



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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APPELLANT'S REPLY BRIEF

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INTRODUCTION

The facts here go way beyond that of a business decision gone awry. B.Riley's CEO Bryant Riley lied to his Board concerning the \$216.50 million Take-Private Transaction of Franchise Group, Inc. Among other things, Riley provided his Board with materially false information about FRG's financial condition and concealed that B.Riley had an outstanding \$200.5 million loan to Brian Kahn's Vintage Capital Management, which was non-performing and under-collateralized by shares of FRG, as well as a \$64.6 million equity interest in FRG through a Kahn-related Investment Advisory Agreement. Because everyone involved failed to do what was right, B.Riley, through a corrupted approval process, committed \$481.6 million to a single entity with a deteriorating financial condition, entangling financially with a man (Kahn) who would later plead guilty to securities fraud.

Because the Company lacked a reasonable Board-level system of information and reporting, Riley's misconduct went undetected. Moreover, the Board's Audit Committee, which was charged with oversight, ignored clear warning signs of Riley's deception.

Riley, without Board approval, subsequently approved an additional Kahn-related commitment—the \$108 million loan to Conn's Inc. to facilitate the company's acquisition of W.S. Badcock LLC, an FRG subsidiary. For the sins of its Board, B.Riley suffered over \$589.6 million in losses, including complete write-

downs on its FRG investments and an astounding \$1.025 billion dollar (89%) loss in market value of the Company's common stock.

Rather than address these incredible facts head on, Defendants hide behind a Trojan Horse of *Caremark* arguments, misstating the relevant standards, drawing unreasonable inferences in their favor, and ignoring important distinctions of fact and law. Defendants' arguments are unpersuasive. B.Riley's Outside Directors face *Caremark* I liability for failing in good faith to implement a reasonable system of oversight. B.Riley's Audit Committee (consisting of Paulson, D'Agostino, and LaBran) face *Caremark* II liability for failing to respond to red flags of Riley's misconduct. In addition, certain directors lack independence from Riley and cannot impartially consider a demand. For the reasons discussed in Plaintiff's Opening Brief ("OB") and below, the Chancery Court erred in its conclusion that demand was not futile.

ARGUMENT

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

A. The Existence of Any Board-Level Reporting and Oversight Systems Does Not Provide Universal Protection Against Liability Under *Caremark* I

Defendants argue that the existence of *any* board-level reporting and oversight system vitiates a claim under *Caremark* I. Defendants’ Answering Brief (“AB”) at 13-18. This is not the law. Defendants ignore *Caremark* I’s “bottom-line requirement that is important: the board must make a good faith effort—*i.e.*, try—to put in place a reasonable board-level system of monitoring and reporting.”¹ “To avoid rendering this bottom-line requirement ‘a chimera,’ this 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.”² Plaintiff does not contend, as Defendants suggest, that B.Riley’s systems should “have operated perfectly or identified every risk.” AB.13-14. Rather, B.Riley’s so-called “board-level reporting and oversight systems” were wholly ineffectual and not “‘reasonably designed to provide to senior management and to the board itself *timely, accurate*

¹ *Marchand v. Barnhill*, 212 A.3d 805, 821 (Del. 2019).

² *Giuliano v. Grenfell-Gardner*, 2025 Del. Ch. LEXIS 224, at *18-19 (Del. Ch. Sep. 2, 2025).

information sufficient to allow management and the board...to reach informed judgments concerning both the corporation's compliance with law and its business performance.'"³ The Complaint's allegations demonstrate that those systems failed to inform the Board of critical information and risks facing the Company at multiple stages, establishing that the Board failed to make the required good faith effort.

Contrary to Defendants' assertion, information not received by the Board directly relates to whether the Board failed to put a system in place. AB.15-16. For example, allegations that the Board did not receive timely information related to risks, including from the Company's ongoing purchases of FRG receivables and the \$200.5 million loan to Kahn's Vintage Capital, directly concern whether the Board tried to put in place a reasonable board-level system of monitoring and reporting" not whether an existing system functioned.⁴ The lack of *any* Audit Committee meetings or minutes prior to 12-13-23, produced in response to Plaintiff's books and records request (A118-120, ¶¶378-383), establishes that no relevant information was received by the Board. Indeed, there is a complete lack of any Board minutes prior to 5-8-23. A112-121, ¶¶363-390.

³ *Giuliano*, 2025 Del. Ch. LEXIS 224, at *19 (citing *In re Caremark Int'l*, 698 A.2d 959, 970 (Del. Ch. 1996)).

⁴ *Marchand*, 212 A.3d at 821.

Defendants argue that in contrast to Plaintiff's cited cases⁵ where the "mission-critical" risks were not addressed by the existing board-level oversight systems, B.Riley's board-level oversight systems were "directed to the very financial and investment risks Plaintiff identifies." AB.16-17. Defendants, however, provide no argument or support that the actual system implemented followed the Audit Committee's written policies and procedures or was otherwise reasonable. Having written policies and procedures for board-level systems of monitoring and reporting is insufficient if no such systems are reasonably implemented.⁶

Defendants wrongly dismiss Plaintiff's contention that B.Riley failed to establish oversight over a "mission critical" aspect of its business, namely its investments. AB.17. First, this argument was, in fact, raised below. *See* A1057,Opp.17 ("[T]he Board had no processes for evaluating or approving material investments."); A1388,Tr.37 ("[I]n *Marchand*, it was the board's job to scrutinize critical aspects of the business. This is an investment company. So how are you going to scrutinize the operations of the company other than through an investment

⁵ *In re Boeing Co. Deriv. Litig.*, 2021 Del. Ch. LEXIS 197 (Del. Ch. Sept. 7, 2021); *Giuliano*, 2025 Del. Ch. LEXIS 224.

⁶ *See Hughes v. Xiaoming Hu*, 2020 Del. Ch. LEXIS 162, at *41 (Del. Ch. Apr. 27, 2020) ("The mere existence of an audit committee and the hiring of an auditor does not provide universal protection against a *Caremark* claim."); *Rich ex rel. Fuqi Int'l, Inc. v. Yu Kwai Chong*, 66 A.3d 963, 983 (Del. Ch. 2013) (acknowledging *Caremark* I claim despite the existence of an audit committee and independent auditor where the company had no "meaningful controls in place").

committee?”). Second, the Audit Committee here was primarily tasked with general risk monitoring and assessment.⁷ A1086,Opp.46; A979-989; A132,¶426. This limited scope does not satisfy the same responsibilities as an Investment Committee, including the evaluation and assessment of transactions and investments in real time. In the absence of an Investment Committee, Riley “possessed unfettered discretion to transact on behalf of the Company and...the Board implemented no oversight over his ability to do so.” OB.28. Indeed, this absence allowed B.Riley, a company with a market capitalization of approximately \$1 billion, to risk exposing upwards of \$481.6 million to a single entity.

The Chancery Court’s cited authorities stand only for the general proposition that “to succeed under [*Caremark* I], ‘the Complaint must plead facts supporting a reasonable inference that the board did not make a good faith effort.’” AB.17-18. These factually distinct cases provide no guidance as to whether Defendants actually made a good faith effort. *See* OB.34-35 (“In *Fisher v. Sanborn*, the complaint contained specific allegations that the risk committee was routinely updated on

⁷ When the Audit Committee determined to investigate potential wrongdoing at B.Riley, its first instinct was to hire existing company counsel. A92,¶282. While the law firm investigations concluded that Riley had no knowledge of Kahn’s conduct at Prophecy, there was no finding that Riley was unaware of Kahn’s or FRG’s financial distress (and the Vintage Loan terms suggest the opposite). A97,¶302; A103-104,¶331. Notably, Defendants refused to produce the written reports of either investigation in response to Plaintiff’s books and records request. A112-121,¶¶363-390.

[risks]”)⁸; *id.* (“In *Guttman v. Jen-Hsun Huang*, ... the complaint failed to allege any facts about the board’s oversight.”)⁹; *id.* (“In *In re MetLife Deriv. Litig.*, the court found ‘an extensive network of internal controls’”)¹⁰. These cases in no way stand for Defendants’ overstated proposition that “the existence of [any] Board-level internal controls,” regardless of whether they were reasonably implemented, requires dismissal of a *Caremark* I claim. AB.18.

B. The Complaint Makes Particularized Allegations that Demonstrate a Sustained or Systematic Failure of Oversight

Defendants try to undercut Plaintiff’s *Caremark* I claim by asserting that the Complaint’s allegations relate to “a single investment decision.” AB.19. However, Defendants fail to explain how allegations that the Board failed to receive or consider critical information starting well before the 5-8-23 Board Meeting and continuing for almost a year—spanning the entire timeline of Defendants’ § 220 production—does not constitute “a sustained or systematic failure of the board to exercise oversight.” Plaintiff does not simply allege that the Board should have received additional information. AB.20. Plaintiff makes particularized allegations that B.Riley’s reporting and information systems were so unreasonable that the Board

⁸ 2021 Del. Ch. LEXIS 61, at *23-25 (Del. Ch. Mar. 30, 2021).

⁹ 823 A.2d 492, 506-07 (Del. Ch. 2003).

¹⁰ 2020 Del. Ch. LEXIS 265, at *32-34 n.188 (Del. Ch. Aug. 17, 2020).

did not receive any critical information concerning the Take-Private Transaction until such information was publicly disclosed in the Company's own filings.

Defendants similarly assert that the Board's lack of diligence into Kahn relates only to "a single transaction." AB.20. This is wrong. B.Riley had engaged in multiple business ventures with Kahn and Kahn-affiliated entities since at least 2018. A40-41, ¶¶69-70, 73-77; A1341-A1342, 12-17-25 Letter. There is no evidence that the Board received any information concerning prior lawsuits and investigations implicating Kahn, indicating the complete absence of a reasonable information or reporting system. A112-120, ¶¶363-383. Indeed, there is no indication that the Board was made aware of the \$200.5 Loan¹¹ to Kahn, let alone the use of the proceeds from the loan, or the \$64.6 million IAA between B.Riley and Kahn prior to B.Riley's public disclosures.

These allegations do not challenge the lack of additional diligence from B.Riley. AB.20. They demonstrate that no system was established in the first place,

¹¹ The Vintage Loan evidences FRG's financial distress. The loan was non-performing PIK and inadequately collateralized with FRG common stock. Defendants argue that the loan was "both overcollateralized and performing" at the "relevant disclosure." AB.19n.8. However, that "value" was based on the orchestrated \$30/share take-private price, rather than the fair value of FRG common stock. On the pre-offer date of March 17, 2023, the collateral was valued at \$172.4 million by the market. A53, ¶115; A1049, Opp.9. Moreover, the loan only bore payment-in-kind interest of 12%, which added debt onto the loan, and was not performing on a cash basis. A77, ¶220.

which enabled Riley to double down to \$481.6 million on B.Riley's exposure to FRG (which Riley understated to the Board was only \$200 million).

Defendants cite *Okla. Firefighters Pension & Ret. Sys. v. Corbat* for the proposition that a flawed or ineffective compliance system does not support bad faith under *Caremark I*.¹² AB.20-21. However, *Corbat* declined to find bad faith in the context of ineffective responses to red flags, not in the context of repeated failures of the Board to implement a reasonable oversight system.¹³

Defendants argue that "Plaintiff is not entitled to the inference that the Board did not discuss the [May/June] Management Projections, Vintage Loan, IAA, or differing FRG projections when analyzing the Take-Private Transaction[.]" regardless of the fact that there is no reference to these topics in the 5-8-23 Board Minutes. AB.21. This makes no sense. Plaintiff is entitled to reasonable, plaintiff-friendly inferences that logically flow from the facts.¹⁴ The omitted topics would have facilitated robust discussion. "Consequently, if a document supports more than one inference, and if the inference that the plaintiffs seek is reasonable, then the

¹² 2017 Del. Ch. LEXIS 848 (Del. Ch. Dec. 18, 2017).

¹³ 2017 Del. Ch. LEXIS 848, at *73-78.

¹⁴ See *United Food & Commer. Workers Union v. Zuckerberg*, 262 A.3d 1034, 1048 (Del. 2021) ("The Court...must accept as true all of the complaint's particularized and well-pleaded allegations, and must draw all reasonable inferences in the plaintiff's favor.").

plaintiffs receive the inference.”¹⁵ Moreover, the April Presentation contains no reference to any of the concealed items, further supporting the inference that they were not discussed by the Board. A573-592. Defendants’ cases are inapt. AB.21-22. There are no Board Materials similar to those in *Petry v. Smith*, allowing the court to draw the contrary inference of board discussions.¹⁶ Moreover, in *In re Baker Hughes Inc. Merger Litig.*, plaintiffs sought to draw an inference that the board and its advisors acted inconsistent with its normal process, a contention that was directly contradicted by other evidence.¹⁷ Here, there is no such speculation.

Plaintiff’s *Caremark* I claim does not assert that the Board never reviewed or discussed the Take-Private Transaction. *See* AB.22. Rather, Plaintiff’s *Caremark* I claim takes issue with the reasonableness of the board-level information and reporting systems, which failed to provide critical information to the Board that was otherwise withheld by Riley.

¹⁵ *In re McDonald’s Corp. Stockholder Deriv. Litig.*, 291 A.3d 652, 695 (Del. Ch. 2023); *see also Ont. Provincial Council of Carpenters’ Pension Tr. Fund v. Walton*, 2023 Del. Ch. LEXIS 92, at *32 (Del. Ch. Apr. 26, 2023) (holding that absence of evidence in minutes about action taken by committee in minutes “supports a plaintiff-friendly inference that the [committee] failed to take action.”); *Teamsters Loc. 443 Health Servs. & Ins. Plan v. Chou*, 2020 Del. Ch. LEXIS 274, at *67 (Del. Ch. Aug. 24, 2020) (holding that “Plaintiff is entitled to the inference that the Board never discussed the subpoena due to its absence from the Board’s minutes.”).

¹⁶ 2021 Del. Ch. LEXIS 134, at *24-27 (Del. Ch. June 28, 2021).

¹⁷ 2020 Del. Ch. LEXIS 321, at *28-30 (Del. Ch. Oct. 27, 2020).

Defendants provide no evidence in their § 220 production that the Audit Committee was aware of the Vintage Loan or the Badcock receivables.¹⁸

Defendants excuse the Board's lack of reporting on the "balance sheet risk" from Badcock receivables because the Take-Private Transaction "contemplated eliminating that exposure through the planned restructuring of FRG[.]" AB.23. The absence of this risk, however, from any Board discussion prior to the 5-8-23 Board Meeting demonstrates the lack of ordinary course Board-level reporting systems. Moreover, the April Presentation does not present Badcock's deteriorating financial condition as a direct risk to B.Riley's balance sheet; it only discusses Badcock as part of the restructuring of FRG. A573-A592.

Finally, Plaintiff does not collapse *Caremark*'s two distinct theories of liability. AB.24. Simply put, Plaintiff's *Caremark* I theory is that Defendants failed to make a good faith effort to implement a reasonable system of oversight, as evidenced by the complete absence of critical information reaching the Board at multiple stages surrounding the Take-Private Transaction.

¹⁸ Defendants contend that Plaintiff cannot assert, at the same time, under *Caremark* II, that the Audit Committee had knowledge of the Vintage Loan and under *Caremark* I that there was no effective reporting system at the Audit Committee to inform the Board about the Vintage Loan. AB.22-23. Plaintiff is allowed to plead his claims in the alternative.

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

A. Plaintiff Adequately Pleads Red Flags

Plaintiff argues in the alternative that if the Audit Committee had knowledge of the true facts concerning Kahn and FRG, demand is still excused under *Caremark* II.

Defendants assert that Riley's omission of critical information during the 5-8-23 Board Meeting could not have served as a red flag to the Audit Committee "because the investment thesis of the FRG Take-Private...was that FRG was a struggling business in need of a significant restructuring." AB.26. Plaintiff does not gainsay that Riley may have had a subjective (albeit irrational) belief that he could turn FRG around as a private company. Even so, that investment thesis did not give Riley license to deceive the Board by presenting them with stale and misleading financial information and omitting that B.Riley already faced significant exposure to the company via the Vintage Loan.¹⁹

To avail themselves of the protections of the business judgment rule, Defendants mischaracterize the red flags as "concern[ing] the Board's assessment of investment risk, transaction structure, valuation, client service, financing decisions

¹⁹ There is substantial doubt as to whether the Board actually approved the Take-Private Transaction. A62, ¶¶157-158; A863-867.

and portfolio company performance.” AB.26. This characterization misunderstands Plaintiff’s theory. Plaintiff does not fault the Audit Committee for its evaluation of the Take-Private Transaction from a process standpoint. Plaintiff faults the Audit Committee for receiving red flags that Riley lied to the rest of the Board about the Take-Private Transaction and failing to respond in any way. When viewed in context and connection with Riley’s presentation of the Take-Private Transaction, “[e]ach of the April Presentation; Badcock-related ‘balance sheet risk’; FRG’s 2023 operating results and public disclosure; and the Vintage loan and IAA with Brian Kahn,” reveal Riley’s active deceit on his Board. *Id.* Defendants’ cited cases are inapt.²⁰

1. The Audit Committee Had Knowledge of Riley’s Deceit

Defendants assert that the Complaint does not adequately plead “that the Audit Committee actually possessed the information attributed to it.” AB.27-28.²¹ Defendants fail to meaningfully challenge the reasonable inferences drawn from the

²⁰ Each of Defendants’ cases deal with reasonable judgments relating to business risk, not wholesale misconduct. *In re ProAssurance Corp. Stockholder Deriv. Litig.*, 2023 Del. Ch. LEXIS 385, at *30 (Del. Ch. Oct. 2, 2023) (business risk related to underwriting large physician groups); *In re Citigroup Inc. S’holder Deriv. Litig.*, 964 A.2d 106, 125, 131 (Del. Ch. 2009) (business risk related to the subprime mortgage market); *Firemen’s Ret. Sys. v. Sorenson*, 2021 Del. Ch. LEXIS 234, at *30-31 (Del. Ch. Oct. 5, 2021) (business risk related to cybersecurity).

²¹ As discussed *supra* (at 11), Defendants’ assertion that the Take-Private Transaction was designed to eliminate any risk relating to Badcock receivables should be rejected. As discussed *supra* (at 11 n.18), Defendants’ coexistence argument should also be rejected.

facts.²² First, the Audit Committee had knowledge of the Vintage Loan— independent of Paulson—because it received a quarterly report of B.Riley’s loan portfolio. A79,¶228 n.84. Considering that the Vintage Loan comprised approximately one-third of B.Riley’s loan portfolio (A1086,Opp.46), it is not speculative to say that the Audit Committee would have monitored FRG’s financial statements, including FRG’s 4Q22 and 1Q23 results, which both raised red flags as to the projections in the April Presentation. Second, even if the Audit Committee was not informed by Paulson of the Badcock-related balance sheet risk, the IAA commitment, or the Management Projections—which would only support the *Caremark* I claim—they became aware of these items through subsequent filings and still failed to act.

Unlike Defendants’ cited cases, Plaintiff does not seek to establish director knowledge through speculative inferences.²³ In *City of Detroit Police & Fire Ret. Sys. v. Hamrock*, the court failed to infer board knowledge of an operational notice even though that specific operational risk fell within the responsibility of the board’s

²² Any suggestion that the Audit Committee lacked knowledge of red flags only supports their indolence under *Caremark* I.

²³ See *In re Kraft Heinz Demand Refused Deriv. Stockholder Litig.*, 2024 Del. Ch. LEXIS 253, at *22-23 (Del. Ch. July 19, 2024) (rejecting speculative inference that director knew that the company’s impairment testing was ineffective, actively hid that fact, and allowed it to continue based on the director attending board and audit committee meetings where “distressed reporting units, trademarks, and brands suffering from impairment risks were discussed.”).

Environmental, Safety and Sustainability Committee (“ESS Committee”).²⁴ Plaintiff here does not seek to impose knowledge of the relevant information to the Board but rather the Audit Committee. Moreover, the operational notice in *Hamrock* was not prepared for the Board or the ESS Committee, nor was it the type of information that the ESS Committee regularly received.²⁵ Here, Plaintiff makes particularized allegations that the information at issue fell within the Audit Committee’s domain in the ordinary course as part of their oversight responsibilities.

Defendants further contend that Plaintiff did not adequately plead that Riley’s omissions at the 5-8-23 Board Meeting “should itself have alerted the Audit Committee that Riley was misleading the Board.” AB.27. The notion that Riley’s omission of material information—that would have otherwise provided the Board with a full understanding of the Take-Private Transaction—was perceived by the Audit Committee as a conscious and benign exercise of managerial discretion, rather than an active deceit, should be rejected.

2. The Concealed Information Served as Red Flags of Riley’s Misconduct

Defendants assert that Riley’s use of the stale and misleading January Projections rather than the Management Projections “reflects a business judgment regarding how to evaluate a transaction[.]” AB.30. First, active concealment is not

²⁴ 2022 Del. Ch. LEXIS 159, at *57-61 (Del. Ch. June 30, 2022).

²⁵ *Id.*

business judgment. It would be different if Riley informed his Board of the unfavorable Management Projections but discounted them for any number of reasons and chose to use the January Projections.

Second, Defendants assert business judgment because the Board discussion focused on B. Riley's own evaluation and calculations of the Take-Private Transaction, rather than FRG's Management Projections. But Riley's projections incorporated the discredited January Projections. A59;¶¶140-142. This is unlike Defendants' cases, wherein a business decision was made by an informed Board, rather than one (deceitful) person.²⁶

Defendants point to B.Riley's rejection of FRG's \$33-per-share counterproposal as a sign that the Board didn't blindly accept Riley's suggestion. AB.31. However, there is no evidence that this counterproposal was discussed at the Board-level. The counteroffer was both made and rejected on April 28, 2023—well before the Board knew about the Take-Private Transaction.²⁷

²⁶ In *ProAssurance*, the “Audit Committee and Board were regularly informed that larger accounts presented higher liability risks.” 2023 Del. Ch. LEXIS 385, at *32-33. In *Citigroup*, the court declined to find bad faith where the defendants were aware of signs of a deterioration in the subprime mortgage market but failed to “cause Citigroup to change its investment policy to limit its exposure to the subprime market.” 964 A.2d at 125, 131.

²⁷ Defendants excuse the Chancery Court's confusion that the Board participated in the seminal April 2023 decision to confirm the \$30 per share offer notwithstanding the dramatic headwinds facing FRG. See Op.27; AB.31 n.12. The Court's error is too significant to ignore.

The Audit Committee’s failure to respond to red flags establishes non-exculpated bad faith.²⁸ Unlike Defendants’ cited cases, the Audit Committee’s bad faith does not arise from its failure to inform itself of certain information. AB.31-32. In *McElrath v. Kalanick*, the court held that the board’s failure to inform itself of a third-party investigator’s preliminary and final reports at the time the board approved the transaction and prior to the close of the transaction, respectively, did not amount to bad faith.²⁹ Here, the Audit Committee had actual knowledge of the red flags evidencing misconduct—namely, the information that directly contradicted or was omitted by Riley’s presentation of the Take-Private Transaction. In *In re TIBCO Software Inc. Stockholders Litig.*, the court similarly declined to find bad faith where the Board failed to further inform itself after learning that its final proposal to acquire another company was based on inaccurate information.³⁰ However, in *TIBCO*, the Board did in fact meet “twice after the share count error was discovered to access and respond to the situation...including at least once with [its financial advisor].”³¹

²⁸ *Chou*, 2020 Del. Ch. LEXIS 274, at *47 (“Plaintiffs must ‘plead [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.’”).

²⁹ 2019 Del. Ch. LEXIS 107, at *27-44 (Del. Ch. Apr. 1, 2019).

³⁰ 2015 Del. Ch. LEXIS 265 (Del. Ch. Oct. 20, 2015).

³¹ *Id.* at *75.

Defendants fail to distinguish *IBEW Local Union 481 Defined Contribution Plan & Tr. v. Winborne*³², providing no analysis as to how the facts differ and why it matters. AB.32-33. Defendants draw an apples-to-oranges distinction between the Management Projections and the April Presentation, stating that the April Presentation was prepared for a different purpose and related to “B.Riley’s value of FRG.” AB.33. However, the April Presentation used information from the January Projections provided by FRG, which were an earlier, outdated version of the Management Projections. A59; ¶¶140-142. Riley’s use of one versus the other does evidence bad faith, when the stated projections “differed so dramatically.”³³ The fact that B.Riley rejected FRG’s \$33-per-share counterproposal or that FRG (not B.Riley) retained a Special Committee does not automatically render the transaction arm’s length. AB.33. Rather, “[i]t was a negotiation under duress with a third party (Kahn) that had an outstanding debt exceeding \$200 million.” OB.14 n.6. At the same time, B.Riley had been engaged in substantial purchases of accounts receivable from Badcock, an FRG subsidiary.

FRG’s 1Q23 results and the July 14 Proxy Statement *were* red flags that alerted the Audit Committee to Riley’s misconduct. AB.33-34. The 1Q23 results were significantly lower than the January Projections (on an annualized basis) that

³² 301 A.3d 596 (Del. Ch. 2023).

³³ *Winborne*, 301 A.3d at 627.

Riley provided the Board on 5-8-23, which should have raised questions with the Audit Committee. A66,¶178. The Proxy Statement revealed that Riley received the updated Management Projections prior to the 5-8-23 Board Meeting, but did not present them to his Board. A57,¶131. The Proxy Statement also disclosed the background leading up to the Take-Private Transaction, including FRG's deteriorating condition. A70-71,¶198. The disclosures reveal Riley's conscious decision to skew the Board's opinion in favor of the Take-Private Transaction by concealing relevant information.

B.Riley coordinated with FRG to announce the Take-Private Transaction contemporaneously with FRG's 1Q23 results.³⁴ A56,¶127. Defendants, however, contend that there are no facts supporting the inference that this coordination was "to support FRG's stock price...or that Riley controlled the timing of FRG's announcements and that the Audit Committee knew about it." AB.34. Riley was aware of the Management Projections, which previewed FRG's disappointing 1Q23 operating results. A57,¶131. There is a strong inference that Riley's agreement to coordinate with FRG was to stabilize FRG's stock price despite disappointing results and to prevent the market (and his Board) from recognizing the full extent of FRG's deteriorating condition. Defendants offer no alternative theory. A65-66,¶¶172,176.

³⁴ Riley's agreement to pay \$30 per share for a failing company and the timing of the transaction suggest that Riley was either somehow beholden to Kahn or acting out of desperation to avoid writing off the \$200.5 million PIK loan.

B. There is a Direct Connection Between the Red Flags and B.Riley's Corporate Trauma

Defendants, as did the Chancery Court, assert that the red flags are not connected to the corporate trauma. AB.35. Defendants, however, provide no justification for attributing the collapse of FRG to one man's actions that occurred outside of the company. Indeed, Kahn's resignation in January 2024 did not prevent FRG from later filing for bankruptcy in November 2024. A109, ¶352. Moreover, there is no legal distinction. If Defendants' breaches of fiduciary duties caused B.Riley to commit almost \$500 million of assets to a deteriorating company, they are liable for those consequences.³⁵ In any event, whether damages were caused by the news of Kahn's Prophecy fraud or by FRG's collapse is a disputed issue for trial.

Defendants question how any of the "red flags actually alerted the Audit Committee" to risks associated with the FRG investment. AB.35. The correct inquiry is whether the red flags alerted the Audit Committee to Riley's misconduct. As discussed *supra* (at 18-19), the answer is yes. Additionally, Plaintiff never asserts that FRG's inability to finance Badcock receivables was the direct cause of FRG's collapse. AB.36. Rather, it illustrates significant issues related to FRG's deteriorating condition prior to the Take-Private Transaction.

³⁵ See *In re Orchard Enterprises, Inc. S'holder Litig.*, 88 A.3d 1, 39 n.25 (Del. Ch. 2014) (recognizing that the "faithless fiduciary" is liable for a breach of his duty of loyalty where he takes a risk that an asset's value will rise or fall, even if the subsequent fall is unrelated to the misconduct at issue).

Defendants imply that corporate trauma cannot be the downstream result of Defendants' failure to monitor or respond to red flags. AB.35-36. However, the requirements outlined in Defendants' cited case *Melbourne Mun. Firefighters' Pension Tr. Fund v. Jacobs* are all met here.³⁶ Indeed, the corporate trauma (B.Riley's loss of its investment in FRG) is "sufficiently similar to the misconduct implied" (Riley's deceit to secure Board approval) by the red flags (Riley's use of favorable, misleading information and omission of certain critical information) "such that the [B]oard's bad faith, 'conscious inaction' proximately caused that trauma."³⁷

³⁶ 2016 Del. Ch. LEXIS 114, at *22 (Del. Ch. Aug. 1, 2016).

³⁷ *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

Defendants assert that Plaintiff's argument on appeal "rests principally on two theories": (1) "that Paulson, D'Agostino, Sheldon and Walters lacked independence because they were named as defendants in a securities class action (*Donaldson*);" and (2) "that D'Agostino lacked independence from Riley based on a personal and professional relationship." AB.38. Defendants' framing isolates single issues and fails to consider independence and impartiality holistically. For the avoidance of doubt, Plaintiff's appeal argues that the Chancery Court failed to consider the facts holistically when determining whether the Outside Directors could impartially consider a demand.

A. The Chancery Court Failed to Consider the *Donaldson* Action in its Holistic Analysis

Plaintiff argues that the Chancery Court failed to consider the *Donaldson* action in addition to other facts when conducting its holistic independence analysis, not simply that D'Agostino, Sheldon, and Walters lack independence because they were named as defendants in that action. AB.38-40.

Even though *Donaldson* is not mentioned in the Complaint, Delaware courts routinely consider court filings in related actions.³⁸ Moreover, Plaintiffs do not mention *Donaldson* to raise, for the first time, the argument that certain Directors could not impartially consider a demand. Unlike *Cal. Pub. Emples. Ret. Sys. v. Coulter*³⁹, *Donaldson* provides additional support for the same contention made in the Complaint. Moreover, it wasn't until after Defendants' motion to dismiss was fully briefed that the *Donaldson* court denied the *Donaldson* defendants' demurrers in its entirety, upon which Plaintiff submitted to the Chancery Court a letter of this supplemental authority. A1227-1228.

Contrary to Defendants' contention, Plaintiff does not cite *Donaldson* to prove that Defendants Paulson, D'Agostino, Sheldon, Antin, and Walters signed a materially misleading registration statement or hold them liable for this misconduct. AB.39. Rather, Plaintiff argues that because Defendants face separate liability for conduct substantially related to misconduct alleged herein, they could not impartially consider a demand because doing so would require them to implicate themselves in this separate action.

³⁸ See e.g., *Baugh v. Ingle*, 2025 Del. Ch. LEXIS 119, at *2 (Del. Ch. May 21, 2025) (judicially noticing court filings in related litigation).

³⁹ 2002 Del. Ch. LEXIS 144, at *40 (Del. Ch. Dec. 18, 2002).

B. D'Agostino Cannot Impartially Consider a Demand

Defendants assert that D'Agostino did not lack independence from Riley, ignoring the devil in the details. Defendants conduct no analysis to rebut Plaintiff's assertion that none of the Chancery Court's cited cases involved all of the factors at play here. AB.41. Instead, Defendants simply cite these cases for their piecemeal holdings, which say nothing about how the allegations against D'Agostino fare in their totality. Defendants' reference to *Highland Legacy Ltd. v. Singer* illustrates this shortcoming.⁴⁰ AB.42. *Highland Legacy* only stands for the proposition that "past service on outside boards or being nominated by an interested party does not impugn a director's current independence." AB.42 (citing Op.40 n.187). *Highland Legacy* says nothing about independence where additional factors exist, such as a close personal friendship and a long-standing professional relationship.

Moreover, neither Defendants, nor the Chancery Court, considered the allegations that D'Agostino lacked independence *holistically with* the other allegations that D'Agostino is a named defendant in the *Donaldson* action, that he served on the Compensation Committee⁴¹, and that he faces a substantial likelihood of liability as a member of the Audit Committee.

⁴⁰ 2006 Del. Ch. LEXIS 55 (Del. Ch. Mar. 17, 2006).

⁴¹ Defendants fail to address Plaintiff's assertion that both directors "continued to award Riley (and Kelleher) with annual executive compensation in excess of \$5 million despite [Riley (and Kelleher)'s] alleged misconduct." OB.48-49.

IV. THE COMPLAINT SATISFIES RULE 12(B)(6)

Defendants urge this Court to affirm the Chancery Court's dismissal of the Complaint under Rule 12(b)(6) for failure to state a claim, even though the Chancery Court never conducted an analysis under Rule 12(b)(6). AB.44-48. In any event, because 'the standard under Rule 12(b)(6) is less stringent than the standard under Rule 23.1, a complaint that survives a Rule 23.1 motion to dismiss generally will also survive a Rule 12(b)(6) motion to dismiss, assuming that it otherwise contains sufficient facts to state a cognizable claim.'"⁴² Such is the case here.

⁴² *Boeing*, 2021 Del. Ch. LEXIS 197, at *63 (internal quotations omitted).

CONCLUSION

The Chancery Court's decision should be reversed.

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