HARNEYS

Ciban v Citco (2020) – reformulating the *Duomatic* principle

On 30 July 2020 the Privy Council handed down their decision in *Ciban Management Corporation v Citco (BVI) Ltd* [2020] UKPC 21, upholding the decision of the British Virgin Islands Commercial Court and the Eastern Caribbean Court of Appeal, and developing our understanding of certain key aspects of company law, especially the *Duomatic* principle and section 175 of the BVI Business Companies Act 2004 (the ***BC Act***).

Facts

The appellant company (the ***Company***) was beneficially owned by Mr Byington, a Brazilian businessman. The Company had a sole corporate director called Tortola Corporation Company Ltd (***TCCL***), which was provided by the registered agent, Citco.

Mr Byington's business was failing and he hoped to put the business's remaining assets (properties in Brazil) beyond the reach of its creditors. He arranged for the formation of the Company so that he remained beneficial owner, but had no ostensible links to it, and caused those assets to be vested in the Company via a process described by the Privy Council as a "sham". Over the years, with Mr Byington's consent, various powers of attorney had been executed by TCCL as director of the Company on instructions from a friend and business partner of Mr Byington, Mr Costa, who was a trusted associate of Mr Byington. Mr Costa was authorised to give instructions to Citco and TCCL in respect of the Company whilst Mr Byington "remained in the shadows".

Later Mr Byington and Mr Costa fell out, partly because of Mr Byington's failure to pay various debts allegedly due to Mr Costa including loans from Mr Costa. Mr Costa asked TCCL to execute a fifth, much broader power of attorney in favour of a Brazilian lawyer, Mr Dellolo, by which Mr Dellolo concluded a contract for sale of the Brazilian properties, which were the Company's only assets. Citco and TCCL were accustomed to acting upon Mr Costa's instructions, and cooperated without question. Only after a sale had been agreed did Mr Costa inform Mr Byington what had happened and that he intended to use the proceeds of the sale to pay off the debts owed to him, and then return the balance to Mr Byington.

Mr Byington then brought legal proceedings in Brazil to stop the sale. Those Brazilian proceedings were settled with a payment to the purchaser for the aborted purchase.

Mr Byington then sued TCCL and Citco in the British Virgin Islands courts alleging breach of tortious and fiduciary duties in granting the power of attorney to Mr Delollo and ignoring alleged "red flags" that the transaction was not approved by Mr Byington as beneficial owner. He also claimed breach of section 80 of the International Business Companies Act (now section 175 of the BC Act) in failing to secure formal shareholder approval for a disposal of over 50 per cent of the Company's assets.

The British Virgin Islands Commercial Court at first instance found as a fact that there had been no such red flags, and there was nothing to suggest to TCCL and Citco that Mr Costa was not executing Mr Byington's instructions in the normal way. The Privy Council accepted the reasoning of Bannister J at first instance that Mr Byington had set up the relationship in this manner and that, by so doing, had accepted the risk that Mr Costa might betray him – he could not then seek to pass that risk to TCCL and Citco.

Mr Byington also alleged that as TCCL was a director, it should have scrutinised the sale. The Privy Council agreed with Bannister J that TCCL's role in the Company was essentially "execution only", and that they did not provide that level of management, and the parties did not expect them to.

The *Duomatic* principle

The Privy Council noted that the above findings meant that it was reasonable for Citco and TCCL to rely on Mr Costa having ostensible authority to act on behalf of Mr Byington. But TCCL owed its duties to the Company, and thus it was necessary to show that Mr Costa also had ostensible authority to bind the Company in granting the fifth power of attorney. The directors owe their duties to the Company, not the beneficial owner. And the Company was the claimant, not Mr Byington. To address this issue, the Privy Council gave detailed consideration to the area of law

known as the *Duomatic* principle. That principle states that "the unanimous decision of all the shareholders in a solvent company about anything which the company under its memorandum of association has power to do shall be the decision of the company" (*Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258).

In the case of the contested sale of the Company's property, Mr Costa clearly did not give express authority to put these events in motion. So the slightly novel question before the Privy Council was whether the principle would apply to Mr Costa's ostensible (rather than express) authority to tell TCCL what to do, and Lord Burrows held that it could: "If actual authority can be conferred informally by unanimous shareholder consent the same should apply to ostensible authority" (at para 38).

But the *Duomatic* principle has a number of specific limitations. One was not relevant (solvency), but others potentially were:

- Firstly, the principle does not normally apply where the shareholder was not aware of what was happening. Hence it could be argued that Mr Byington was not aware of, and therefore could not have consented to, the sale. The court rejected this, and held that because Mr Byington had set up a structure where he could remain in the shadows to protect his business's assets from creditors, it would be inequitable of him to assert subsequently that he had not approved the giving of authority to Mr Costa.

- Secondly, dishonesty is normally a bar to the application of the principle, and it was alleged by Mr Byington that Mr Costa was dishonest in his endeavours, and that the court should not effectively permit an agent to defraud the Company. However the Privy Council asserted this was looking at the wrong part of the sequence of events. Even if the proposed sale had been completely fraudulent (which they did not necessarily accept), the issue was whether Mr Byington or TCCL had been dishonest – not Mr Costa (para 44).

- Thirdly, the court noted that Mr Byington was not technically the shareholder – he was the ultimate beneficial owner. The shares were in bearer form, and were held by a lawyer in Florida on his behalf. But the court was satisfied in appropriate cases the assent of the beneficial owner could be sufficient, relying in particular upon the comments of Newey J in *Rolfe v Rolfe* [2010] EWHC 244 (Ch), para 42, that "the assent of the beneficial owners of a share can meet *Duomatic* requirements."

In finding that the *Duomatic* principal applied (and that it was reasonable for TCCL to act on Mr Costa's instructions as a representative of the ultimate beneficial owner), the Privy Council therefore dealt with the apparent informality of the process, as from TCCL's perspective there was therefore no need to obtain a formal shareholder resolution for the purposes of section 80.

Related issues

The Privy Council also considered the role and duties of the registered agent. They confirmed that a registered agent is not to be treated as a director, and normally its duties are limited to providing ongoing company administration but acknowledged that it could embrace accurately passing on relevant information and instructions received from Mr Byington (as ultimate beneficial owner) to TCCL as director.

The Privy Council also expressed disapproval of two statement of law by the first instance judge: (i) that the duty under section 80 was owed to Mr Byington and not to the Company; and (ii) that the sale of the Company's assets was "in the usual or regular course of the business carried on by the company" because it was essentially a single-purpose vehicle. Both of those clarifications are welcome, and in line with reservations previously expressed in relation to the first instance decision by the editors in *British Virgin Islands Commercial Law* (4th edn, Sweet & Maxwell) at 2.324-2.326.

Comment

Although Lord Burrows, giving the decision of the Privy Council, demurred from saying so explicitly, this decision will develop understanding around the scope of the *Duomatic* principle. The decision may lead to a flurry of changes in company law textbooks on the issue. Indeed, much of the reasoning behind the decision seems to have been driven by the disapproval of the various courts for Mr Byington's conduct. On the agreed facts it was accepted that Mr Byington set up the Company as part of a scheme to put assets out of the reach of creditors, whilst still retaining control from the shadows. When his scheme backfired, the courts were short on sympathy and unwilling to hold a third party professional service provider liable for the consequences, although as the Privy Council noted, there might be potential claims by the ultimate beneficial owner against Mr Costa.

Key takeaways:

In our view the key points to note from this decision are:

- The *Duomatic* principle can apply to cases of ostensible authority (as well as express authority)
- A company may still be bound by an agent acting on authority from the ultimate beneficial owner who does not have full knowledge of the specific action if it would be inequitable for them to deny they had granted the agent authority
- An ultimate beneficial owner can provide assent under the *Duomatic* rule in appropriate cases
- Registered agents do not owe greater duties in relation to the company's affairs beyond their statutory duties and such other duties as they may assume
- BVI law does not impose on directors a lower standard of care than that applicable under English law
- A director's duty under section 175 of the BC Act is owed to the company, not the shareholders

- A disposal of the sole asset of the company is not subject to the “usual course of business” exemption only by reason of the fact that the company is a single-purpose vehicle
- Shareholders may wish to include specific protections (often called “reserved matters”) in the memorandum and articles of association requiring shareholder approval in writing before the company can take certain actions such significant disposals or other key corporate actions

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