

***Haft v. Haft*, 671 A.2d 413 (Del.Ch.,1995)**

The questions presented are whether a proxy to vote shares of stock was validly made irrevocable when granted and, if so, whether it continues to be irrevocable.

The case arises from a July 28, 1993 transaction in which Herbert H. Haft transferred a block of the Class B common stock of Dart Group Corporation (“Dart”) to his younger son Ronald S. Haft in exchange for cash, a note, and the grant of a “lifetime” irrevocable proxy to vote the stock transferred. The stock in question is a block of 172,730 shares of Class B common stock of Dart, the sole class of voting stock of the corporation. The Class B shares that were transferred constituted 57% of the then outstanding Class B shares and thus carried with them the power to elect the board of directors of Dart.

The July 1993 transaction arose in the context of a complex and apparently acrimonious family dispute that included the dissolution of the long-term marriage between Herbert and Gloria Haft. The three children of the marriage were pulled to one side of that dispute or the other. Elder son Robert and daughter Linda sympathized with their mother. Their brother Ronald may have been inclined differently. In any event, the July 1993 transaction might be interpreted as an alliance between Herbert and Ronald. At the time of Herbert's transfer of legal title to the Dart Class B stock to him, Ronald also signed an employment contract with Dart to become President and Chief Operating Officer of the company, a position that had formerly been held by Robert. In connection with acceptance of that office Ronald acquired from the Company, options to buy additional shares of Class B stock, or so it is alleged.

If it was a long term alliance that was envisioned in July 1993 by Herbert and Ronald, events were to disappoint those expectations. On September 12, 1994, Ronald instituted suit against Dart seeking the specific performance of his alleged option to purchase additional Class B stock. That suit (the “option litigation”) was one of a complex welter of suits instituted among members of the Haft family [...]. On July 18, 1995, Ronald instituted this litigation against his father. This suit (the “proxy litigation”) [...] seeks a declaration that the proxy given to Herbert was validly revoked on June 30, 1995, or, in the alternative, that the proxy will be revocable once the promissory note given in consideration of the transfer of the Class B common stock is satisfied.

[...]

In this opinion I address and reject Ronald Haft's motion for summary judgment with respect to his claim that he effectively revoked the proxy that was part of the July 1993 transaction and I reject, as well, plaintiff's claim that the proxy will (has) become revocable once the note that he gave to Herbert Haft in July 1993 is satisfied.

I. General Background

Herbert H. Haft is the founder of Dart and has been Dart's Chief Executive Officer and Chairman of the Board since 1960. [...] Dart's capital structure comprises two classes of stock: Class B common stock which has voting rights and has always been held only by members of the Haft family, principally Herbert, and Class A common stock which has no voting rights and is publicly traded. Prior to the July '93 transfer to Ronald, the B stock was owned by Herbert (172,730 shares or 57%); Gloria (18%); Robert (8.33%); Linda (8.33%) and Ronald (8.33%). Herbert also owns 122,747 shares of the Class A Dart common stock.

As mentioned, as part of the July transfer Ronald Haft acquired an option to purchase certain authorized but unissued shares of Dart Class B stock. That option covered up to 197,048 shares at a price equal to 110% of the then current market price of the non-voting Class A common stock.

The terms of the July 1993 stock transfer were as follows: Herbert transferred to Ronald all 172,730 shares of Class B stock that he owned in exchange for stated consideration of \$13,818,400, consisting of \$2.8 million in cash and a twenty year promissory note (due on August 1, 2013) for the balance. This sale was made pursuant to a Contract for the Transfer of Securities (the "Transfer Contract"), in conjunction with which Ronald executed and delivered the promissory note (the "Note"). At the same time, Ronald granted a "lifetime" irrevocable proxy back to his father. Notably, of course, the irrevocable proxy that accompanied the transfer would make it more likely that Herbert would be able to continue to elect the board of Dart, despite any division of the proceeds of the sale that a marital court might order as part of a division of marital property.

Some ten months later, on May 17, 1994, all five members of the Haft family signed two settlement agreements that attempted to settle all disputes among the family members, including a divorce settlement. After this settlement, business relations between Ronald and Herbert appear to have deteriorated. On September 6, 1994, Ronald Haft attempted to exercise the option purportedly granted in his employment contract to purchase 197,048 shares of Dart Class B stock. The Company's board of directors, however, refused to recognize that right at that time. On September 7, 1994, an Executive Committee, comprised of four non-Haft directors, was formed to act in areas of disagreement between Ronald and Herbert Haft, and by October 11, 1994, the role of this Executive Committee is claimed to have been expanded to include all affairs of Dart, effectively removing Herbert (the fifth director) from board deliberations. Sometime shortly after this, Herbert, who continued as Dart CEO, advised the Executive Committee that Ronald should be terminated from his positions with Dart. The board did not do so; a standstill order entered by this court in the option litigation precluded such action at that time without prior notice and hearing, a procedure that was not employed.

On June 30, 1995, Ronald Haft sent his father a letter purporting to revoke the proxy Herbert held. Without indicating the grounds for revocation, the letter simply stated that it "hereby revokes the Proxy ... [t]hat the Proxy is no longer in effect and [that Ronald] shall retain the vote" of the Class B common stock. In response Herbert Haft purported to rescind the transfer of the Dart Class B stock asserting that the purported revocation by Ronald was a material breach of the stock sale contract. This suit was then instituted by Ronald in order to secure a declaratory adjudication of the validity of Ronald's revocation of the proxy, or in the alternative, a declaration that the proxy would be revocable when the Note is satisfied. [...]

II. The Proxy Was Irrevocable When Granted

In order for Ronald Haft to establish that the proxy has been validly revoked, he must first show that the proxy, which on its face purports to be irrevocable, is in fact revocable under Delaware law. For the reasons set forth in this section I conclude that at the time that Ronald Haft purported to revoke the proxy it was irrevocable in law and that the revocation was therefore without legal effect.

Under Section 212(e) of the Delaware General Corporation Law, a proxy is irrevocable "if it states that it is irrevocable and if, and only as long as, it is coupled with an interest sufficient in law to support an irrevocable power." The obvious first candidate for an "interest" that would support the irrevocability of

the proxy in this instance would be a security interest in the stock protecting Herbert's right to be paid the principal amount of the Note, plus interest. The parties agree that a security interest in the stock itself would be sufficient to support an irrevocable proxy. They disagree, however, on the more basic question, whether any security interest in the Class B shares was created in this instance.

1. The Parties Created a Security Interest in the Class B Shares Under Delaware Law.

It is agreed that Delaware law governs the question whether a security interest was created. The applicable law is Articles 8 and 9 of the Delaware version of the Uniform Commercial Code. Article 9 generally governs the creation, perfection, and enforcement of security interests in property and applies to “any transaction (regardless of its form) which is intended to create a security interest in personal property.” 6 *Del.C.* § 9-102(1)(a) (1991). Security interests in share certificates (or certificateless shares for that matter) are not excluded from its provisions. Thus, in determining the validity of a claimed security interest in securities, one must turn first to Article 9.

(a). Intent to create the security interest :

A security interest is a property right in identified property created by contract for the purpose of protecting in some respect some right, title, or interest of the secured party. Recognizing the fundamental fact that security interests result from the contractual act of a grantor, Ronald Haft asserts that he, as the property owner (after the transfer of the stock) had no intention at the time he gave the proxy that it should be held and used to protect any right, title, or interest of Herbert. He presents his own sworn affidavit to that effect and points to the fact that after the closing of the July 1993 transfer his father presented him with a formal security agreement, which he did not sign.

It is elementary that the intention necessary to form a contract is not found in the private subjective mental state of either of the parties to a negotiation, but is the meaning that a reasonable person would attribute to their expressions of assent, given the context of the words and acts that preceded their claimed agreement and culminated in it. Thus, courts do not look for and give legal force to a private subjective state of mind (intent) but to objective acts (words, acts and context) that constitute the enforceable contract and the “objective” (reasonable person) interpretation of what the contracting parties meant (intended) to do. Looking to the objective evidence reflected in the record, I find no material dispute concerning the relevant circumstances surrounding the transfer. The intent that the law requires for the creation of a security interest is, in my opinion, certainly present here.

The most important circumstance is the clear language of the operative legal document executed by Ronald Haft. The Note contains a paragraph entitled “Collateral” in which it states that *the note “shall be secured solely by the collateral, the Shares.”* This language is part of an effective legal act that created rights. In light of this language in a signed document, no inconsistent private reservation is effective to create a material issue of fact concerning “intent” to create a security interest. No magic words are needed to create a security interest. Under the objective theory of contracts, when a writing is clear, “the writing itself is the sole source for gaining an understanding of intent.”

Notwithstanding the terms of the Note, Ronald now argues that Herbert's repeated subsequent attempts to get him to sign a prepared draft of a pledge agreement and his later refusal, evidence the fact that there was no intent to create a security interest at the time the Note, Contract, and Proxy were originally executed. Such evidence is, however, legally irrelevant given the legal standard referred to above. In other circumstances such conduct might create a fact issue, but here, given the terms of the Note itself, this extrinsic evidence creates no litigable issue with respect to the question whether the parties acted in a way in which a reasonable person would have concluded that they intended to create a security interest.

(b) *The Security Interest is Enforceable:*

Given the existence of an agreement to grant a security interest, Section 9-203 lays out the formal requisites of the enforceability of such an interest. Generally a security interest created by agreement is enforceable when (1) the debtor has rights in the specific collateral, (2) value is given by the creditor and (3) the collateral is identified either by possession of the creditor or description in a signed security agreement. Section 9-203, however, also provides that it is “subject to the provisions of ...Section 8-321 on security interests in securities.” Thus, in order for a security interest in securities to attach and be enforceable it must satisfy the requisites of Section 8-321.

Under Section 8-321(1), where the collateral is a security, it is insufficient, in order for the security interest to attach and be enforceable, simply to identify the collateral. In the context of securities, the collateral must be “transferred”: “a security interest in a security is enforceable and can attach only if it is transferred” to the secured party or a person designated by him pursuant to a provision of Section 8-313(1).

[...]

Section 8-313(1) provides several ways in which such a transfer may occur. [...] Principally involved in this case is the process defined by subsection (a). That subsection simply requires possession of the certificated securities by the secured party or a person designated by him. The critical question thus becomes who was in possession of the share certificates following the transaction and in what capacity.

It is agreed that the firm of Wilmer, Cutler & Pickering (“WC&P”) has held and continues to hold the certificates. The capacity in which WC&P holds the shares is, however, actively disputed. Herbert Haft contends that WC&P were his lawyers and hold the shares as his agent. If Herbert is correct in this view then the requirements of Section 8-313(1)(a) would be satisfied and he would have an enforceable security interest in the Dart Class B stock. Ronald Haft, however, asserts that WC&P actually held the shares for him for safekeeping and not for his father. If Ronald is correct about this no security interest was created. Both parties admit, however, that WC&P has stated, and is of the belief that, it holds the shares as escrow agent for and as an accommodation for both parties.

[The court concludes that WC&P was “designated” by Herbert, whether that firm acted for Herbert alone or jointly for both men, and therefore the requisite elements for the creation of a security interest in the Class B shares were satisfied.]

III. The Proxy Is Irrevocable Irrespective of any Satisfaction of the Note

With respect to Ronald's claim that the Proxy will be revocable once the Note is paid in full, I conclude that Herbert Haft's interests in Dart other than as a person with a security interest in the transferred Class B shares, are sufficient to render specifically enforceable the contractual undertaking of irrevocability.

1. The Applicable Statute:

The Delaware General Corporation Law states that a proxy may be made irrevocable “if, and only as long as, it is coupled with an interest sufficient in law to support an irrevocable power.” 8 *Del.C.* § 212(e) (1991). Most agency powers are, of course, terminable by the grantor of the power at will. Irrevocable powers or powers in which the holder has a property right are an exception. The *Restatement (Second) of Agency* formulation is conventional: an irrevocable power or “power given as security” is “a power ... held for the benefit of the power holder ... and given to secure the performance of a duty or to protect a title, ... such power being given when the duty or title is created or given for consideration.” Generally, of course, irrevocable powers arise in transactions in which the “agent” bargains for or requires the power as a means of protection of her own legally protectable interest.

In this case, Herbert Haft asserts that he required the irrevocable proxy in order to protect both his right to be paid the cash due on the Note and as a means to protect his interests in Dart, which included his interest as holder of Class A stock, and as the CEO of the company. It was of course obvious that if he were to sell his majority block of the Class B shares, without retaining (in effect) the vote, he would open himself to a number of risks: such as the possibility of a merger, recapitalization, or other transaction that disadvantaged him as the holder of a security interest in the B stock, or more pointedly, the possibility of his removal as the firm's CEO by a board that would no longer have to look to him for reappointment. [...]

Under the Delaware corporation law an interest sufficient to support an irrevocable proxy must be either “an interest in the stock itself or an interest in the corporation generally.” Do Herbert Haft's interests, other than as a secured creditor, qualify under the statute? As I now explain, in my opinion they do.

2. Relevant Legal Precedents

The predecessor of Section 212 was amended as part of the general revision of the Delaware General Corporation Law in 1967. The language in question (“an interest in the corporation generally”) was introduced into our statute at that time. The apparent purpose for doing so was to erase the implication arising from dicta in a 1933 Master's Report, which had been confirmed by this court. The report was in the case of *In re Chilson*, Del.Ch., 168 A. 82 (1933). The *Chilson* dicta was to the effect that in order to support irrevocability of a proxy, the holder had to have an interest in the stock itself. [...] This effect was, however, arguably dissipated by the enactment of new §212(e) in 1967, which made it very clear that other interests (interests other than in the stock itself) could legitimately be contractually protected by the grant of an irrevocable proxy.

Prior to the 1967 revision the question whether the interest of a CEO in his position was such an interest as, standing alone, would support the enforceability of the agreed-upon irrevocable proxy according to its terms had occasionally been addressed by courts in other jurisdictions. In *Deibler v. Chas. H. Elliott Co.*, 368 Pa. 267, 81 A.2d 557 (1951), the Pennsylvania Supreme Court, applying Delaware law, held that an irrevocable proxy given to the seller of corporate stock both to secure payment for the stock and to protect his on-going contract of employment with the corporation, remained irrevocable after the note had been paid. The court accepted the argument that the on-going employment contract constituted a sufficient interest to specifically enforce the agreement made. [...]

3. Policy Considerations:

No Delaware court has been required to address this question under the language of amended Section 212. In now doing so, it is appropriate to acknowledge that the corporate law has tended to distrust and discourage the separation of the shareholder claim as equity investor (i.e., the right to enjoy distributions on stock if, as, and when declared) from the right to vote stock. For example there was for many years a rather clear rule against the sale of a corporate vote unattached to the sale of the underlying stock. A powerful argument can be advanced that generally the congruence of the right to vote and the residual rights of ownership will tend towards efficient wealth production.

A proxy is, of course, a means temporarily to split the power to vote from the residual ownership claim of the stockholder. In the vast number of instances in which proxies to vote stock are used, however, this split occasions no significant divergence between the interests of the proxy holder and the holder of the residual corporate interest because the proxy is of relatively short duration and in all events is revocable unilaterally. Thus, in effect, the grant of the proxy represented a judgment (which may be enforced through revocation) that the holder of the proxy will exercise it in the economic interest of the residual owner. A potentially inefficient split between the interests of the voter and the interests of the residual

owners may, however, develop when the proxy is irrevocable. Such a holder is free from the unilateral control of the grantor and may be expected to be inclined to exercise voting rights in a way that benefits himself. There is of course, as a general matter, nothing legally suspect in contracting parties exercising contracted for rights in a self-interested manner. Yet the exercise of voting control over corporations by persons whose interest in them is not chiefly or solely as a residual owner will create circumstances in which the corporation will be less than optimally efficient in the selection of risky investment projects. (A simple, if gross, example: the holder of an irrevocable proxy with voting control might simply refuse to elect a board that will accept the best investment projects (those with the highest risk adjusted rate of return) unless some side payment to him is arranged). The special additional costs associated with such a divorce between ownership and voting (the costs being expressed either as an otherwise unnecessary expense or as the selection of non-optimizing investment projects) will of course tend to diminish as the voter's interest becomes aligned with the residual owners interest.

In this light, the dicta of *In re Chilson* may be thought to offer a means of limiting the agency costs that irrevocable proxies occasion. By recognizing only an interest in the stock itself as an interest that will support the irrevocability of a proxy, the rule of *Chilson* would eliminate a class of cases in which the incentives of the proxy holder to exploit the corporation would be greatest, that is, those in which she simply has no economic interest at all in the residual equity of the firm. Of course the *Chilson* rule does not entirely eliminate the inefficient incentive structure that the divorce of voting power and benefit occasions; the proxy voter/secured lender still is a creditor and thus may not be inclined to accept high-risk/high-reward projects, even if they have a positive risk-adjusted net present value. But the *Chilson* rule would moderate the effect.

4. Fashioning a Rule of Judicial Decision:

In the field of corporation law, courts have for centuries played and do still play an enormously important role in creating that law interstitially through the accretionary process of case by case rulings. Indeed the doctrine of fiduciary duty and the *ex post* protection against investor exploitation it offers, arguably provides an important support for the basic utility of the public corporation. When, in the absence of authoritative text or precedent, courts are modernly called upon to fashion corporate law rules interstitially, it is appropriate for the court, among other considerations, to consider the future effects generally of alternative rules and, in doing so, to consider especially the efficiency effects of those alternatives, to the extent they can reliably be detected. Thus, reasoning of the foregoing kind is not inappropriate to the institutional role of courts. But while not inappropriate, rarely will such reasoning directly produce an applicable rule or a ruling. To state what I would suppose is obvious, the corporate law, as applied in specific cases by courts, is institutionally a rich stew; the corporation law's underlying efficiency concerns are mediated through a body of authoritative rules, principles and practices to which courts owe loyalty. In this instance I confess to the view that a corporation law rule allowing for the specific enforceability of an irrevocable proxy that is coupled only with the holder's interest in maintaining a salaried office seems mischievous in terms of its possible efficiency effects. But in light of the 1967 amendment to the Delaware statutory law, the existence of the *Deibler* [opinion], and the absence of contrary precedent, I am required to express the opinion that such an interest – the interest that Herbert Haft had and retains as the senior executive officer of Dart – is sufficient under our law to render specifically enforceable the express contract for an irrevocable proxy. So concluding, I thus have no need to address the effect of his ownership of a block of non-voting Class A Dart stock. [...]