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Duomatic Principle: The limits of Directors to bind companies

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It has long been the position in the BVI[1] that directors of a company can rely on the *Duomatic* principle which recognises that a company's shareholders can informally give approval through unanimous consent which legally binds the company without the need of any formal shareholder resolution.

This principle was confirmed in *Ciban Management Corporation v Citco (BVI) Ltd* ("**Ciban**")[2]. In that case, the ultimate beneficial owner of the company, Mr B, authorised Mr Costa to give instructions to the company's Registered Agent, Citco[3] and director, TCCL[4]. Over the years, with Mr B's consent, several powers of attorneys ("POA") had been executed by TCCL on Mr Costa's instructions. When Mr B and Mr Costa's relationship deteriorated, Mr Costa instructed TCCL to execute a fifth POA for a contract for the sale of the company's asset.

Having previously relied on Mr Costa's instructions to issue POAs, TCCL and Citco approved the fifth POA and thereby allowed the sale of the asset. Mr B became aware of the transaction and sued TCCL and Citco alleging breach of their fiduciary duties in granting the POA claiming that the transaction was not formally approved by him as the ultimate beneficial owner and shareholder of the company[5].

The BVI Commercial Court held that the *Duomatic* principle applied. As such, the company was bound by the informal consent of Mr B as the ultimate beneficial owner to the representation that Mr Costa had authority to instruct TCCL and Citco to issue the fifth POA. The court further found that Mr B, having set up a mode of operation on which TCCL and Citco relied, Mr Costa had authority to instruct them to issue previous POAs, Mr B was estopped from denying that he consented to giving Mr Costa authority.

From that decision, the following key principles can be levied for the purposes of BVI law:

1. the Duomatic principle applies to apparent authority;
2. consent may be by way of conduct; and
3. consent of both the the ultimate beneficial owner and registered shareholder can bind the company.

The case of *Ciban* illustrates that the Duomatic principle, therefore, provides some comfort to directors who honestly act on any apparent authority given by shareholders to their agents, provided that there is a mode of operation or conduct which the directors have become accustomed to relying on.

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The limits of the Duomatic Principle

However, the limits of such protection are evident from the recent decision of *Green Elite*[6] where a director was unable to rely on a shareholder's informal agreement. The court clarified that the principle, although characterised by its informality, must be underpinned by a degree of certainty. Namely, it must be possible to identify that an agreement was intended to have legal effect and that such was on terms which were certain. Most importantly, the shareholders must have been aware that their consent to such conduct was being sought.

In *Green Elite*, the issue was whether the directors of a company had lawfully paid the proceeds of the sale of the company's sole asset to three employees (the "**Three Employees**").

The director sought to justify the payments by reference to the *Duomatic* principle, alleging that there had been an informal "understanding" between the shareholders in 2008 that the funds would be used to pay employees at some point in the future for their service in respect of an initial public offering.

Incorporated in 2010 as a joint venture ("**JV**") equally between Mr Fang and Delco, Green Elite's sole purpose was effecting an employee share benefit for the listing of JV's business. After the sale of Green Elite's asset, the proceeds were paid into a bank account of Mr Fang who caused the funds to be paid in three instalments to the Three Employees. Delco was not told of this disposition nor was there any directors' meeting held or any formal shareholder resolution passed to approve the payment.

In upholding the first instance decision, the Court of Appeal found that there was no *Duomatic assent* as the shareholders were not aware and could not have been aware that their consent was being sought for the sale of the shares and thus could not have applied their minds to the issue of assent as the discussions surrounding the sale took place in 2008 before the incorporation of *Green Elite* in 2010.

On this basis, the court found that the directors could not rely on the informal discussions of the shareholders as there could not have been any certainty as to the terms relating to the sale to legally bind the company given that such understanding between Mr Fang and the shareholders took place before the incorporation of *Green Elite*. Thus, the shareholders could not have expected that at the time of discussions, and in fact before the incorporation of *Green Elite*, that they were intending for the discussions to create legal relations.

Another decision that further limits the *Duomatic* principle is *Arrowcrest*[7] (also decided in 2023). In that case, Mr Taruta owned 100% of the shares in Arrowcrest, which in turn owned 100% of the shares in Enard. VTB Bank applied to the BVI Court for recognition of a Russian judgment which VTB Bank had obtained against Mr Taruta and to enforce that judgment by way of a receivership order over the shares in Enard.

It was found that as the sole shareholder of Arrowcrest, Mr Taruta exercised *Duomatic control* over Arrowcrest to direct how the shares in Enard could be voted upon and, therefore, the appointment of the receivers was an appointment over the power held by Mr Taruta under the *Duomatic* principle.

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On appeal, the Court found that while a shareholder of a company may have power to direct the way the shares in that company are voted on, the *Duomatic* principle does not give the shareholder the power or control to deal with or dispose of the company's assets[8]. Accordingly, the court found that the *Duomatic* principle was irrelevant, thus the first instant judge had no jurisdiction to make the receivership order.

Key takeaways

The case of *Ciban* illustrates that while directors can rely on informal shareholder assent to bind the company, *Green Elite* confirms that directors may be limited in relying on informal discussions with shareholders if there were no certain terms which could lead to an intention to legally bind the company. Further, *Arrowcrest* illustrates that shareholders cannot give themselves freestanding power or control over a company's assets by relying on the *Duomatic* principle.

Therefore, it is important that directors of BVI companies ensure that (i) shareholders have full knowledge of all matters that may bind the company; (ii) an actual assent can be objectively ascertained; and (iii) where assent has been given by way of agreement, the agreement is unqualified and does not lack any critical detail.

References:

[1] In Re Duomatic Ltd [1969] 2 Ch 365

[2] [2020] UKPC 21.

[3] Citco (BVI) Limited

[4] Tortola Corporation Company Ltd

[5] This was required for disposal of over 50% of the Company's assets Mr. B also claimed a breach of section 80 of the International Business Companies Act (now section 175 of the Business Companies Act,2004)

[6] *BVIHCMAP2022/0013 (1) Fang Ankong and (2) HWH Holdings Limited v Green Elite Limited (in Liquidation)*

[7] *Arrowcrest Ltd v JSC VTB Bank BVIHCMAP 2021/0043*

[8] for any purpose other than the furtherance of the objective of the company

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