a substantial likelihood of liability under *Caremark* prong I.

that the Audit Committee Directors knew of red flags of corporate misconduct and consciously ignored them. Instead, Plaintiff asks the Court to infer bad faith from allegations that Bryant Riley allegedly failed to present certain information to the Board concerning the FRG Take-Private—allegations that, at most, challenge the Board’s diligence and business judgment, rather than establish *Caremark* red flags. Plaintiff likewise failed to show that a majority of the Demand Board was controlled by any interested director.

Plaintiff’s appeal reprises the exact same demand-futility theories the Court of Chancery rejected. This Court should affirm.

SUMMARY OF ARGUMENT

1. **Denied.** The Court of Chancery concluded that Plaintiff failed to show that a majority of the Outside Directors face a substantial likelihood of liability under the first prong of *Caremark*. The allegations in the Complaint establish that B. Riley had proper Board-level reporting and oversight systems, including an active Audit Committee charged with risk oversight that met regularly and worked with the Company's outside auditors. Those allegations foreclose a claim under *Caremark*'s first prong. Plaintiff cannot plead particularized facts demonstrating that the directors utterly failed to implement any reporting/information system or controls.

2. **Denied.** The Court of Chancery held that the Audit Committee Directors do not face a substantial likelihood of liability under *Caremark*'s second prong. Because the Company's directors are exculpated, Plaintiff must plead particularized facts supporting a reasonable inference that they acted in bad faith—*e.g.*, that they knew of red flags of wrongful conduct at B. Riley and consciously disregarded them. Plaintiff does not plead actual knowledge, identify any *Caremark* “red flags,” or connect his purported red flags to the alleged corporate trauma. Instead, he repackages hindsight criticism of the Board's evaluation of the FRG Take-Private as a claim for bad faith oversight.

3. **Denied.** The Court of Chancery held that Plaintiff failed to overcome the presumption that the Outside Directors were independent. Plaintiff did not plead

particularized facts creating a reasonable doubt that a majority of the Board could not consider a demand.² His allegations comprise ordinary director compensation, longstanding professional relationships, and social familiarity, which Delaware law holds time and again are insufficient to rebut independence. And, Plaintiff waived any challenge to the Court of Chancery's independence analysis as to Brandt or LaBran because he relegates these directors to a passing footnote without analysis. Del. Supr. Ct. R. 14(b)(vi)(A)(3).

4. The Court can also affirm the dismissal of Counts III and IV against the Outside Directors on an alternative ground briefed by the parties but not decided below. In particular, Plaintiff failed to plead a non-exculpated claim under Rule 12(b)(6) and *In re Cornerstone Therapeutics Inc. Stockholder Litigation*, 115 A.3d 1173 (Del. 2015).

² Defendants did not contest the independence of Bryant Riley, Kelleher, or Antin in the Court of Chancery.

STATEMENT OF FACTS

A. B. Riley and FRG

B. Riley is a Delaware financial services company headquartered in Los Angeles. A253. B. Riley invests in, and sometimes acquires, companies or assets with attractive risk-adjusted return profiles. *Id.* Its Board had nine members during the relevant period: co-CEOs Bryant Riley and Thomas Kelleher, and the Outside Directors. A34, 37-39 (Compl. ¶¶ 49, 57-64). Each director is protected by an exculpation provision in B. Riley’s certificate of incorporation that shields them to the fullest extent permitted under Delaware General Corporation Law Section 102(b)(7) (the “Exculpation Clause”). A426-427.

B. The FRG Take-Private

B. Riley had a years-long business relationship with FRG which, until August 2023, was a publicly traded operator and franchiser of consumer businesses, including The Vitamin Shoppe, Pet Supplies Plus, Sylvan Learning and American Freight. A479. From 2018 to 2023, B. Riley advised on and/or financed multiple FRG-related transactions, including transactions involving FRG’s founder, Brian Kahn, and Kahn’s private equity firm, Vintage Capital Management (“Vintage”). A40-45 (Compl. ¶¶ 69-77); A575. Plaintiff does not allege any fraud or misconduct during those earlier transactions.

Included among these transactions was FRG's acquisition of W.S. Badcock Corporation ("Badcock") in 2021. A46 (Compl. ¶ 82). In December 2021, B. Riley Receivables, LLC entered into an agreement with Badcock to acquire its existing consumer credit receivables. A47 (Compl. ¶¶ 84-86). B. Riley affiliates continued to acquire consumer credit receivables from Badcock through March 2023, when B. Riley determined that it would rather explore an acquisition of FRG. *Id.* (Compl. ¶ 87); A620. On March 19, 2023, B. Riley submitted a non-binding proposal to acquire FRG for \$30 per share. A52 (Compl. ¶ 109).

FRG formed a special committee to evaluate the proposal, advised by Wachtell, Lipton, Rosen & Katz and Jefferies. A54 (Compl. ¶¶ 119-120). During the negotiations, FRG's management updated projections that had been shared with B. Riley in April 2023 (the "January Projections") to reflect worsening economic conditions (the "Preliminary Management Projections"). A54 (Compl. ¶ 121); A622. In April, FRG made a counteroffer to B. Riley of \$33 per share. A624. B. Riley declined the counteroffer based on diligence and information received after B. Riley's initial proposal, including the Preliminary Management Projections, and held firm at \$30. A624. Further updated projections (the "Management Projections") were "posted to [FRG's] virtual data room" on May 5, 2023. A57 (Compl. ¶ 131).

On May 8, 2023, B. Riley’s Board met to consider the transaction. A58 (Compl. ¶ 135). The Board received a presentation that summarized B. Riley’s historical relationship with FRG and explained B. Riley’s investment thesis (the “FRG Acquisition Presentation”). *Id.* ¶ 136. The FRG Acquisition Presentation summarizes B. Riley’s five-year relationship with FRG and included the January Projections and B. Riley’s estimates of FRG’s projected adjusted EBITDA. A575-576. Most of the presentation addresses B. Riley’s post-transaction strategic plans, including refinancing FRG-subsidiary Pet Supplies Plus and selling The Vitamin Shoppe, Buddy’s and Sylvan Learning, to allow B. Riley to reduce FRG’s debt. A581. Plaintiff alleges that the presentation did not include the Management Projections uploaded to the virtual data room a few days earlier, or any discussion of a loan that B. Riley made to Vintage. A59 (Compl. ¶ 140); A78 (Compl. ¶ 227). The Board approved the transaction on May 9, 2023. A867. The transaction closed on August 21, 2023. A257.

C. Kahn’s Prophecy-Related Fraud

In November 2023, several months after the FRG Take-Private closed, John Hughes, a co-founder of Prophecy Asset Management LP, pleaded guilty to securities fraud. A79-80 (Compl. ¶ 232). Kahn was implicated as an unindicted co-conspirator in that fraud. A80 (Compl. ¶ 233).

After seeing this news, B. Riley's Board and Audit Committee (Paulson, D'Agostino and LaBran), conducted a review that included B. Riley's relationship with Kahn and FRG, a slew of short-seller allegations, and FRG financial results and related public statements by FRG and Kahn. A90-91 (Compl. ¶ 280). The Audit Committee first retained Sullivan & Cromwell LLP to conduct a review and, after the Company's auditor requested an additional review, retained Winston & Strawn LLP to conduct a second investigation. A98-99 (Compl. ¶¶ 306-309). Neither firm found evidence of misconduct at B. Riley, or that any B. Riley personnel had knowledge of the alleged Prophecy fraud before it became public. A971-72, 977.

D. The Court of Chancery Decision

Plaintiff filed this derivative action without making a pre-suit litigation demand on the Board in February 2025. A125 (Compl. ¶ 409). The Complaint asserts breach of fiduciary duty claims against the Management and Outside Directors, alleging failed oversight, material misstatements and omissions, corporate waste, and bad faith.³ A28 (Compl. ¶ 25); Op. 13.

Defendants moved to dismiss the Complaint under Court of Chancery Rule 23.1 for failure to plead demand futility and under Rule 12(b)(6) for failure to state a claim. Op. 13. The Court of Chancery held that Rule 23.1 was dispositive and

³ Documents produced in response to Plaintiff's books and record demand are incorporated by reference into the Complaint by the parties' agreement and located at A573-592, A858-867, A968-989, A1029-1031, A1209-1215.

dismissed the Complaint for failure to plead demand futility. Op. 14, 42. The Court did not reach any of the Rule 12(b)(6) arguments, including the Outside Directors' separate motion under *In re Cornerstone Therapeutics*.

Applying the test set forth in *United Food & Commercial Workers Union & Participating Food Industry Employees Tri-State Pension Fund v. Zuckerberg*, 262 A.3d 1034, 1058 (Del. 2021), the Court considered demand futility on a director-by-director basis, asking whether each director faced a substantial likelihood of liability or lacked independence from someone who did. Op. 15-17. The Court explained that demand is excused only if the answer is “yes” for at least half of the demand board. Op. 16. Because Defendants did not contest, for purposes of the motion, Plaintiff's allegations that Riley, Kelleher, and Antin lacked independence or disinterestedness, Plaintiff was required to plead particularized facts showing that at least two additional directors were disabled from considering a demand.⁴ *Id.*

The Court held that Plaintiff failed to do so. It described the case as a “hindsight critique of a business decision gone awry,” and rejected Plaintiff's attempt to “recast an unfortunate investment as a breach of the duty of loyalty.” Op. 1. The Court concluded that Plaintiff's oversight theory “stretches *Caremark* well beyond its limits,” because Plaintiff “essentially complains that the board did not

⁴ The Court limited its analysis to Brandt, D'Agostino, LaBran, Sheldon, and Walters (the “Demand Majority”). Op. 16-17.

uncover fraud at an outside company before the federal government did.” *Id.* Accordingly, the Court held that “[i]mperfect diligence on an investment that later sours is a matter of business risk, not bad faith.” Op. 2.

The Court rejected Plaintiff’s *Caremark* prong I theory because the Complaint did not allege an “utter failure” to implement Board-level reporting or controls. Op. 21-23. The Court concluded that the Complaint itself conceded sufficient Board-level reporting and oversight mechanisms to defeat Plaintiff’s claim, including an Audit Committee charged with risk oversight and the engagement of outside auditors. *Id.*

The Court next rejected Plaintiff’s *Caremark* prong II theory. The Complaint did not plead particularized facts showing that any Outside Director knew of and consciously disregarded red flags of wrongdoing at B. Riley. Op. 23-27. The Court held that Plaintiff’s purported “red flags”—declining financial projections, debt downgrades, and other aspects of the FRG transaction—were “quintessential business risks” bearing on the wisdom of an investment, not red flags of improper corporate conduct. Op. 24-27. The Court further explained that the alleged misconduct underlying Plaintiff’s theory occurred at Prophecy, not at B. Riley, and concluded that Plaintiff’s allegations amounted to hindsight criticism of due diligence and business judgment, rather than bad faith oversight. Op. 27.

Finally, the Court rejected Plaintiff's independence theory. Directors are presumed independent, and Plaintiff relied on "ordinary course director compensation, stale business and personal ties, and generic social relationships." Op. 2, 30-41. The Court found those allegations insufficient to overcome the presumption of independence as to the Demand Majority. Op. 30-41. Having found that five directors could consider a demand, the Court did not reach Paulson. Op. 17, 41. Because Plaintiff failed to plead that a majority of the Board was disabled, the Court dismissed the Complaint. Op. 41-42.

ARGUMENT

I. THE COURT OF CHANCERY CORRECTLY HELD THAT THE OUTSIDE DIRECTORS DID NOT FACE A SUBSTANTIAL LIKELIHOOD OF LIABILITY UNDER CAREMARK PRONG I

A. Question Presented

Did the Court of Chancery correctly conclude that Plaintiff failed to plead particularized facts demonstrating that the Outside Directors face a substantial likelihood of liability under *Caremark* prong I where the Complaint concedes the existence of functioning Board-level reporting and oversight systems? A201-204.

B. Scope Of Review

This Court reviews *de novo* the Court of Chancery's dismissal of a derivative complaint under Court of Chancery Rule 23.1. *Brehm v. Eisner*, 746 A.2d 244, 253 (Del. 2000).

C. Merits of the Argument

The Court of Chancery's decision under *Caremark* prong I is correct. A *Caremark* oversight claim is "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment." *In re Caremark Int'l Inc. Deriv. Litig.*, 698 A.2d 959, 967 (Del. Ch. 1996); Op. 19. To state a claim under *Caremark*'s prong I, Plaintiff must plead particularized facts demonstrating that "the directors **utterly failed** to implement any reporting or information system or controls." *Stone v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (emphasis added). That standard turns on whether the Board failed to establish board-level reporting and

oversight mechanisms—not whether those systems operated perfectly or identified every risk that, with the benefit of hindsight, a plaintiff contends should have come before the board. *See In re Gen. Motors Co. Deriv. Litig.*, 2015 WL 3958724, at *14-15 (Del. Ch. June 26, 2015), *aff’d*, 133 A.3d 971 (Del. 2016). To circumvent this settled requirement, the Opening Brief (“Opening”) attempts to collapse *Caremark’s* distinct theories of liability, recasting alleged shortcomings in transaction diligence and business judgment as evidence that the Board failed to implement any reporting or oversight. Yet allegations about how a board evaluated a particular transaction are not allegations that the board failed to establish board-level reporting or oversight.

1. The Complaint Acknowledges Board-Level Reporting and Oversight Mechanisms.

The Complaint itself acknowledges that B. Riley had board-level reporting and oversight systems, including an active Audit Committee that met regularly, engaged external auditors, and retained outside counsel to review matters and report to the Board. A90-91, 99 (Compl. ¶¶ 280, 309); A979-989 (Audit Committee Charter); Opening 29 (Committee’s duties include “oversight and risk assessment”). Those allegations demonstrate that the Outside Directors did not “utterly fail[] to implement any reporting or information system or controls,” and preclude a prong I claim. *See Stone*, 911 A.2d at 370, 372-73; *see also Marchand v. Barnhill*, 212 A.3d

805, 823 (Del. 2019) (recognizing that existence of board-level systems of monitoring and oversight vitiates a claim under *Caremark* prong I).

Plaintiff’s invocation of the “mission critical” language from cases such as *Marchand* and *In re Boeing Co. Derivative Litigation*, 2021 WL 4059934 (Del. Ch. Sept. 7, 2021), does not alter the analysis.⁵ Opening 25. Whether or not those decisions extend *Caremark* beyond the monitoring of legal compliance, they do not eliminate the key distinction between *Caremark*’s two prongs. The relevant question under prong I remains whether the Complaint pleads particularized facts supporting a reasonable inference that the Board failed to make any good faith effort to implement a board-level reporting and oversight system.⁶ Here, the Complaint does not.⁷

Plaintiff focuses on information that he contends the Board did not receive or consider—such as the existence of the Vintage loan, the timing of the FRG

⁵ Plaintiff cites *In re Walt Disney Co. Derivative Litigation*, 825 A.2d 275 (Del Ch. 2003), as “sustaining [a] *Caremark* claim on a motion to dismiss relating to employment contract.” (Opening 25, n.25.) *Disney* did not involve *Caremark* claims.

⁶ Plaintiff provides no support for his argument that “[t]he existence of written policies . . . is insufficient [under *Caremark*’s first prong] if those policies and procedures are not followed,” (Opening 24), nor does the Complaint identify any policy or procedure that the Outside Directors failed to follow.

⁷ Plaintiff’s discussion of “positive law” in his *Caremark* prong I discussion (Opening 25) is misplaced because it addresses a point the Court discussed in connection with *Caremark*’s second prong, not the first. *See* Op. 23, 27.

transaction, the Management Projections, and other details surrounding the acquisition. *Id.* at 26-30. Those allegations do not answer the question presented by *Caremark*'s first prong. They concern whether an existing oversight system functioned as Plaintiff believes it should have (prong II), not whether the Board failed to put a system in place.

Nor does *Boeing* suggest otherwise. In *Boeing*, the Court found that although Boeing maintained an Audit Committee responsible for financial risk, the complaint supported a reasonable inference that Boeing had failed to establish any board-level system directed toward airplane safety—the “mission critical” risk at-issue. *Boeing*, 2021 WL 4059934, at *26-27. Here, by contrast, Plaintiff's own allegations establish that B. Riley maintained an Audit Committee charged with reviewing “the company's policies with respect to risk assessment and risk management,” together with reporting mechanisms directed to the very financial and investment risks Plaintiff identifies. A132 (Compl. ¶ 426); A979-989. Plaintiff does not allege the absence of a reporting system, which is a fundamentally different claim. *Marchand*, 212 A.3d at 821 (“[O]ur case law gives deference to boards and has dismissed *Caremark* cases even when illegal or harmful company activities escaped detection[.]”).

Giuliano likewise illustrates the key distinction. There, the complaint alleged the absence of any board-level system directed toward FDA compliance—the central

regulatory risk facing the company. *See Giuliano v. Grenfell-Gardner*, 2025 WL 2502176, at *1, *7-9 & n.61 (Del. Ch. Sept. 2, 2025). Here, Plaintiff identifies no comparable absence of board-level oversight. Rather, he challenges the adequacy of the Board’s consideration of a particular investment decision. *See* Opening 27-31. Whatever the merits of those criticisms, they are not allegations that the Board failed to implement any reporting or oversight system.

Plaintiff’s new argument, that B. Riley had no investment committee (Opening 27), does not save his argument. First, this argument was never presented below and the Court should disregard it now. Del. Supr. Ct. R. 8. But, in any event, the argument fails because B. Riley’s Audit Committee was tasked with oversight of B. Riley’s investments and their risks. *See, e.g., Marchand*, 212 A.3d at 821-23; *see also* Op. 21-22 (“For B. Riley—a financial services firm—an Audit Committee tasked with risk assessment and the Board’s hiring of financial and legal advisors is the sort of industry-specific compliance approach Delaware law expects.”).

Plaintiff’s attempt to distinguish the Court of Chancery’s cited authorities misses the point. Opening 34-35. *Fisher*, *Guttman*, and *MetLife* all confirm the same dispositive principle articulated by this Court in *Marchand*: to succeed under *Caremark*’s first prong, the Complaint must plead facts supporting a reasonable inference that the board did not “make a good faith effort—*i.e.*, try—to put in place a reasonable board-level system of monitoring and reporting.” *Marchand*, 212 A.3d

at 821. *Guttman* describes “the kind of fact pleading that is critical to a *Caremark* claim, such as contentions that the company lacked an audit committee [or] that the company had an audit committee that met only sporadically and devoted patently inadequate time to its work” *Guttman v. Huang*, 823 A.2d 492, 507 (Del. Ch. 2003). *Fisher* and *MetLife* make clear that a claim under *Caremark*’s first prong will fail where the complaint concedes the existence of internal controls, *such as* the existence of audit and risk committees that meet regularly. *Fisher ex rel. LendingClub Corp. v. Sanborn*, 2021 WL 1197577, at *10-11 (Del. Ch. Mar. 30, 2021); *In re MetLife Inc. Deriv. Litig.*, 2020 WL 4746635, at *13 (Del. Ch. Aug. 17, 2020). These cases do not prescribe a particular committee structure that a board must adopt, and such an argument would fail in any event because Plaintiff acknowledges that B. Riley’s Audit Committee was charged with “oversight and risk assessment, which included monitoring B. Riley’s loans and investments.” Opening 29. The Complaint contains the defect that required dismissal in *Fisher*, *Guttman*, and *MetLife*: it concedes the existence of Board-level internal controls, including an Audit Committee charged with risk assessment and risk management which met regularly. *See* A132 (Compl. ¶ 426); A979-989.

2. Plaintiff May Not Recast Alleged Deficiencies in the Board's Oversight of the FRG Transaction as a Sustained Oversight Failure.

Plaintiff attempts to salvage his *Caremark* prong I claim by arguing that B. Riley's Board-level reporting and oversight mechanisms were poorly implemented because the Board allegedly failed to receive or consider certain information concerning the FRG transaction. Opening 26-34. This is not a proper *Caremark* first prong inquiry. Liability arises only from "a sustained or systematic failure of the board to exercise oversight," *Caremark*, 698 A.2d at 971, and the Complaint alleges no such sustained or systematic failure here.

The Complaint does not allege the Board abandoned its oversight responsibilities, failed to convene its Audit Committee, ceased receiving reports, or disabled its reporting structure. Plaintiff instead challenges the Board's consideration of a single investment decision. Plaintiff argues that the Board should have received different information concerning the FRG Take-Private, including the Management Projections and information about the Vintage loan,⁸ the Investment Advisory Agreement, and the timing of the transaction. Opening 26-34. But those allegations concern the adequacy of the Board's oversight in a specific instance, not

⁸ Plaintiff argues that the collateral for this loan was "significantly underwater" (Opening 27), but the Complaint does not allege that the loan was undercollateralized or non-performing at the time of the relevant disclosure—because it was not. At the time of the disclosures, the loans were both overcollateralized and performing. A412.

a sustained or systematic failure to exercise oversight over time. At most, Plaintiff alleges that the Board should have received additional information, or reached a different decision, in the summer of 2023. That is not a *Caremark* prong I claim.

Plaintiff faults the Board for failing to conduct additional diligence into Kahn, including investigating his background, the use of proceeds from the Vintage Loan, and other aspects of his relationship with B. Riley. Opening 27-30. Those allegations similarly challenge the scope and adequacy of the Board's diligence regarding a single transaction. Plaintiff identifies no authority requiring a board considering an arm's-length acquisition to conduct the type of separate investigation of a counterparty's principal that he now advocates in hindsight. Whether the Board should have undertaken additional diligence is a business judgment, *see In re McDonald's Corp. S'holder Deriv. Litig.*, 291 A.3d 652, 691 (Del. Ch. 2023); it does not support an inference that the Board failed to make a good-faith effort to establish board-level reporting and oversight systems.

The Court of Chancery recognized this distinction, explaining that, "allegations that a compliance system was flawed or ineffective do not support an inference that directors utterly failed to monitor, as is mandatory for *Caremark* liability." Op. 23. Delaware law does not require directors to enact oversight systems that are flawless or prevent every business loss. *E.g., Okla. Firefighters Pension & Ret. Sys. v. Corbat*, 2017 WL 6452240, at *24 (Del. Ch. Dec. 18, 2017)

(explaining that even where compliance “efforts failed in many instances . . . that is not enough to support a plausible inference of bad faith” and that “[b]ad results alone do not imply bad faith”). Nor does a court, under *Caremark*’s first prong, “examin[e] the effectiveness of a board-level compliance and reporting system after the fact.” *See Marchand*, 212 A.3d at 821. Yet that is just what Plaintiff asks the Court to do.

Plaintiff is not entitled to an inference that the Board failed to discuss the updated Management Projections, Vintage Loan, IAA or differing FRG projections when analyzing the FRG Take-Private. Opening 26-30. Board minutes are not transcripts, and Delaware courts have rejected the contention that the absence of a particular topic from minutes establishes that the Board never considered it.⁹ In *Petry ex rel. FedEx Corp. v. Smith*, 2021 WL 2644475, at *10 (Del. Ch. June 28, 2021), *aff’d*, 273 A.3d 750 (Del. 2022) (TABLE), plaintiff argued that the fact that the board minutes did not evidence discussion regarding compliance entitled plaintiff to an inference that the director defendants had not discussed or attempted to oversee the remediation of illegal cigarette shipments. 2021 WL 2644475, at *10. The court disagreed, pointing to a general discussion of “the cigarette transportation litigation pending in New York,” and finding that the reasonable inference to draw is that “the Board was engaged on this issue[.]” *Id.*; *see also In re Baker Hughes*

⁹ The transaction was approved the next day, on May 9 via unanimous written consent. A867.

Inc. Merger Litig., 2020 WL 6281427, at *10-11 (Del. Ch. Oct. 27, 2020) (finding “intuitively [] inconceivable” the requested inference that board failed to review audited financial statements because minutes did not record express review).

Plaintiff asserts that 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.” Opening 42. The documents Plaintiff incorporated into his Complaint demonstrate otherwise. The May 8 board minutes alone reflect a substantive discussion of the FRG Take-Private and B. Riley’s business rationale, including questions from directors, discussion of meetings with FRG management, updates concerning transaction diligence and documentation, and B. Riley’s longstanding business relationship with Kahn. A861-862. Plaintiff is not entitled to some contrary inference because the minutes do not memorialize every topic he now contends should have been discussed. *See, e.g., Pettry*, 2021 WL 2644475, at *10.

Plaintiff’s theory on appeal further illustrates why his prong I claim fails. In arguing that no meaningful reporting system existed, Plaintiff asserts that “there was no reporting system” regarding the balance sheet risk associated with the Badcock receivables and the existence of the Vintage loan. Opening 26. Yet elsewhere he argues that the Audit Committee possessed knowledge of those matters by virtue of its oversight responsibilities. *Id.* at 38-40. Plaintiff asks the Court to accept contradictory assertions, both that “there was no reporting system in place to inform

the Board of the ‘continued balance sheet risk’ from ongoing purchases of Badcock receivables” (Opening 26), and that “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” (*id.* at 38). Plaintiff also alleges that “[t]here was no effective information system to inform the Board about the Company’s \$200.5 million loan to Vintage” (*id.* at 26), and that the Audit Committee had “presumptive awareness of the \$200.5 million loan” (*id.* at 40).

As Plaintiff himself acknowledges, one “cannot have it both ways.” *Id.* at 37. Either the Board had reporting mechanisms through which the Audit Committee acquired information—defeating a claim that the Board systematically failed to exercise oversight—or not. Plaintiff’s attempt to plead both theories underscores that his allegations concern the operation of an existing oversight system, not the absence of one. *See* A1392 (Tr. 41:19-23).

Moreover, Plaintiff’s assertion that the Board lacked a reporting system concerning B. Riley’s “continued balance sheet risk” from Badcock receivables, Opening 26, is unsupported. The documents incorporated into the Complaint acknowledge that B. Riley’s acquisition strategy contemplated eliminating that exposure through the planned restructuring of FRG, including asset sales, refinancing, and debt reduction. A581-582.

Finally, Plaintiff's argument collapses *Caremark's* two distinct theories of liability. Plaintiff relies on *Collis* for the proposition that, "[h]aving implemented such a system o[r] controls," directors cannot "consciously fail[] to monitor or oversee its operations" (Opening 24-25 & n.22 (quoting *Lebanon Cnty. Emps' Ret. Fund v. Collis*, 311 A.3d 773, 795 (Del. 2023))), but this implicates *Caremark's* second prong—whether directors consciously disregarded known risks after implementing an oversight system—not whether they made a good-faith effort to establish such a system at all. Plaintiff's particular allegations regarding the Board's purported failure to receive, appreciate, or act on particular information concerning the FRG transaction do not support a reasonable inference that the Board engaged in the sustained or systematic failure to exercise oversight required under *Caremark's* first prong.

II. THE COURT OF CHANCERY CORRECTLY FOUND THAT THE AUDIT COMMITTEE DIRECTORS DO NOT FACE A SUBSTANTIAL LIKELIHOOD OF LIABILITY UNDER CAREMARK PRONG II

A. Question Presented

Did the Court of Chancery correctly reject Plaintiff's *Caremark* prong II theory where the Complaint did not plead particularized facts that the Audit Committee knew of, and consciously ignored, red flags of wrongful conduct at B. Riley, but instead sought to convert an investment loss caused by later-revealed misconduct at an unaffiliated third party into a non-exculpated claim of bad-faith oversight liability? A205-214, A217-221.

B. Scope of Review

This Court's review is *de novo*. *See supra* Section I.B.

C. Merits of the Argument

The Court of Chancery correctly rejected Plaintiff's *Caremark* prong II theory. Op. 23-27. Because the Audit Committee Directors are exculpated, Plaintiff is required to plead specific facts reflecting bad faith: that the Audit Committee knew of red flags of wrongful conduct at B. Riley yet consciously disregarded them. *Constr. Indus. Laborers Pension Fund v. Bingle*, 2022 WL 4102492, at *1-2 (Del. Ch. Sept. 6, 2022), *aff'd*, 297 A.3d 1083 (Del. 2023) (TABLE).¹⁰ The Complaint

¹⁰ Plaintiff abandons his red flags theory as to the whole Board, and presses only a narrowed claim against the three Audit Committee Directors.

does not do so. It pleads no red flags of corporate misconduct and pleads no particularized facts supporting a reasonable inference that the Audit Committee knowingly disregarded such red flags.¹¹

1. Plaintiff Does Not Plead Red Flags or Conscious Disregard.

Plaintiff identifies several categories of information he contends the Audit Committee already possessed and argues that Bryant Riley’s alleged failure to present that information to the Board during its consideration of the FRG Take-Private should have alerted the Audit Committee to misconduct. None of those allegations constitute a *Caremark* red flag, much less something the Audit Committee actively disregarded, principally because the investment thesis of the FRG Take-Private—like that of many B. Riley transactions—was that FRG was a struggling business in need of significant restructuring.

Each of the FRG Acquisition Presentation; Badcock-related “balance sheet risk”; FRG’s 2023 operating results and public disclosures; and the Vintage loan and IAA with Brian Kahn (Opening 38-41) concern the Board’s assessment of investment risk, transaction structure, valuation, client service, financing decisions and portfolio company performance. Delaware courts repeatedly distinguish such

¹¹ Plaintiff argues that the Court erred by referring to “positive law” because *Caremark* applies to oversight of “mission-critical” risks. Opening 25. This is wide of the mark. Plaintiff fails to plead particularized facts demonstrating that the Audit Committee consciously disregarded signs of non-compliance relating either to legal obligations, or to any “mission-critical” aspect of B. Riley’s business.

business judgments from illegal or unlawful *Caremark* “red flags” evidencing corporate misconduct or bad faith breaches of fiduciary duty. *See, e.g., In re ProAssurance Corp. S’holder Deriv. Litig.*, 2023 WL 6426294, at *14 (Del. Ch. Oct. 2, 2023) (business risks are not red flags of improper conduct); *In re Citigroup Inc. S’holder Deriv. Litig.*, 964 A.2d 106, 125, 131 (Del. Ch. 2009) (imposing *Caremark* liability for business risk would “eviscerate the core protections of the business judgment rule”); *Firemen’s Ret. Sys. of St. Louis ex rel. Marriott Int’l Inc. v. Sorenson*, 2021 WL 4593777, at *13 (Del. Ch. Oct. 5, 2021) (plaintiff must allege directors “knew about ‘red flags’ alerting them to corporate misconduct and ‘consciously failed to act after learning about evidence of illegality’”) (citation omitted).

a. The Complaint Does Not Plead That the Audit Committee Actually Knew the Information Riley Allegedly Omitted.

Plaintiff’s principal argument under *Caremark* prong II is that the Audit Committee already knew of the Badcock-related balance sheet risk, the Vintage Loan, the IAA commitment and the Management Projections, and that Bryant Riley’s alleged omission of those matters from the Board’s consideration of the FRG Take-Private should itself have alerted the Audit Committee that Riley was misleading the Board. Opening Br. 38-42. That theory fails because Plaintiff does not adequately plead either premise. Plaintiff does not plead particularized facts supporting a reasonable inference that the Audit Committee actually possessed the

information attributed to it. Plaintiff instead relies on Paulson’s alleged participation in the transaction negotiations and then stacks inference upon inference: that Paulson received all the information, understood it to reveal a problem, and “would have reported” it to the Audit Committee “had it been functioning.” *Id.* at 38-39. Delaware law does not permit a plaintiff to establish director knowledge through speculative inferences. *City of Detroit Police & Fire Ret. Sys. ex rel. NiSource, Inc. v. Hamrock*, 2022 WL 2387653, at *24 (Del. Ch. June 30, 2022) (refusing to impose constructive knowledge; plaintiff “must allege particular facts to support an inference of” knowledge); *In re Kraft Heinz Demand Refused Deriv. S’holder Litig.*, 2024 WL 3493957, at *10-11 (Del. Ch. July 19, 2024) (allegation that director received “unspecified information” while attending board meetings where distressed reporting units, trademarks, and brands suffering from impairment risks were discussed was insufficient to support inference he knew Kraft’s impairment testing “was ineffective, covered it up, and allowed it to continue”); *Lazard Debt Recovery GP, LLC. v. Weinstock*, 864 A.2d 955, 964 (Del. Ch. 2004) (inferences must be reasonable and not byproduct of “irrational, plaintiff-friendly speculation”).

Plaintiff’s attempt to distinguish *Hamrock* underscores that point. Opening 41-42. Plaintiff argues that he is not asking the Court to impute constructive knowledge because the supposed red flags fell within the Audit Committee’s “domain.” *Id.* at 42. But that is simply another version of constructive knowledge.

In *Hamrock*, the court rejected this theory, refusing to infer board knowledge of an operational notice warning that over-pressurization was a “known risk” that could lead to a “catastrophic event,” even though that specific operational risk fell within the responsibility of the board’s Environmental, Safety and Sustainability Committee. 2022 WL 2387653, at *2-3, *23-24 & n.11. Because the complaint did not plead particularized facts that the operational notice was presented and known to the directors, the Court held that no inference of knowledge was warranted. *Id.* at 24. The same is true here. Plaintiff alleges that the FRG Management Projections and information concerning Badcock-related receivables risk were “presumptively” known by Paulson (A64 (Compl. ¶ 169)) and “would have” reached the Audit Committee, because these matters fell within its “domain.” Opening 38-39, 42. That is insufficient. *See Wood v. Baum*, 953 A.2d 136, 142 (Del. 2008) (membership on Audit Committee is not sufficient to infer scienter under Delaware law).

Additionally, specific to the Badcock “balance sheet risk” (Opening 38), the Complaint alleges that B. Riley’s acquisition strategy contemplated eliminating exposure through the planned restructuring of FRG, including asset sales, refinancing, and debt reduction. A581. Plaintiff pleads no facts explaining why the Board required additional reporting concerning a risk the proposed transaction was designed to eliminate.

Finally, as to the Vintage Loan, Plaintiff's argument cannot be reconciled with his assertion elsewhere that the Board "was not notified of the \$200.5 million loan until it was publicly disclosed in a 12-13-23 Form 8-K." Opening 26; *see also* A79 (Compl. ¶ 228). Although Plaintiff may plead alternative theories, each must rest on reasonably conceivable, particularized facts. His *Caremark* prong II theory rests on the assertion that, because the Audit Committee had general responsibility for risk oversight, it knew of the Vintage Loan and IAA. As explained above, that is constructive knowledge, not a particularized allegation of actual knowledge.

b. Even Assuming the Audit Committee Knew Those Matters, They Were Not Caremark Red Flags.

Even assuming the Audit Committee already knew the information Plaintiff attributes to it, Riley's alleged omission of that information from the May 8 Board discussion did not constitute a *Caremark* red flag. Opening 38-39.

First, the use of the January Projections rather than the Management Projections (posted to the data room only days earlier) in the FRG Acquisition Presentation reflects a business judgment regarding how to evaluate the transaction, not corporate misconduct. As reflected in the Presentation itself, the Board's discussion focused almost totally on B. Riley's evaluation of the Take-Private—including the anticipated value of FRG after restructuring—using B. Riley's own calculations, rather than FRG's standalone management projections. A574-92. This was a perfectly valid Board business judgment under Delaware law. *See*

ProAssurance, 2023 WL 6426294, at *14; *Citigroup*, 964 A.2d at 125, 131.¹² And the alleged failure to discuss the Badcock balance sheet risk is not a red flag for the same reason.

Second, and relatedly, Plaintiff's argument is contingent on the Court inferring that the updated Management Projections, Vintage Loan, IAA and Badcock receivables were (a) not discussed at the May 8 meeting because they are not referenced in the Board minutes, and (b) that Riley concealed them. Opening 39. Neither inference is warranted for the reasons discussed. *See supra* Section I.C.2. Further, the transaction history reflects that after receiving additional diligence materials and FRG's Preliminary Management Projections, B. Riley rejected FRG's \$33-per-share counterproposal and held its offer at \$30 per share. A624. These allegations do not support a reasonable inference that the Board accepted Riley's suggestion without inquiry, much less that the Audit Committee—inconceivably—thought he deceived the Board and consciously elected to participate in a fraud.

At bottom, Plaintiff contends that the Audit Committee should have asked additional questions, demanded different materials, or conducted further diligence.

¹² Plaintiff faults the Court of Chancery for stating that B. Riley considered updated projections before responding to FRG's counterproposal. Opening 42. Any error in this regard does not supply the many missing elements of Plaintiff's claim. The omission of the updated Management Projections does not, without particularized allegations of purposeful deception and conscious disregard, establish a *Caremark* red flag or bad faith by the Audit Committee.

Opening 39, 42. Even if accepted, this concerns the adequacy of the directors' inquiry, not a conscious decision to disregard known misconduct. An allegedly inadequate inquiry sounds, at most, in the duty of care, and does not establish non-exculpated bad faith absent "intentional dereliction." *McElrath ex rel. Uber Techs., Inc. v. Kalanick*, 2019 WL 1430210, at *10 (Del. Ch. Apr. 1, 2019), *aff'd*, 224 A.3d 982 (Del. 2020) ("[T]here is a vast difference between an inadequate or flawed effort to carry out fiduciary duties and a conscious disregard for those duties.") (citation omitted); *id.* at *10-16 (finding no bad faith despite where directors failed to review investigative report that would have demonstrated trade secret misappropriation); *In re TIBCO Software Inc. S'holder Litig.*, 2015 WL 6155894, at *2 (Del. Ch. Oct. 20, 2015) (failure to investigate basic matters following discovery of a share-count error stated only an exculpated duty of care claim).

Plaintiff's reliance on *IBEW Local Union 481 Defined Contribution Plan & Trust ex rel. GoDaddy, Inc. v. Winborne*, 301 A.3d 596 (Del. Ch. 2023), is misplaced. As the Court of Chancery explained, the transaction and alleged valuation disparity in *Winborne* bear no resemblance to the allegations here. Op. 27 n.132. *Winborne* involved an internal, related-party transaction in which the company paid \$850 million to buy a liability that it contemporaneously valued at \$175.3 million. 301 A.3d at 626-27, 630-31; Op. 27 n.132. And, the \$175.3 million figure was not one of several competing forecasts: it was a balance sheet liability

prepared by management, audited by Ernst & Young, signed by the directors, and treated as a critical audit matter. *Winborne*, 301 A.3d at 626-27. The *Winborne* board approved a payment nearly five times that amount without any reconciling explanation. *Id.* This extreme valuation disparity, coupled with a conflicted process favoring the buyout's beneficiaries, supported an inference of bad faith. *Id.* at 626-32.

Nothing even close is alleged here. Plaintiff simply compares the standalone Management Projections with a presentation focused on the anticipated future economics of the Take-Private, and B. Riley's value of FRG following the contemplated restructuring. Those materials were prepared for different purposes and do not establish that B. Riley valued FRG at a fraction of the price it agreed to pay. Nor was the Take-Private an internal buyout situation. It followed an arm's-length negotiation with an independent Special Committee, represented by Wachtell and Jefferies, and B. Riley rejected FRG's \$33-per-share counterproposal to hold its offer at \$30 per share. A624.

c. FRG's Earnings Release and Proxy Statement did not alert the Audit Committee to misconduct at B. Riley.

Plaintiff next relies on FRG's May 10 earnings release and July 14 proxy statement as "red flags." Opening 39-40. Those disclosures described FRG's operating performance and the Take-Private. They did not disclose misconduct at B. Riley, or suggest that Bryant Riley deceived the Board. Information reflecting

that FRG faced headwinds, or that its results fell below projections, is business information not evidence of corporate misconduct. *See supra* Section II.C.1.b.

The timing of FRG's May 10 announcement does not support an inference of wrongdoing. Plaintiff alleges that FRG announced the Take-Private one minute before releasing disappointing first-quarter results and asserts that this timing should have alerted the Audit Committee that Bryant Riley had coordinated the announcements to support FRG's stock price. Opening 39-40. But the Complaint pleads no particularized facts supporting that inference, or that Riley controlled the timing of FRG's announcements and that the Audit Committee knew about it.

d. The December 2023 disclosures of the Vintage Loan and IAA were not red flags.

Plaintiff argues that B. Riley's December 2023 public disclosures of the Vintage Loan and IAA also served as red flags that Bryant Riley lied to the Board during the May 8 meeting. Opening 40-41. The disclosures Plaintiff cites establish only that the Vintage Loan and IAA existed—not that Bryant Riley previously misrepresented anything to the Board, that the Board was unaware of them, or that the Board was obligated to discuss every aspect of B. Riley's relationship with Vintage/Kahn during consideration of the Take-Private. The Complaint pleads no particularized facts showing that the disclosures contradicted any prior representation Bryant Riley made to the Board, or otherwise suggest he deceived the

Board. Without that missing piece, the disclosures could not constitute red flags requiring the Audit Committee to investigate or take remedial action against Riley.

2. Plaintiff Fails to Plead a Plausible Connection Between the Supposed “Red Flags” with B. Riley’s Corporate Trauma.

Plaintiff fails to connect any supposed red flag to the alleged corporate trauma. *Melbourne Mun. Firefighters’ Pension Tr. Fund ex rel. Qualcomm, Inc. v. Jacobs*, 2016 WL 4076369, at *8 (Del. Ch. Aug. 1, 2016) (corporate trauma “must be sufficiently similar to the misconduct implied by the red flags such that the board’s bad faith . . . proximately caused that trauma.” (internal quotation marks and citation omitted)), *aff’d*, 158 A.3d 449 (Del. 2017) (TABLE). B. Riley was damaged when it learned in November 2023, along with the whole world, that Kahn was an unnamed conspirator in Prophecy’s securities fraud, thereby jeopardizing its investment in FRG.

Plaintiff contends that FRG’s decline was caused not by revelations concerning Kahn’s connection to Prophecy, but because of FRG’s inability to finance Badcock receivables, poor performance, discontinuation of its dividend, and default on its loan agreement. Opening 43. Yet Plaintiff fails again to explain how any purported red flags actually alerted the Audit Committee to those risks. The alleged use of the January Projections, or the alleged failure to consider the Vintage Loan and IAA, do not suggest or predict that FRG would discontinue its dividend, default on its debt, or otherwise suffer the financial distress Plaintiff identifies as

corporate trauma. A209-211; A1156-1157. Indeed, the Complaint concedes that B. Riley's losses materialized only after Kahn's public implication in the Prophecy fraud triggered a series of events affecting FRG and, downstream, B. Riley's investment. *See, e.g., id.*; A79-86 (Compl. ¶¶ 232-257). Plaintiff cannot establish the causal connection required by *Melbourne Firefighters* by relabeling the consequences of that event as the corporate trauma.

Moreover, Plaintiff's causation theory fails on its own terms. Nothing in the Complaint supports the premise that B. Riley's post-closing strategy depended on continuing to finance Badcock receivables. To the contrary, B. Riley's acquisition strategy contemplated a restructuring of FRG. A581. The Complaint pleads no facts establishing that the alleged inability to continue financing Badcock receivables—the event Plaintiff identifies as the beginning of FRG's decline—was inconsistent with, or undermined, the acquisition strategy approved by the B. Riley Board.

III. THE COURT OF CHANCERY PROPERLY CONSIDERED THE ALLEGATIONS AND CORRECTLY FOUND THAT THE OUTSIDE DIRECTORS WERE INDEPENDENT

A. Question Presented

Did the Court of Chancery correctly conclude that Plaintiff failed to satisfy Delaware's rigorous pleading standard and overcome the presumption of director independence where the Complaint fails to plead particularized facts establishing that any Outside Director was beholden to, dominated, controlled by, or under the influence of an interested party such that their discretion was sterilized? A221-232.

B. Scope Of Review

This Court's review is *de novo*. *See supra* Section I.B.

C. Merits Of The Argument

Delaware law presumes director independence. Plaintiff bears the burden to plead particularized facts creating a reasonable doubt that a majority of the nine-person demand board could impartially consider a demand. *See Teamsters Union 25 Health Servs. & Ins. Plan v. Baiera*, 119 A.3d 44, 59 (Del. Ch. 2015); *Zuckerberg*, 262 A.3d at 1060. The Court of Chancery held that Plaintiff failed to overcome that presumption.¹³

¹³ For purposes of its motion, the Company did not argue Bryant Riley, Kelleher, or Antin's independence. Plaintiff had the burden to challenge the impartiality of at least two of: Brandt, D'Agostino, LaBran, Paulson, Sheldon or Walters. Op. 16.

Plaintiff's appeal rests principally on two theories. First, he argues that Paulson, D'Agostino, Sheldon and Walters lacked independence because they were named as defendants in a securities class action (*Donaldson*). Opening 45-46. Second, he argues that D'Agostino lacked independence from Bryant Riley based on a personal and professional relationship. *Id.* 46-49. Plaintiff makes no argument concerning Paulson's or Walters' independence apart from *Donaldson*, and his only additional argument as to Sheldon is that Sheldon served on the Compensation Committee that approved ordinary-course compensation for Bryant Riley and Kelleher. Opening 48-49. None of those allegations overcome Delaware's presumption of independence.

Further, Plaintiff forfeited any challenge to the Court of Chancery's independence determinations regarding Brandt and LaBran, and its decision not to address Paulson, by relegating those issues to a single footnote unsupported by argument. Opening 46 n.48; Del. Supr. Ct. R. 14(b)(vi)(A)(3); *see also Smith v. Del. State Univ.*, 47 A.3d 472, 479 (Del. 2012) (“[T]his Court generally will not review legal issues on appeal that are not fully and fairly presented in the opening brief.”); *Thomas v. State*, 293 A.3d 139, 141 (Del. 2023) (“Summary arguments unsupported by legal argument, analysis, and authority are waived.”). Neither Brandt nor LaBran is discussed in Plaintiff's independence argument. Plaintiff's only chance of

success, therefore, is to overcome the presumption of independence as to two of Paulson, D'Agostino, Sheldon, and Walters. He fails to do so.

1. The Donaldson Action Does Not Create a Reasonable Doubt about D'Agostino, Sheldon or Walters' Independence.

Plaintiff argues that D'Agostino, Sheldon and Walters lack independence because they were named as defendants in *Donaldson*. Opening 45-46. That argument fails.

First, the Complaint does not discuss the *Donaldson* action, the claims asserted in that action, or the facts Plaintiff now says the Court of Chancery should have considered. Plaintiff asks this Court to reverse based on matters outside the pleadings. That is impermissible. *See Cal. Pub. Emps.' Ret. Sys. v. Coulter*, 2002 WL 31888343, at *12 (Del. Ch. Dec. 18, 2002) (“Arguments in briefs do not serve to amend the pleadings.”).

Nor may Plaintiff satisfy his burden by outsourcing his pleading obligation to different plaintiffs in a different case. Rule 23.1 requires Plaintiff to plead with particularity, here, facts establishing that demand is excused in this action. References to parallel litigation do not suffice. *Rattner v. Bidzos*, 2003 WL 22284323, at *14 (Del. Ch. Sept. 30, 2003) (“conclusory and cryptic allegations” about a companion federal securities action insufficient to merit demand excusal under Rule 23.1).

Second, the claims in *Donaldson* are very different. They involve strict liability claims brought under Sections 11, 12, and 15 of the Securities Act of 1933, A1231, that have “no bearing on whether the directors [here] acted in good faith.” *In re Zimmer Biomet Hldgs., Inc. Deriv. Litig.*, 2021 WL 3779155, at *23-24 (Del. Ch. Aug. 25, 2021) (parallel securities action premised on Sections 11 and 15 of the Securities Act inapposite to derivative claims for bad faith because strict liability claims “do not require a showing of scienter”), *aff’d*, 279 A.3d 356 (Del. 2022) (TABLE).¹⁴

2. Plaintiff’s Allegations Concerning D’Agostino’s Relationship with Bryant Riley Do Not Rebut the Presumption of Independence.

Plaintiff argues that the Court of Chancery failed to consider D’Agostino’s independence holistically. Opening 46-48. Plaintiff is wrong: the Court of Chancery recognized that independence allegations are considered in their totality and evaluated Plaintiff’s allegations concerning D’Agostino’s alleged personal, professional, board and financial ties. Op. 32-33, 39-41 (court considers the facts “in their totality and not in isolation”). Nothing in the Court’s opinion suggests that it applied a piecemeal standard. Op. 39-41.

¹⁴ Plaintiff’s *Donaldson* theory is the only point Plaintiff identifies in the Court of Chancery’s independence analysis about Walters and Paulson. Plaintiff’s challenge to Walters’ and Paulson’s independence falls with his *Donaldson* theory.

Rather than address that holding head-on, Plaintiff repackages the same allegations he argued below: that D’Agostino and Bryant Riley attended the same university, belonged to the same fraternity, remained friends, socialized, served together on the Board, participated in other board nominations and D’Agostino received ordinary director compensation. Opening 47-48. As the Court of Chancery concluded, none of these allegations, whether considered individually or collectively, supports a reasonable inference that D’Agostino was so beholden to Bryant Riley that he lacked independence. Op. at 39-41; *Beam ex rel. Martha Stewart Living Omnimedia, Inc. v. Stewart*, 845 A.2d 1040, 1051-52 (Del. 2004) (allegations that directors “moved in the same social circles, attended the same weddings, developed business relationships before joining the board, and described each other as ‘friends,’” insufficient to rebut presumption of independence); *Crescent/Mach I P’rs, L.P. v. Turner*, 846 A.2d 963, 980-981 (Del. Ch. 2000) (allegation of “long-standing 15-year professional and personal relationship” insufficient to defeat independence); *Highland Legacy Ltd. v. Singer*, 2006 WL 741939, at *5 (Del. Ch. Mar. 17, 2006) (“conclusory allegations” that the directors were dominated by the interested party because they served together on a few boards of unaffiliated companies insufficient to defeat independence); *Aronson v. Lewis*, 473 A.2d 805, 816 (Del. 1984) (board nomination is insufficient to defeat independence), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del.

2000); *Simons v. Brookfield Asset Mgmt. Inc.*, 2022 WL 223464, at *15 (Del. Ch. Jan. 21, 2022) (payment of director fees is insufficient to defeat independence).

Plaintiff's attempt to distinguish *Highland Legacy* misses the point. Opening 48. Plaintiff argues *Highland Legacy* is inapposite because the case did not involve a personal friendship. *Id.* But the Court of Chancery cited *Highland Legacy* for a different proposition: that "past service on outside boards or being nominated by an interested party does not impugn a director's current independence." Op. 40 & n.187.

Holistically, Plaintiff's allegations amount to this: D'Agostino and Bryant Riley have known each other for a long time, socialized, overlapped professionally, and served together on boards. Delaware law is clear that those ordinary relationships do not overcome the presumption of independence.

3. Service on the Compensation Committee Does Not Strip D'Agostino or Sheldon of Independence.

Plaintiff argues that D'Agostino and Sheldon lack independence because they served on the Compensation Committee and approved ordinary-course compensation for Bryant Riley and Kelleher. Opening 48-49. Approving executive compensation is one of the responsibilities of a board committee. Plaintiff pleads no particularized facts suggesting that the exercise of that responsibility created a relationship of domination or material dependence. Nor does Plaintiff explain why

approving ordinary-course compensation would render directors unable to consider a demand.

IV. THE COURT MAY AFFIRM ON ALTERNATIVE GROUNDS

A. Question Presented

Can the Court of Chancery's judgment be affirmed as to the Outside Directors on the alternative ground that Plaintiff failed to state a claim under Rule 12(b)(6), where Plaintiff engaged in impermissible group pleading and failed to plead a non-exculpated claim against any Outside Director? *See, e.g.*, A1003-24; A1184-86; A1220-26.

B. Scope of Review

This Court may affirm the Court of Chancery's judgment on any ground supported by the record. *See Hercules Inc. v. AIU Ins.*, 783 A.2d 1275, 1277 (Del. 2000). Dismissals under Rule 12(b)(6) are reviewed *de novo*. *See, e.g., In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 167-68 (Del. 2006).

C. Merits of the Argument

The Court should affirm under Rule 23.1. Independently, the judgment can be affirmed as to Counts III and IV against the Outside Directors because Plaintiff failed to plead a non-exculpated claim under Rule 12(b)(6). Having dismissed the Complaint for failure to plead demand futility, the Court of Chancery had no need to reach the Outside Directors' separate Rule 12(b)(6) arguments. Op. 41. Those arguments provide an additional basis to affirm as to the Outside Directors.

Counts III and IV are breach of fiduciary-duty claims brought only against the Outside Directors. Because the Outside Directors are protected by an exculpatory

provision, *supra* Statement of Facts Section A, Plaintiff was required to “plead a non-exculpated claim” against each of them. *In re Cornerstone Therapeutics*, 115 A.3d at 1179-1180. Facts sufficient to plead demand futility are not necessarily enough under *Cornerstone*’s demanding standard. *See, e.g., Atallah v. Malone*, 2023 WL 4628774, at *13-14 (Del. Ch. July 19, 2023) (dismissing claim against outside director where plaintiffs sufficiently pled demand futility). And group pleading fails as a matter of law. *See In re Tangoe, Inc. S’holders Litig.*, 2018 WL 6074435, at *12 (Del. Ch. Nov. 20, 2018).

Under *Cornerstone*, Plaintiff had three routes to plead non-exculpated claims. He could have alleged “facts supporting a rational inference that [the Outside Directors] [1] harbored self-interest adverse to the stockholders’ interests, [2] acted to advance the self-interest of an interested party from whom they could not be presumed to act independently, or [3] acted in bad faith.” *Cornerstone*, 115 A.3d at 1179-80. Plaintiff conceded below that he was pursuing only the third route: bad faith. A1121-22. For the reasons discussed here and in the Outside Directors’ opening briefing below, *see* A1017-24, Plaintiff failed to allege bad faith as to any Outside Director.

First, Plaintiff relies on impermissible group pleading. Because “each director has a right to be considered individually when the directors face claims for damages in a suit challenging board action,” *Cornerstone*, 115 A.3d at 1182,

“liability of the directors must be determined on an individual basis.” *In re Emerging Commc’ns, Inc. S’holders Litig.*, 2004 WL 1305745, at *38 (Del. Ch. May 3, 2004); *accord Cornerstone*, 115 A.3d at 1182 & n.36. The Complaint does not satisfy that requirement.

Plaintiff’s allegations against Antin, Brandt, D’Agostino, LaBran, Sheldon, and Walters make the defect clear. Rather than plead that any particular Outside Director had “separate discussions with [Riley]” or took “a particularly active role in” the challenged conduct, *In re BGC Partners, Inc. Derivative Litig.*, 2021 WL 4271788, at *12 (Del. Ch. Sept. 20, 2021), Plaintiff focuses on actions by committees as a whole, directors’ compensation, alleged prior links to Riley, and attendance at Board meetings where transactions were approved and investigatory updates were provided. *See, e.g.*, A31-168 ¶¶ 37-40, 42-45, 58-61, 63-64, 276, 282, 284, 309, 318, 321, 415, 433-88, 487, 502-04, 506, 510-11. In other words, Plaintiff “attempt[s] to coax out an inference of disloyalty based on group pleading against the [Board and various] Committee[s] as a whole.” *Atallah*, 2023 WL 4628774, at *13. That is insufficient. *Id.*

Second, Plaintiff fails to plead bad faith. *Cornerstone*’s third prong applies “where a director knowingly violates the law or undertakes intentional misconduct unrelated to a desire to advance the interests of a conflicted party.” *In re BGC*, 2021 WL 4271788, at *11. The question is whether “the director[s] exercise[d]

‘subjective bad faith.’” *Id.* (citation omitted). Adequately alleging bad faith is “necessarily a difficult burden to carry,” and “an inference of bad faith does not arise merely from a director’s allegedly deficient performance.” *Ligos v. Tsuff*, 2022 WL 17347542, at *9 (Del. Ch. Nov. 30, 2022). Rather, “the facts [pled] must be sufficiently egregious that, despite lack of self-interest or dependance on any interested party, a court may find it reasonably conceivable that the fiduciary was acting against the interest of the entity.” *Id.* That inference is especially unwarranted here, where the Outside Directors had significant “skin in the game” through substantial company stock ownership. *Cf. In re Oracle Corp. Deriv. Litig.*, 867 A.2d 904, 930 (Del. Ch. 2004) (commentators recognize that owning company stock tends to align insider interests with public stockholders).

Plaintiff’s allegations fall well short of this demanding requirement. There are no allegations of illegal activity by any Outside Director—let alone any allegation that one “knowingly violate[d] the law.” *In re BGC*, 2021 WL 4271788, at *11. Nor does Plaintiff plead an intentional dereliction of duty or a deliberate effort to act contrary to B. Riley’s interests by any Outside Director. *See supra* Section II.C.; A1003-1024; A1220-1226. Armed with hindsight, Plaintiff instead challenges the extent to which certain Outside Directors informed themselves or the efficacy of their responses to alleged issues. But the former is no more than an exculpated breach of the duty of care, *see supra* Section II.C.1.b., and the latter

merely “quibble[s] with the timing or success of corrective action” and thus “necessarily fail[s],” *see Clem v. Skinner*, 2024 WL 668523, at *8 (Del. Ch. Feb. 19, 2024).

Plaintiff’s own allegations show the opposite of bad faith. In the weeks and months after Kahn’s connection to the Prophecy fraud became public, the Board and Audit Committee launched two robust investigations, neither of which found wrongdoing by B. Riley. That is good faith. Plaintiff failed to plead a non-exculpated claim under Rule 12(b)(6) against the Outside Directors, and the dismissal of Counts III and IV can be affirmed on that basis as well.

CONCLUSION

The judgment of the Court of Chancery dismissing the Complaint should be affirmed in full.

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Dated: July 30, 2026

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