

ARTICLES

The Trial of the Hidden Agenda: Part I

By T. Ray Guy

The plaintiff was a hedge fund that, along with affiliates controlled by a single investment manager, collectively held one of the largest blocks of stock of the defendant corporation. The complaint filed by the plaintiff in the Court of Chancery of Delaware ostensibly sought an order from the court, pursuant to section 220 of the Delaware Corporation Code, requiring the corporation to turn over books and records for inspection by the hedge fund. A few weeks earlier, the hedge fund and its affiliates had initiated a proxy contest for control of the corporation, and the hedge fund then sent a written demand that the company produce records on a wide variety of subjects. When the corporation refused the demand, the hedge fund filed its suit under section 220.

The statute required the plaintiff to prove that its purpose was a proper one and that the documents sought by its statutory demand were reasonably related to that purpose. Both the hedge fund's written demand for inspection and the subsequently filed complaint recited several purposes that, if true, would have been considered proper. In pretrial discovery, responding to the defendant's request for production, the plaintiff (not surprisingly) did not produce any documentary evidence that would directly contravene its claimed purpose.

The company's primary defense was that the hedge fund did *not* have a proper purpose for the request—that its stated purpose was a ruse and that its actual purpose was to generate publicity for the proxy contest. The company also contended that the request was overbroad, encompassing among other things information already in the possession of the hedge fund or available from other sources.

At trial, the hedge fund shareholder presented one witness, a corporate representative employed by its manager, who predictably testified that the fund's purposes in sending the demand and filing suit were noble: to investigate possible mismanagement at the company, to evaluate potential corrective measures, and to obtain information with which to communicate with stockholders in the proxy contest. He further testified that the books and records for which inspection was requested were related to those purposes. The company obviously could offer no witness as to the state of mind of the hedge fund's decision makers, who had managed to avoid admitting any improper purpose in sending the inspection demand and filing and pursuing the lawsuit.



So what was the outcome? We'll get back to that. For now, let's look at the concept of ascertaining, and proving, your opposing party's unstated motives—its "hidden agenda."

The Opponent's Motivation as a Trial Theme

Most of us have received, acted upon, or even given the advice that a good trial plan should be built around simple themes. Effective persuasion includes (among other things) reducing the complex to the simple and providing memory devices for the retention of disparate arguments and multiple pieces of evidence. The bits and pieces of your case are more readily remembered by the trier of fact at decision time if they support or relate to a common theme or central idea. On the other hand, powerful demonstrative aids and vivid word pictures can be lost on jurors if we don't enhance their comprehension and retention of facts by relating them to a simple story line or, at most, a few such story lines.

The hardest part of putting such advice into practice is determining the most compelling theme or themes. And your opponent's motivation for the acts that (you claim) provoked the dispute can provide such a theme, a strong framework on which to build your presentation.

The Criminal Trial-Practice Analogue: Motive

Our friends who practice criminal law are no doubt more attuned to this notion than those of us who try civil cases. For them—and for the rest of us who enjoy watching reruns of *Law & Order* or *The Practice* on television—the familiar concept is that of "motive." Distinguished from "intent," motive is rarely an actual element of a crime, but it nonetheless typically occupies a significant amount of the parties' and court's attention in a criminal trial. The obvious reason is that proof that the accused had a strong motive to commit the crime is a powerful persuasive tool in convincing the trier of fact the accused *did* commit the crime; conversely, the absence of such a motive renders the defendant's guilt less likely.

There are several similarities between the concept of "motive" in criminal law and the subject matter of this article—the "hidden agenda" in civil litigation. We'll discuss them in the following paragraphs.

The Search for the Hidden Agenda

Not every trial or arbitration involves a concealed motive. There are, of course, cases in which the dispute involves a genuine disagreement; conflicting but genuinely held memories of the events leading to the dispute; or good-faith belief on the part of each party that its position is correct. Two automobiles collide in an intersection; each driver believes that he or she had the right of way, because, after all, everyone considers himself or herself a careful driver who simply wouldn't have ignored a traffic signal. A once-promising venture fails; each party believes that it has done its best to make it succeed and, therefore, that the failure must necessarily be the fault of the other party. One company manufactures and ships parts that the purchaser contends were

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not suited for the intended use; the manufacturer knows all the steps that were taken on the factory floor to ensure compliance, while the purchaser is equally certain that the goods when received would not fit into the assemblies it planned to ship to its customers, and the case proceeds to trial with each side convinced that its position is right.

And there are other cases in which the defendant's conduct that provoked the lawsuit, litigation, and its subsequent litigating posture were *not* in good faith but did not involve a hidden motive—nothing other than to win, whether at trial or by attrition. To borrow an example from literature, in John Grisham's novel *The Rainmaker*, the defendant Great Benefit Life Insurance Company repeatedly denied claims, but in doing so was not pursuing some concealed aim other than to avoid paying claims. In the automobile-collision case, one motorist may realize that he or she is at fault but persist (through trial and thereafter) in insisting that the light was green with no hidden motive other than to be absolved of deserved liability. The parts supplier may realize that the parts were not satisfactory but contend otherwise just to avoid a ruinous judgment.

However, in three decades of trial practice I've seen many cases in which the dispute leading to the lawsuit resulted from one party's hidden agenda (always my opponent's, naturally). Human conduct is seldom truly random. People generally act or fail to act for cognizable reasons. Choices have consequences, and those choices—including the ones that lead to conflict and ultimately to litigation—often stem from unexpressed, underlying desires or motives. One party is pursuing an unstated goal, a "hidden agenda," that generates the dispute necessitating resolution through litigation or arbitration. Your ability to prevail at trial or in arbitration is significantly enhanced if you can convince the jury or judge or arbitration panel that your opponent's hidden agenda is the *real* reason they're being called on to decide and rule on the issues that divide the parties.

This hidden agenda—an unacknowledged reason why the opposing party acted as it did—is something more than "to make more money" or "to breach the contract." Ferreting it out requires conscious thought, putting yourself in the opposing party's shoes; understanding the forces at work in its world; temporarily assuming, as nearly as possible, the opponent's mindset; and discerning the strategy or goal that caused the opponent, not just to do something adverse to your client, but to do so in precisely the way he or she did.

And *proving* the hidden agenda to the satisfaction of the trier of fact requires marshaling circumstantial proof, typically objective in nature, to demonstrate what your opponent will never admit and what your client isn't competent to testify to: the opponent's intent or state of mind.

Proving the Hidden Agenda: The Section 220 Case Example

In the case described in the opening paragraphs—the stockholder demand for inspection of books and records—the defendant corporation relied on a substantial amount of objective,

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circumstantial evidence that the shareholder had an unstated improper purpose, entirely different from the proffered one, in sending the statutory demand and thereafter in prosecuting its suit. For one thing, the hedge fund's control person had for years served on the defendant company's board of directors, during the entire period when the alleged mismanagement was supposedly occurring. For that matter, in his capacity as a director he had voted to approve most of the transactions that his hedge fund now supposedly wanted to investigate. Many of the categories of documents that the plaintiff purportedly sought to review involved information that had been, or on his request would have been, made available to the plaintiff's control person by virtue of his position as a director.

Further, the plaintiff's letter demanding review of books and records was far lengthier than necessary, with the statement of the alleged purpose and the listing of requested documents occupying only a few of the letter's 24 single-spaced pages. The rest of the demand letter consisted of lurid recitations of supposed wrongdoing on the part of company management, directors, and related parties. A legitimate request for information could have been made in a much shorter letter, shorn of the accusations and allegations. And immediately after sending the statutory demand—and without waiting for a response, which was due five business days later—the plaintiff made its allegations public with a press release and by including the demand as an attachment to filings with the Securities and Exchange Commission (SEC), where they could easily and immediately be accessed online and read by other voting stockholders. Those allegations of corporate misconduct that were superfluous to a legitimate request for information were undeniably germane to an indirect communication to shareholders who would soon vote in the proxy contest. Shortly thereafter, when the hedge fund filed its complaint initiating the lawsuit, it likewise immediately (weeks before an answer was due) attached a copy of the complaint to a press release and concurrently filed it as an attachment to SEC filings on Forms 13D and 14A.

Finally, the hedge fund and its affiliates had for months, both before and after announcing its proxy contest, carried on a publicity campaign through a drumbeat of SEC filings concerning the company, with similar accusations of mismanagement and self-dealing—more than a dozen Forms 13D and 14A during the eight months preceding the sending of the statutory demand. Most of the superfluous accusations in the section 220 demand letter had already been made known to company management and its board of directors through the earlier SEC filings and accompanying press releases, adding to the impression that the demand for inspection was intended primarily for an audience other than its ostensible addressees.

Ultimately, the court of chancery agreed that the hedge fund's actual purpose—its hidden agenda—was not its stated one, and denied any relief. The court ruled that the stated purpose “verge[d] on being a ruse” and that the hedge fund appeared to have pursued its books-and-records demand largely for its utility as a rhetorical platform.

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A section 220 case differs from most trials in that the statute in question places the plaintiff's motive—its intent in sending its demand and filing suit—directly in issue. If the hedge fund's real purpose was its desire to use the court of chancery as a tool in the proxy-fight public-relations campaign, then the hedge fund necessarily did not have a proper purpose for the demand, as required by the statute. In contrast, in most business litigation, the motivation of your opponent in filing suit or provoking the dispute is *not* directly in issue, but the circumstantial proof of an unstated purpose either inferentially rebuts other elements of the opponent's claim or defense, or at least undermines the opponent's credibility.

Proving a Hidden Agenda with Circumstantial Evidence: Proprietary Seed

The above section 220 case illustrates another parallel with proof of motive in criminal cases: the nature of the proof of the opponent's hidden agenda. The opposing party will always control the direct evidence of its intent—testimony from the opponent's mouth or testimony from its corporate representatives—and your opponent cannot be expected to oblige you by admitting its real intentions. You rely on objective but circumstantial evidence pointing to the hidden agenda and on your ability to persuasively argue the inferences that you want the jury or judge or arbitrators to draw from that evidence.

I'll illustrate with another example, one in which the opponent's real intention was *not* an explicit element of its cause of action or of our defense. Several years ago we represented a United States-based producer of proprietary cotton seed in arbitration involving the termination of our client's relationship with its local distributor in another country. During the course of our initial client interviews and subsequent investigation we learned some interesting things about the agricultural-seed industry. Among other things, we learned that there is a difference between "generic" seed and "proprietary" seed. Generic seed is generally available for production and sale by any entity (including governmental agricultural authorities) and is not marketed for any specific benefits or characteristics. Proprietary seed, on the other hand, is marketed under the label of a particular seed company and reflects the company's seed "technology"—its experience in generating and testing new strains of seed—as well as its reputation for seed quality and beneficial characteristics.

Our client, Stoneville Pedigreed Seed Co., had been in existence for more than seven decades and had developed a strong following among cotton planters in the United States. (John Grisham's novel *A Painted House*, set in rural Arkansas in 1951, includes a scene in which the narrator's grandfather is negotiating with migrant laborers for their services harvesting cotton. "'What kinda cotton?' Mr. Spruill asked. 'Stoneville,' my grandfather said. 'The bolls are ready. It'll be easy to pick.'") In the early 1990s, seeking to expand into overseas markets, Stoneville entered into a distributorship agreement with a seed distributor in a European Union country, shortly after the local agricultural authorities removed restrictions on imported cotton seed. As it



turned out, there was substantial demand among the country's farmers for proprietary seed, and Stoneville's imported seed quickly gained impressive market shares, to the mutual profit of Stoneville and its local distributor. However, the relationship between producer and distributor deteriorated during the later years of their multi-year distributorship agreement. Stoneville became frustrated with (among other things) the distributor's continued failure to send reports of its activities with respect to Stoneville seed, as required by the distributorship agreement, as well as by the distributor's incessant demands for compensation for lost sales and other damages supposedly caused by Stoneville's seed.

A final problem arose when local authorities, at the urging of environmental groups, imposed a temporary ban on imports of seed containing even trace amounts of genetically modified organisms (GMOs). Genetically modified seed is popular here in the United States, where Stoneville produced most of its seed for export and sale. Seed is genetically engineered for a number of purposes, such as making it resistant to a particular pesticide so that the crop will survive when that pesticide is applied to kill weeds. However, overseas markets have been slower to adopt GMO seeds. And because seed grown without deliberate genetic modification is often grown in close proximity to genetically enhanced seed, it is difficult to prevent non-GMO seed from exhibiting minute amounts of GMO characteristics because of natural (wind or animal) transmittal of organisms from nearby fields containing genetically modified seed. The local government's ban was illogical, and it affected imported seed produced by competitors as well as our client—but the local distributor blamed Stoneville for the problem and made clear that it wanted compensation for lost sales.

When Stoneville announced that the distributorship agreement would not be renewed at the end of its primary term, the distributor responded by suing in a local court for more than 100 million Euros—an amount approximating the distributor's total sales of Stoneville seed during the term of its agreement. The complaint sought damages for wrongful termination under local law, as well as compensation for sales lost as the result of the government's anti-GMO fiat.

Fortunately for our client, the distributorship agreement contained an arbitration clause, and thus we were able, by filing and expeditiously prosecuting the arbitration, to accelerate the resolution of the dispute in a neutral forum. As we began working with Stoneville's officers and employees to prepare the case for arbitration, we—client and law firm—expected the dispute to break down into simple, us-versus-them elements: Either Stoneville was entitled to rely on the distributorship agreement's fixed term, or the pro-distributor, anti-termination statutes in the distributor's home country would control and create extra-contractual liability; either our client caused lost sales by failing to prevent adventitious GMO contamination, or neither party was at fault when government officials arbitrarily imposed a new and oppressive interpretation of the governing seed-quality regulations.

However, as we met with our client and reviewed the documents evidencing its contentious relationship with the local distributor—and began to understand some simple facts about the seed industry—another subtext began to emerge, one that involved something unique about the seed industry. Like other plants, when cotton plants grow, they do not just produce cotton fiber; they also produce more cotton seed. The company that gins the cotton can, if it chooses (and is permitted) to do so, separate the seeds from the ginned cotton and resell them. During the term of the distributorship agreement, the local distributor built facilities for ginning cotton and concurrent seed production; the distributorship agreement permitted the distributor to produce limited amounts of second-generation seed—processed from cotton grown from imported Stoneville first-generation seed—as a hedge against Stoneville’s potential weather-related inability to supply the country’s demand for seed. The agreement obligated the distributor to report its sales of locally produced seed and to pay royalties on such sales. Stoneville was aware that the distributor had built and equipped a seed-processing plant, and Stoneville had actually sent employees overseas to assist the distributor in readying its plant for production. But over the years, as Stoneville repeatedly asked for reports of the distributor’s local production of seed, the distributor consistently denied that any such sales had occurred, proffering a variety of excuses: Weather destroyed the entire crop, for example, or the plant malfunctioned and ruined an entire run of seed.

What we noticed as we reviewed sales records was that the distributor’s purchases of seed exported by Stoneville—which increased dramatically during the early years of the agreement—had declined during the later years. We further found that when the GMO controversy arose, blocking import of most of Stoneville’s seed, the distributor nevertheless seemed able to meet farmers’ demand for Stoneville seed. Finally, as the term of the agreement came to an end, the distributor seemed to have on hand an inventory of Stoneville’s seed that did not match its purchases of imported seed—and the distributor began brazenly advertising locally produced Stoneville seed for sale, even touting it to farmers and local dealers as being superior to imported seed (including Stoneville imported seed) because of the absence of any inadvertent GMO contamination!

In short, we determined that our opponent, which claimed to have been devastated and grievously harmed when our client announced that it would not renew the distributorship relationship, had for years been pursuing a hidden agenda: producing and stockpiling inventories of second-generation Stoneville seed. The distributor, while asserting consistent crop or production failures and failing to report to Stoneville its production and sales of locally produced seed, had in fact been successfully producing seed, meeting a portion of its dealers’ demand with locally grown seed and concurrently multiplying its stockpiles. It appeared that the distributor had planned and prepared for the fully anticipated end of the distributorship agreement, when it would be able to meet market demand for product bearing our client’s proprietary-seed technology without having to pay for it.



The hidden agenda became our theme for the arbitration. While we still had to defend against the distributor's various claims of Stoneville's supposed nonperformance, our overriding theme was that the distributorship relationship did not end when Stoneville announced that the agreement would not be extended beyond the primary term. Rather, it came to an end gradually, over a period of years, as our opponent cheated and lied to our client while preparing in stealth for a post-termination future.

As discussed above—and as is typical in “hidden agenda” cases—our proof was circumstantial; the distributor's witnesses vehemently denied any wrongdoing, and we had no admissions or other direct evidence that the distributor had been appropriating Stoneville's seed technology while planning for termination. The circumstantial evidence was objective, primarily numerical, in nature. Stoneville had of course kept records of the foreign distributor's annual purchases of imported Stoneville seed. The stagnation and decline in such purchases was suspect, given proof from other sources that the demand among the country's farmers for imported proprietary seed continued strong throughout the term of the agreement. Further, however, on our motion the arbitral tribunal ordered the distributor to produce its records of sales of Stoneville seed within its territory. Such sales *increased* steadily even as the distributor's imports of Stoneville seed *declined*. The gap between imports and sales could only have been filled by seed produced in the distributor's local facilities, collected during ginning of cotton plants grown from imported seed—even while the distributor claimed to have produced little or no seed, paid little or no royalties, and took steps to undermine Stoneville's reputation in the country in anticipation of the expected end of the term of the distributorship agreement.

After an evidentiary hearing, the arbitral tribunal ruled that the distributor had breached the distributorship agreement and that Stoneville had not done so—and scheduled a further hearing, several months later, to determine the damage suffered by Stoneville from the distributor's breach. The case settled in the interim. I am convinced that Stoneville was in the right and deserved to win. I am also of the firm belief, however, that the victory resulted in part from the mutual decision of client and lawyers to focus our case on the faithless distributor's hidden agenda—its intention to appropriate Stoneville's proprietary seed and market it as its own following termination—instead of simply reacting and responding to the distributor's unfounded claims.

To Be Continued

The next issue of this newsletter will feature Part II of this article, containing an additional case example involving a hidden agenda and setting out four lessons to remember in presenting and proving your opponent's hidden agenda:

1. Don't lose sight of the explicit elements of your claims or defenses.

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Corporate Counsel

FROM THE SECTION OF LITIGATION COMMITTEE ON CORPORATE COUNSEL

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2. Don't assume an unnecessary burden of proof.
3. Marshal your circumstantial proof.
4. Determine the best time to raise the hidden agenda and the best way to do so.

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