Article

Green Elite: The Duomatic Principle, s.175 and directors' liability for unauthorised payments

Authors: Matthew Brown, Counsel

The Eastern Caribbean Court of Appeal recently handed down judgment in *Fang Ankong and anr v Green Elite Limited (in Liquidation)* BVIHCMAP2022/0013. The case addresses a number of important legal issues relating to the operation of the Duomatic principle[1], the meaning and effect of s.175 of the BVI Business Companies Act, 2004 (the "BCA"), and a BVI director's liability for unauthorised payments.

Below is a summary of the case and a list of the key points from the Court of Appeal's decision. A copy of that judgment is available here.

The Basic Facts

At its heart the case concerned payments (totalling c.HK$150 million) that had been made by a BVI company – Green Elite – to three of its directors, who were also employees of the company. The company subsequently went into liquidation and its liquidators alleged that those payments – which comprised the sale proceeds of assets previously owned by Green Elite – had been made by the directors in breach of their fiduciary duties.

Among other things, liquidators alleged that in making the relevant payments the directors had: (a) acted in breach of s.121 of the BCA (which imposes a duty on a BVI director to exercise his or her powers as director for a proper purpose and in compliance with the BCA and the company's M&As – "**s.121**"); and (b) failed to comply with the requirements of s.175 of the BCA (which they alleged also constituted a separate breach of s.121) ("**s.175**").

For the benefit of any non-BVI lawyers reading this, s.175 applies where there is a disposition by a BVI company of more than 50% in value of its assets which is not made in the usual or regular course of the business carried on by the company. It is intended to provide an important check on the directors' power to dispose of the company's assets, in that (among other things) it requires that the proposed disposal be authorised by a shareholders' resolution.

In *Fang*, the liquidators' allegations were defended on the basis that: (a) the relevant shareholders had authorised the payments in accordance with the Duomatic principle; and (b) s.175 did not apply to the payments, but if it did the directors had complied with its requirements.

The Decision of the BVI Commercial Court

At first instance [2] Jack J found that the Duomatic principle did not apply, as the "understanding" relied upon by the directors (as allegedly authorising the relevant payments) had not been intended by the shareholders to be legally binding. In particular, Jack J found that certain key terms had not been agreed upon. Therefore, the payments constituted a breach of s.121, as they had had not been made for a proper purpose.

[1] Taken from the case of the same name: [1969] 2 Ch. 365
[2] BVIHC (Com) 2018/0222 (unreported, delivered 17 January 2022)

Jack J also found that the payments constituted a breach of s.175. Although 3 separate payments had been made – none of which individually comprised more than 50% in value of Green Elite's assets – there was, in reality, only one transaction, and the value of that transaction exceeded the 50% threshold. Jack J accepted that the transaction was "potentially" one made in the usual or regular course of the company's business (as a holding company), but ultimately found that the directors had not complied with the requirements of s.175.

In light of those findings, Jack J *inter alia* ordered the directors to account to Green Elite (jointly and severally) for the full value of the unauthorised payments, plus interest.

The Court of Appeal Decision

The Court of Appeal dismissed the defendants' appeal. In short, it upheld Jack J's decision on the Duomatic principle and his overall conclusion on s.175 (albeit those parts of the judgment dealing with s.175 were strictly *obiter*). However, there are several interesting aspects of the Court of Appeal's analysis:

(1) On the Duomatic principle, the Court of Appeal confirmed that whilst Duomatic assent does not involve the application of contractual principles (such as offer, acceptance and consideration), there must (among other things) be material from which assent can be objectively ascertained. Further, in cases in which an understanding or agreement is alleged (i.e. where the party is not relying upon silence or acquiescence), the objective approach for the ascertainment of assent is broadly similar to the objective approach which must be taken when determining formation of a contract, including the intention to create legal relations and certainty of terms.

The Court of Appeal reiterated that the Duomatic principle requires unequivocal shareholder assent. Therefore, particularity in respect of the terms of the agreement or understanding is something that a court is entitled to consider when determining whether, objectively, the shareholders intended to bind themselves.

(2) On the meaning and effect of s.175, the Court of Appeal made clear (albeit *obiter*) that:

(a) The section is capable of being engaged where there are transfers, dispositions etc. that individually do not constitute 50% in value of the assets of the company but which form part of one single transaction that exceeds that 50% threshold.

(b) In order for the "usual or regular course of business" exception to be engaged, the company in question must actually be carrying on a business in the sense of an "ongoing commercial activity". The Court of Appeal expressed the view – disagreeing with Jack J – that simply holding shares does not constitute the carrying on of a business. In taking that position, the Court of Appeal distinguished (and appeared to ultimately disagree with) the view that it had previously expressed in *Fong v Wong*[3] , when addressing s.80 of the IBCA 1984 (the predecessor to s.175).

(c) Although s.175 does not expressly set out the same, a breach of that section does give rise to certain consequences, including for the purpose of the duties imposed by s.121 of the BCA.

(3) On a director's liability for unauthorised payments, the Court of Appeal agreed with Jack J that where a director causes a company to make unauthorised payments for which the company receives no value, the director is liable to the company to pay compensation equal in amount to the payments made. In reaching that view the Court of Appeal cited with approval the English Court of Appeal decision of *Auden McKenzie (Pharma Division) v Patel*[4], which had itself cited the well-known line of authorities dealing with the payment of unauthorised dividends, including *Bairstow v Queens Moat House Plc*[5].

Comment

The Court of Appeal's decision provides helpful guidance on the operation of the Duomatic principle in those cases in which an informal agreement or understanding is alleged. The case also confirms the principles governing a director's liability for unauthorised payments. However, perhaps the most striking part of the Court of Appeal's decision is its *obiter* remarks on s.175, including its analysis of the "usual or regular course of business" exception. Given the large number of holding companies in this jurisdiction, the Court of Appeal's analysis (if adopted in future cases) is likely to lead to an increase in the number of disputes concerning s.175 - a risk of which BVI directors will need to be aware

[3] BVIHVMAP2018/0001 and BVIHCMAP2018/0002 (unreported, delivered 27 March 2019).
[4] [2019] EWCA Civ 2291
[5] [2001] EWCA Civ 712.

Contact:

Matthew Brown
Counsel
matthew.brown@conyers.com
+1 284 852 1121

For further information please contact: media@conyers.com