



IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

JOHN SCHNATTER,)	
)	
Plaintiff,)	
)	C.A. No. 2018-0542-AGB
v.)	
)	
PAPA JOHN'S INTERNATIONAL, INC.,)	PUBLIC VERSION --
)	Filed: September 11, 2018
Defendant.)	
)	

DEFENDANT'S MOTION TO DISMISS

Defendant Papa John's International, Inc. (the "Company"), by and through its undersigned counsel, hereby moves to dismiss the above-captioned action under Chancery Court Rule 12(b)(6). The grounds for this motion are as follows:

1. Plaintiff John Schnatter sought to examine the Company's books and records, and filed this litigation, for an improper purpose. The Company planned to (and will, if necessary) prove as much.

2. But Schnatter has now demonstrated—definitively and as a matter of law—that any further prosecution of this action would be for an improper purpose. In particular, on August 30, 2018, he filed a purported derivative suit raising the same issues that are the subject of his Section 220 demand and this action. For the reasons set forth below, this action should be dismissed, and Schnatter can seek the

relevant documents in discovery in his plenary action, should his new complaint survive a motion to dismiss.

BACKGROUND

3. The background to this dispute is well known, as Schnatter's erratic conduct has been quite public. He made ill-conceived statements about the NFL last fall and resigned as the Company's CEO. The July 2018 revelation that Schnatter used an egregious racial slur during a business meeting led to his resignation as board Chairman.

4. But Schnatter now apparently regrets that he no longer runs the Company, so he is fighting back—without apparent regard to harm that his conduct has wrought on the Company.

5. A special committee was formed to address issues regarding the Company's arrangements with Schnatter. Compl. ¶ 5. On July 15, two agreements between Schnatter and the Company were terminated. *Id.*

6. In an apparent attempt to retaliate, on July 18, Schnatter demanded a broad range of documents from the Company, including all documents about the special committee's decision. Ex. A.¹

¹ Citations in the form "Ex. ___" refer to exhibits to the Affidavit of Brian Morris, Esq. in Support of Defendant's Motion to Dismiss, filed contemporaneously herewith.

7. On July 25, the Company responded to Schnatter’s demand, offering an extensive list of documents to address the concerns raised in his demand. Ex. B. Schnatter filed this action the following day.

8. From the beginning, Schnatter has demonstrated a lack of interest in receiving the documents he demanded. He took no action to obtain the documents that the Company offered, even after the Company reached out with a draft confidentiality agreement on August 10. Ex. C. Having heard nothing from Schnatter, the Company tried again on August 24. *Id.* Schnatter has still not responded and thus has not obtained the documents that the Company offered more than a month ago.

9. Schnatter served his discovery requests on August 6. Trans. ID 62316192. More than half of his substantive document requests seek documents that Schnatter requested in his Section 220(d) demand—contrary to Delaware law. *See* Ex. D at 10-14.

10. When the Company resisted Schnatter’s improper discovery requests, Schnatter moved to compel on August 23. Trans. ID 62379364.

11. Unable to obtain through discovery the documents that he demanded in his Section 220 demand, Schnatter made clear that his demand was only a ploy. On August 30, Schnatter filed a complaint in this Court (the “Derivative

Complaint”), purporting to raise derivative claims, on the very topics for which he sought documents under Section 220. Ex. E (without exhibits).

12. In light of the Derivative Complaint, the Company’s counsel asked Schnatter’s counsel if this action was now moot. Schnatter’s counsel indicated that Schnatter intended to pursue both this action and the Derivative Complaint simultaneously.

ARGUMENT

13. Under Delaware law, a director may seek to examine a corporation’s books and records “for a purpose reasonably related to the director’s position as a director.” 8 *Del. C.* § 220(d). “This case qualifies as one of the rare exceptions to this Court’s general reluctance to conclude that a fiduciary’s presumed right to access books and records has been rebutted.” *Bizzari v. Suburban Waste Servs., Inc.*, 2016 WL 4540292, at *8 (Del. Ch. Aug. 30, 2016) (LeGrow, J.).

14. This action should be dismissed because Schnatter’s filing of the Derivative Complaint belies the propriety of his stated purpose for his Section 220(d) demand in this action.

A. Schnatter’s Derivative Complaint destroys his Section 220(d) purpose.

15. Although a director’s inspection rights are presumptively broad, they are by no means absolute. Indeed, “[i]f the corporation bears its burden of proving

that the director does not have a proper purpose for the requested inspection, inspection will be denied.” *Holdgreiwe v. Nostalgia Network, Inc.*, 1993 WL 144604, at *3 (Del. Ch. Apr. 29, 1993); *see also State ex rel. Farber v. Seiberling Rubber Co.*, 168 A.2d 310, 312 (Del. Super. Ct. 1961) (“The test is what use the director intends to make of the record, no matter in what classification it should fall, and not what type of record he seeks to use.”).

16. Under Delaware law, the filing of a plenary suit destroys the purpose of seeking documents to investigate mismanagement. *See, e.g., Cent. Laborers Pension Fund v. News Corp.*, 2011 WL 6224538, at *2 (Del. Ch. Nov. 30, 2011) (“Because Central Laborers’ currently-pending derivative action necessarily reflects its view that it had sufficient grounds for alleging both demand futility and its substantive claims without the need for the assistance afforded by Section 220, it is, at this time, unable to tender a proper purpose for pursuing its efforts to inspect the books and records of News Corp.”), *aff’d on other grounds*, 45 A.3d 139 (Del. 2012); *Bizzari*, 2016 WL 4540292, at *6 (“By filing the Plenary Action, Mr. Bizzari effectively conceded that the books and records he seeks are not necessary or essential to his stated purpose of investigating mismanagement or wrongdoing with respect to the removal or asset sale issues.”). In other words, a

plaintiff cannot sustain a Section 220 action if the same plaintiff has filed a plenary action on the same topics.²

17. Schnatter’s only purpose for his Section 220 demand is to “investigate whether members of the Board have breached their fiduciary duties to the Company and its stockholders.” Ex. F at 13. The particular focus of his demand appears to be actions taken by the Company’s special committee in response to Schnatter’s recent conduct, the Company’s actions regarding Schnatter, and alleged harassment at the Company. *See* Ex. A. Those are the same topics raised in the Derivative Complaint. *See, e.g.*, Ex. E ¶¶ 17-38.

18. Schnatter has certified to this Court that he has a sufficient factual basis to plead demand futility and to support the claims in the Derivative Complaint. *See* Ct. Ch. R. 11(b)(3) (providing that, by filing a pleading, a party “is certifying that to the best of the person’s knowledge, information, and belief, formed after an inquiry reasonable under the circumstances . . . the allegations and other factual contentions have evidentiary support”); *see also Taubenfeld v.*

² This general principle has a limited exception—when the derivative action is eventually filed during the pendency of a Section 220 action because of the *company’s* delay—that does not apply here. *Cf. Romero v. Career Educ. Corp.*, 2005 WL 3112001, at *2 (Del. Ch. Nov. 4, 2005) (holding that the “filing of a derivative complaint will not make an otherwise proper purpose improper” when “the overlap in suits results from a defendant’s failure to comply with its § 220 obligations”).

Marriott Int'l, Inc., 2003 WL 22682323, at *3 (Del. Ch. Oct. 28, 2003) (“[The complaint] was a certification under Rule 11 that the plaintiffs had enough information to support their allegations.”); *Bizzari*, 2016 WL 4540292, at *6 (“Mr. Bizzari and his counsel presumably concluded they possessed sufficient information under Rule 11 to file the complaint without first inspecting books and records.”). It is inconsistent with that certification for Schnatter to contend in this action that he still needs the Company’s books and records to determine whether “the other members of the Board are fulfilling their fiduciary duties,” Ex. A. *See also Parfi Hldg., AB v. Mirror Image Internet, Inc.*, C.A. No. 18457, at 6 (Del. Ch. Mar. 23, 2001) (Strine, V.C.) (TRANSCRIPT) (“By filing this plenary action, the plaintiff in the [Section] 220 case has already necessarily conceded that [it] had enough information to file allegations of mismanagement in a complaint with good faith and for its counsel to have satisfied the necessary pleading standards.”).

19. Accordingly, because Schnatter has decided to pursue his Derivative Complaint, he no longer has a proper purpose (assuming, incorrectly, that he *ever* had a proper purpose) to inspect the Company’s books and records regarding the claims in his Derivative Complaint. *Cf. Cent. Laborers*, 2011 WL 6224538, at *1 (“In short, once the derivative action is filed, . . . the stockholder may not, as a

general matter, demonstrate a proper purpose for invoking Section 220.’). This case should be dismissed.

B. Schnatter may not circumvent Delaware law by pursuing both derivative discovery and books and records under Section 220(d).

20. Schnatter may try to distinguish the cases and arguments above by noting that he purported to seek books and records in his capacity as a director and filed the Derivative Complaint in his capacity as a stockholder.³ This distinction cannot save Schnatter’s Section 220 complaint from dismissal; he may not use a dual-litigation process to circumvent Delaware law.

21. First, Schnatter should not be able to use the derivative suit to obtain the documents that he is seeking in this Section 220 action. It is well settled that a Section 220 plaintiff “cannot use the discovery process in a books and records case to gain access to the books and records ultimately at issue.” *Maitland v. Int’l Registries, LLC*, 2008 WL 2440521, at *2 (Del. Ch. June 6, 2008). Schnatter already tried to do so through the discovery he propounded in this action (*see* Ex. D), and he should not be able to open a collateral attack, in the form of the Derivative Complaint, to obtain Section 220 documents another way.

³ Incidentally, this is just one point of proof that Schnatter’s purpose is not proper. *See, e.g., Bizzari*, 2016 WL 4540292, at *9 (rejecting Section 220(d) demand where director “did not demand the inspection in order to carry out his fiduciary obligations to the companies”).

22. Second, now that a plenary action has been filed, Schnatter should be required to obtain the relevant documents through that action alone. Using Section 220 as a means to obtain post-filing derivative discovery is not a proper purpose and mandates dismissal of the underlying Section 220 claim. Then-Vice Chancellor Strine in *Parfi* made a similar observation. Noting that the Section 220 action was “really . . . about discovery in the underlying actions,” the *Parfi* Court did not “think that is a proper primary purpose under Section 220, in a situation where the 220 plaintiff has already made a decision—an informed decision to initiate two pieces of litigation against the company.” *Parfi*, C.A. No. 18457, at 6 (“What happens at that point is that there are other processes under law [*i.e.*, discovery] which are wholly sufficient to satisfy the plaintiff’s purposes.”); *see also Bizzari*, 2016 WL 4540292, at *6 (“Mr. Bizzari can complete any additional ‘investigation’ under the much broader discovery that will be available to him under the Court’s rules. The availability of discovery in the Plenary Action undercuts Mr. Bizzari’s alleged need to investigate mismanagement through an inspection demand.”).

23. Third, a motion to dismiss the Derivative Complaint under Rule 23.1 will soon be filed. Under long-standing Delaware law, discovery in support of the claims alleged in the Derivative Complaint should be stayed. *See, e.g., Brehm v.*

Eisner, 746 A.2d 244, 266 (Del. 2000) (noting that “the Court will not permit discovery under Chancery Rules 26-37 to marshal the facts necessary to establish that pre-suit demand is excused”). As explained by commentators, “the plaintiff typically will be denied the opportunity to engage in discovery both as to the merits of the underlying claim in general and even for the more limited purpose of uncovering facts relevant to his or her assertion that demand is excused. Only if the court determines on the strength of the complaint alone that plaintiff may proceed will discovery typically be permitted.” Donald J. Wolfe, Jr. & Michael A. Pittenger, *Corporate and Commercial Practice in the Delaware Court of Chancery* § 9.02[b][3], at 9-71 (2017 Supp.) (“[T]he Court of Chancery has routinely granted motions to stay discovery pending resolution of the defendants’ motion to dismiss the complaint for failure to make a demand under Chancery Court Rule 23.1.”). Schnatter should not be able to circumvent a discovery stay by obtaining the documents in this Section 220 action. *Cf. Cent. Laborers*, 2011 WL 6224538, at *1 (stating that “Section 220 was not adopted as a substitute for litigation discovery”); *Highland Select Equity Fund, L.P. v. Motient Corp.*, 906 A.2d 156, 165-66 (Del. Ch. 2006) (“Of course, there is nothing objectionable about availing oneself of federal rights to stay discovery. But that action should not then be

followed by a Section 220 demand that seeks what amounts to one-way discovery into the same matters.”), *aff’d*, 922 A.2d 415 (Del. 2007) (TABLE).

* * *

24. Whether or not Schnatter’s Derivative Complaint is able to survive a Rule 23.1 motion, his sole mechanism for obtaining the documents he seeks is discovery *in the derivative action*. This Section 220 action should be dismissed: that is the consequence of the choice he made to file the Derivative Complaint while this Section 220 action was pending (and his implicit concession that he does not actually require the documents he demanded under Section 220).

CONCLUSION

For the reasons discussed above, this action should be dismissed with prejudice.

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