Irrevocable Proxies

By

Deborah A. DeMott*

Fragility is an inescapable quality of any agency relationship. Albeit acting in breach of contract, agent and principal each has power to terminate the relationship at any time, the agent by renouncing authority and the principal by revoking it. In contrast, courts in the United States have long recognized a category of more durable relationships in which one person has power to affect another person's legal relationships–a characteristic of an agency relationship–but does not act as an agent. In such relationships, the person acting is not subject to an agent's fiduciary duties and the terms of the parties' contract govern when and how the relationship may be terminated. A prime example is a proxy conferring authority to vote shares that is granted irrevocably by a shareowner to the proxy holder.[1] The circumstances under which a proxy may be made irrevocable, plus the duties assumed by the holder of such a proxy, underlie a recent judgment from Delaware's Court of Chancery involving high-profile media personalities linked by a complex ongoing relationship.

It's helpful to begin with the rationales that justify the ability of parties to an agency relationship to terminate it unilaterally. "You're fired," like its counterpart "I quit," is a

---

*David F. Cavers Professor of Law, Duke University of Law. I served as the Reporter for the American Law Institute's Restatement (Third) of Agency, which published in final form in 2006.

[1]On the position under English common law, see Francis M.B. Reynolds, Bowstead & Reynolds on Agency ¶ 10-013 at 614 (18th ed. 2006).

manifestation of intention that terminates the agent's authority although it may also constitute a breach of contract. Agency is a consensual relationship in which one person (the agent) consents to act on behalf of another (the principal) and subject to the principal's control, and the principal manifests assent to the relationship with the agent.[2] The principal's consent, like that of the agent, remains a relevant question throughout the duration of their relationship. This differentiates agency doctrine from contract and other bodies of law in which agreement at the outset of a relationship determines legal consequences that may later follow.[3] By appointing an agent, a principal risks being subject to unpredictable and unwanted consequences of the agent's dealings with third parties so long as the agent acts with actual authority or the third party reasonably believes that the agent so acts. The agent represents an extension or reflection of the principal's own personality; it's been argued that the power of an agent acting with actual or apparent authority is so strong that "the principal must be free to call it back."[4] From the standpoint of the agent, the power to renounce authority holds out the prospect of advantageous opportunities that the agent may pursue freed of fiduciary duties the agent would owe the principal in an ongoing agency relationship.

Courts in the United States have long recognized the possibility that an agency-like power might be made irrevocable. In 1823, in Hunt v. Rousmanier's Administrators, Chief Justice Marshall held that a power–in Hunt a power of sale–might be made irrevocable if the

---

[2]Restatement (Third) of Agency § 1.01 (2006).

[3]Id. § 3.10, cmt. b.

[4]Francis Reynolds, "When is an Agent's Authority Irrevocable, in Making Commercial Law: Essays in Honour of Roy Goode 259 (Ross Cranston ed., 1997).

power holder possessed a proprietary interest in the "subject matter of the agency itself."[5] Some jurisdictions, and the Restatements of Agency, apply a broader standard, which enables a power to be made irrevocable when it is given as security and held for the benefit of the power holder or a third person.[6] A power given as security is given to protect a legal or equitable title or to secure performance of a duty distinct from duties owed the holder of the power by the power's grantor that are incident to a relationship of agency. Under either standard, an agent's interest in protecting his in the agency relationship does not suffice to support an irrevocable power. Additionally, when an actor is simply an agent, not a holder of an irrevocable power, specific performance will not be an available remedy for breach of an agency contract.

Many cases develop the implications of these limitations on irrevocable powers and remedies, most recently in the branded hospitality industry, in which the owner of a brand often manages a property owned by others. In Government Guarantee Fund v. Hyatt Corp., a resort hotel's owner and a manager agreed that the manager would receive a commission equal to 5% of the hotel's gross revenues in exchange for its management services and for rebranding the hotel with its trade name.[7] The agreement also provided that the manager's authority would be irrevocable for ten years, perhaps in recognition of work by the manager requisite to improving the hotel. The owner revoked the manager's authority two years into the ten year period. The court held that the manager's authority terminated when the owner revoked it. Although the manager might have claims against the owner for breach of contract, specific performance of the

[5] 21 U.S. (8 Wheat.) 174 (1823).

[6] Restatement (Third) of Agency § 3.12 (1).

[7] 95 F.3d 291 (3d Cir. 1996).

management agreement would not be an available remedy.[8] The manager's interest in receiving its future commissions did not constitute a sufficient interest to support an irrevocable power, nor did the manager's commitment to use its trade name and other intellectual property make its relationship with the owner anything other than simple agency. In a later case involving different parties in the same type of relationship, the court granted the owner's motion for a preliminary injunction terminating the manager's operation following the owner manifestation of intent to revoke the manager's authority.[9] The court agreed with the owner's argument that it could no longer trust the manager to act in its best interests and, were the manager to remain in position, it might be tempted to divert business to other hotels it managed.

Against this background, the contemporary treatment of an irrevocable proxy to vote shares is exceptional because it may permit the creation of an irrevocable power to protect what appears to be an agent's interests in ordinary incidents of the agency relationship, in particular continued employment. Irrevocable proxies initially encountered judicial hostility. In many cases and for many years, courts refused to enforce irrevocable proxies unless the holder had a proprietary interest in the shares themselves, as would a proxy holder who has lent money to the shareowner on the security of the shares themselves.[10] This restrictiveness likely reflected the insight that, by separating voting power from ownership, a proxy creates or augments its holder's voting power uncoupled from any underlying economic interest the holder may have in the corporation. By so doing, the proxy may tempt its holder to use voting power to further the

---

[9]2660 Woodley Rd. Joint Venture v. IIT Sheraton Corp., 1998 WL 1469541 (D. Del. 1998).

[10]See Restatement (Third) of Agency § 3.12 cmt. d.

holder's interests at the expense of the corporation, for example through transactions on uncommercial terms between the holder and the corporation. Moreover, the power exercised by the holder of an irrevocable proxy always implicates two sets of interests, those of the shareowner or owners who granted the proxy and those of the corporation's other shareowners and other constituents. Judicial reluctance to enforce irrevocable proxies may also have reflected concern for spillover effects beyond the interests of the shareowners who granted the proxy.

On the other hand, an irrevocable proxy may constitute the sole realistic mechanism through which shareowners may coalesce in an effective manner and act to benefit the corporation and all its constituents. Central to an irrevocable proxy's effectiveness is specific enforcement according to its terms, as opposed to money damages for breach of contract, should a member of the proxy-granting coalition seek to defect by revoking his proxy. Accordingly, some courts considered whether the proxy holder's motivations appeared to encompass concern with the interests of the corporation more generally as opposed to interests purely personal to the holder.[11]

In most states, corporation statutes now address the circumstances under which a proxy may be made irrevocable, often requiring that the proxy: (1) expressly provide for irrevocability; and (2) be "coupled with an interest." Statutes vary in specifying such interests and in whether such specification is exclusive. The Delaware statute, which does not specify particular types of interests that will support irrevocability, also provides that a proxy may be made irrevocable "regardless of whether the interest with which it is coupled is an interest in the stock itself or an

[11] Restatement (Third) of Agency § 3.12, cmt. d.

interest in the corporation generally."[12]

Whether an interest in employment by itself suffices to support an irrevocable proxy remains a relatively open question. Delaware authority supports this basis for irrevocability but with express reservations about its wisdom and consequences. In the leading (and relatively recent) case, Haft v. Haft, the CEO and controlling shareholder of a publicly-traded corporation induced his younger son to become the corporation's president and chief operating officer in the midst of turmoil internal to the family.[13] The father transferred a controlling block of stock to his younger son plus cash, in exchange for a note and the grant of a lifetime irrevocable proxy to vote the stock. Disputes followed over the composition of the corporation's board of directors and the validity of an option to buy shares held by the son, culminating in a letter from son to father purporting to revoke the proxy. The court held that the proxy was enforceable, finding that the father's interest in the stability of his tenure as the corporation's CEO sufficed as an interest to support irrevocability under the applicable Delaware statute. The court expressed qualms about the wisdom of this holding: "[t]he 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 investment projects," noting the prospect that the holder of an irrevocable proxy might refuse to elect directors who will choose projects with the highest investment return unless the holder receives a side payment.[14] Perhaps more typically, the holder of an irrevocably proxy might choose to elect

---

[12]Del. Code Ann. tit. 8, § 212(e).

[13]671 A.2d 413 (Del. Ch. 1995).

[14]671 A.2d at 421-22.

only those directors who are likely to maintain the holder in office, even though the corporation is not prospering under the holder's management and appointing a better senior officer might improve the corporation's performance. In any event, in Haft itself the proxy-holding father had a separate interest that would conventionally support an irrevocable proxy because the proxy was also given to protect his interest as his son's creditor, which was created by a loan secured by an interest in the stock the father transferred to his son.[15]

Although well-grounded, the court's qualms in Haft might also apply to other arrangements that align voting power disproportionately to residual economic ownership interests. For example, when a corporation has multiple classes of shares with voting rights that are disproportionate to residual ownership interests, similar risks appear to be present; holders of high-vote stock with interests and perspectives not shared by holders of low-vote stock may elect directors whose decisions are "less than optimally efficient" from the standpoint of owners of a majority of the corporation's invested equity. An irrevocable proxy given to support an interest in employment differs in the level at which it confers power, on an individual agent as opposed to a class of equity investors. The court's reluctant acceptance of the irrevocable proxy in Haft may best be understood against a background that's tolerant of other governance arrangements that may also create divergent interests.

Additionally, directors elected by a holder of an irrevocable proxy, like directors elected by high-vote shares, serve as fiduciaries on behalf of the entire corporation. Decisions that favor the proxy holder or holders of the high-vote shares at the expense of other shareholders are vulnerable under fiduciary norms. The existence of fiduciary constraints on how power is used

[15] 671 A.2d at 419.

may allay concerns about the wisdom of permitting creation of the power in the first instance.

Consider now the duties of the holder of an irrevocable proxy as well as business circumstances in which such a proxy might be used. Both are illustrated by a recent Delaware case, In re IAC/InterActive Corp.[16] IAC, a public company, owns several media and internet businesses. It has a dual-class share structure; all of its high-vote Class B common stock is owned by Liberty Media Corp., another media and communications company. Through its ownership of IAC's Class B stock, plus its ownership of IAC common stock, Liberty holds 61.7% of IAC's voting power. In contrast, Liberty is the direct or beneficial owner of only 29.9% of IAC's invested equity. However, the power to vote Liberty's shares in IAC is held by IAC's CEO and Chairman, Barry Diller, to whom Liberty granted an irrevocable proxy in 2001. Thus, although Liberty is IAC's controlling shareholder, Mr. Diller has power to exercise Liberty's voting rights, subject to the terms of his agreements with Liberty.

The circumstances leading to the grant of the irrevocable proxy are revealing. Liberty's relationship with IAC began in 1992 when Liberty was an affiliate of a large cable-television company. IAC (then called Silver King Communications) operated television broadcast stations. Liberty acquired an option to purchase a controlling interest in Silver King's high-vote shares that it was unable to exercise because the Federal Communications Commission (FCC) barred the ownership of broadcast stations by cable television operators. The solution was to create an entity to which Liberty would contribute its option in exchange for an issue of nonvoting convertible preferred stock. Mr. Diller would own the new entity's voting shares and thus be able to exercise the option to buy the Silver King shares. Liberty agreed that so long as Diller ran

[16] 2008 WL 837032 (Del. Ch. Mar. 28, 2008).

Silver King, he would have an irrevocable proxy to vote any Silver King shares that Liberty or its affiliates owned or might own in the future, in particular shares of common stock acquired by converting the preferred stock held by Liberty. Subsequent corporate mutations and transactions preserved this basic allocation of corporate equity ownership and control rights, with Liberty eventually acquiring ownership of shares carrying a majority of the voting power in IAC. The FCC approved the arrangement, noting that Mr. Diller have voting control of stock owned by Liberty, thereby distancing the cable-system operator from exercising governance rights associated with ownership of shares in a broadcasting company. Thus, regulatory prohibitions on cross-ownership made attractive the separation of share ownership from power to vote the shares.

When IAC's share price slumped in 2005, the relationship between Liberty and Mr. Diller soured and other investors demanded strategic change. IAC's senior management responded with a proposal to spin off four of IAC's businesses through a distribution of shares in newly-created public companies (the "spincos") to IAC's shareholders. The proposal, supported in concept by Mr. Diller and IAC's board, would structure shares in the spincos on one tier without replicating the dual-class structure of IAC. Although the scope of Mr. Diller's proxy would not extend to shares in the spincos, the spinoff transaction itself would be subject to a shareholder vote in which Mr. Diller would have power to vote Liberty's IAC shares. With one-tier voting structures in the spincos, Liberty would not have majority control over them.

Liberty reacted to the spinoff proposal by executing and delivering a consent to IAC through which it purported to vote its IAC shares to remove Mr. Diller and other directors from

IAC's board.[17] In the litigation that inevitably followed, Liberty argued that Mr. Diller's support of the one-tier voting structure for the spincos violated his express and implied duties to it and had the effect of terminating Mr. Diller's proxy. The court, finding no breach by Mr. Diller, held that Liberty's attempt to remove directors from IAC's board was ineffectual because Mr. Diller, through the irrevocable proxy, retained power to vote the IAC shares owned by Liberty.

In its agreement with Mr. Diller, Liberty retained the right to consent to specified actions that IAC might take. The court held that the proposed distribution of spinco shares did not fall within any specified category, many of which concern actions that might create legal obstacles to Liberty's continuing ownership of IAC shares. However, Liberty also argued that Mr. Diller had an obligation to act as its faithful "steward" in voting its controlling block of IAC shares.[18] More specifically, Liberty characterized Mr. Diller's duty as holder of its proxy to "preserve its voting interest in IAC as Liberty may dictate."[19] Although Liberty traced this duty to an implied contractual duty of good faith and fair dealing, the court treated Liberty's argument as an attempt to subject Mr. Diller to an overarching fiduciary duty despite an explicit agreement that specified the limits to Mr. Diller's power to vote Liberty's shares by stating the transactions and circumstances when Liberty's approval would be necessary.

Its complexities aside, this dispute illustrates fundamental distinctions between relationships of common-law agency and those governed by irrevocable proxies. If a proxy has validly been made irrevocable, the holder's power to vote the shares covered by the proxy

---

[17]Under Delaware law, unless the corporation's articles otherwise provide, shareholders may exercise voting power through signed written consents. Del. Code Ann., tit. 8, § 228.

[18]2008 WL 837032 at *32.

[19]Id.

survives a manifestation by the shareowner attempting to revoke the proxy. Moreover, a holder of an irrevocable proxy is not an agent. Although the IAC judgment does not explicitly make this point, surely it underlies the court's analysis. An agent acts as the principal's fiduciary with duties to act loyally for the principal's benefit in all matters connected with the agency relationship.[20] In contrast, subject to limits imposed by agreement with a shareowner, the holder of an irrevocable proxy is free to act in its own interests in voting the shares. Enabling the proxy holder to protect or pursue its own interests is, after all, the rationale for creating an irrevocable proxy.

Moreover, a principal always has power to furnish instructions to an agent although by so doing the principal may breach its contract with the agent; receiving such instructions, the agent has a choice whether to comply with the instructions or resign.[21] Thus, were he voting Liberty's IAC shares as its agent, Mr. Diller would be obliged to choose between compliance or resignation. An agent always serves subject to the principal's control; the principal's power to give interim instructions to the agent is integral to its power of control. In contrast, a person who holds an irrevocable proxy does not act as the shareowner's agent in voting the shares. Liberty's relationship with Mr. Diller thus created no power to furnish interim instructions–its rights were fixed through the specifications in their agreement.

Common-law agency doctrine furnishes essential context for understanding the circumstances under which a proxy may be made irrevocable. Likewise, only by recognizing that an irrevocable proxy does not create a relationship of common-law agency do the proxy holder's

---

[20]Restatement (Third) of Agency § 8.01.

[21]Id. § 1.01, cmt. f.

duties and rights become intelligible.

-