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With all due authority... Part two of our series on the impact of Fang Ankong and HWH Holdings Limited v Green Elite Limited

FEBRUARY 2023

The recent Court of Appeal judgment of the BVI case of Fang Ankong and HWH Holdings Limited v Green Elite Limited (in Liquidation) affirmed the BVI Commercial Court judgment finding the directors of Green Elite Limited (**Green Elite**) liable for HK$158.7m, plus interest, for failure to obtain shareholder consent. Our summary of the judicial analysis can be read here.

So, how are we going to be advising our corporate clients in the BVI?

Case Details

Green Elite was incorporated to effect an employee share benefit scheme for three employees to reward them upon listing of the joint venture (**JV**). Green Elite's shareholders were Mr Fang, acting through HWH Holdings Limited, and Delco Participation BV (which was owned jointly by two individuals). The directors of Green Elite were Mr Fang and three employees, with no representative from Delco.

In 2014, Green Elite sold the shares in the JV to a third party without director or shareholder approval. The share proceeds were paid to Mr Fang in three tranches. He did not disclose that he kept the proceeds to his JV partners and eventually distributed the consideration to the three employees. In 2018, Green Elite commenced proceedings against Mr Fang and the three directors for breach of fiduciary duties and failure to comply with section 175 of the BVI Business Companies Act 2004 (as amended) (**BCA**).

Mr Fang tried to rely on the '*Duomatic principle*' in that there was an "understanding" between the shareholders that there would be an incentive scheme for certain key employees to be rewarded on the IPO of the JV. Mr Fang argued that he did not fail to comply with section 175 of the BCA as:

- each transfer amounted to 33% and did not hit the threshold of 50%;
- the distribution was made in the regular course of Green Elite's business; and
- there was an approval at board level by Mr Fang and the three directors, and at shareholder level by Duomatic assent.

Duomatic Principle

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The *Duomatic* principle recognises situations where directors of a company can rely on the unanimous agreement of the members without the need for a formal resolution. The principle is characterised by its informality but it is key to distinguish between informality and certainty. It must be possible to identify that the agreement was intended to have legal effect and was on certain terms. Shareholders must also be aware that their assent is being sought.

Key considerations in deciding whether the "understanding" in this case was legally enforceable included: (i) was a price for the shares agreed; (ii) was there a method for fixing a price; and (iii) was a lock-up period agreed. At first instance, the judge found that failure to agree these points and the fact that when this "understanding" was made, Green Elite had not even been incorporated, was "*fatal to the "understanding" having legal effect*".

The Court of Appeal judge found that the "understanding" lacked critical details and there was no meeting of minds, therefore there was no *Duomatic* assent.

Dispositions under section 175 of the BCA

Section 175 of the BCA is designed as a safeguard for a company from a disposition of more than 50% of its assets without director and shareholder approval. Although in practice we regularly see the requirement for shareholder approval disapplied in a company's memorandum and articles of association, this case should remind directors of the importance of thoroughly considering the transaction and obtaining shareholder approval in cases where there may be any ambiguity.

The BCA requires that details of any disposition of more than 50% in value of a company's assets, if not made in the usual or regular course of business, shall be submitted by the directors to the members for their authorisation by resolution.

Directors will need to consider that the phrase "regular course of business" in section 175 is not the same as the "ordinary course of business". Although in certain situations, it could be argued that a sale or disposition of assets could be seen as being in the ordinary course of business, Green Elite carried on no business in the sense of ongoing commercial activity and so the dispositions could not be said to be in the "usual and regular" course of its business as required to avoid the section 175 requirements.

Finally, it is important to note that multiple smaller sales of assets, even if they happen at separate times, may be considered one disposition for the purpose of section 175 if the total value is over 50% of the company's total assets. In the judgment, the transfer of the sale proceeds of Green Elite were seen as *"one composite transaction"*. The purpose of section 175 of the BCA would be undermined if a director could divvy up a sale of assets into multiple parts to avoid its effect.

Takeaways

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There are principles, such as *Duomatic* assent or the exception to section 175, which could assist directors who have not obtained satisfactory corporate authorisations for a transaction. However, this case illustrates that their applicability is far from certain and, at the end of stressful and costly litigation, the court's decision may not go your way.

Our advice? Directors in doubt of their authority, the extent of shareholder support for an action, or whether a transaction is in the regular or usual course, should not rely on either of these provisions. It is far safer to put in place the necessary corporate authorisations, even if you believe the other parties are in agreement on the proposed course of action.

And if section 175 causes operational delays in running the business? Amend your articles of association to dis-apply it.

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