Secret shareholders, ostensible authority and the *Duomatic* principle in offshore corporate structures

Introduction

The recent decision of the Privy Council in *Ciban Management Corporation v Citco (BVI) Ltd* [2020] UKPC 21 considered the application of the *Duomatic* principle to a situation in which the ultimate beneficial owner is not the registered shareholder of the company concerned, but controls it from the shadows through an agent. It is, in many ways, a decision grounded in common sense given the facts, but it is backed up (at least as to the main decision) by both interesting and concise legal reasoning. It will, no doubt, be a decision which provides comfort to professional corporate services providers in the offshore jurisdictions.

The Facts

Central to the case was a BVI company called Spectacular which had issued bearer shares. Spectacular's registered agent was Citco (BVI) and its sole (nominee) director was a company known as TCCL. The individual ultimately behind Spectacular was a Brazilian businessman, Mr Byington, on whose behalf a Florida lawyer held the bearer shares.

Mr Byington, motivated by his desire not to be discovered as the ultimate beneficial owner of Spectacular, refused to sign any management agreement with Citco or TCCL. Instead, he used a long-standing agent, a Mr Costa, to communicate all instructions to Citco. This system of communication had been in place since Spectacular's acquisition.

Over the next two years, on instructions communicated directly or indirectly by Mr Costa to Citco which passed them on to TCCL, Spectacular issued four different powers of attorney authorising a Brazilian lawyer to conduct various activities on its behalf. All those activities were approved by Mr Byington, albeit that approval was not communicated to any of the professionals who dealt with Mr Costa.

In 2001, unknown to Mr Byington, Mr Costa instructed Citco BVI to cause Spectacular to grant a further power of attorney to the Brazilian lawyer which authorised the sale of real estate in Sao Paulo, Spectacular's only asset. Citco and TCCL obeyed the instructions they received and granted the power of attorney. The lawyer entered

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into a contract for sale of the property, and Mr Costa sought to use the proceeds of sale to discharge debts owed to him by Mr Byington.

Having been told by Mr Costa what had happened after the event, Mr Byington caused Spectacular to sue Citco and TCCL for breaching their duties in permitting the power of attorney to be granted. TCCL defended the claim on the basis that Mr Costa had received ostensible authority from Mr Byington, and that Mr Costa's instructions were binding on Mr Byington as an act of the company under the *Duomatic* principle.

The Decision

In reaching its conclusion that TCCL was not in breach of its duty of care to Spectacular as a director, the Privy Council tied together two different principles: ostensible authority and the *Duomatic* principle.

At the outset the Board approved the general reasoning of the Court of Appeal that TCCL was not in breach of duty because it had simply complied with the system established by Mr Byington over a number of years. In using and maintaining such a system Mr Byington "*accepted the risk that Mr Costa might one day betray him*". The Board agreed there was no failure by TCCL to identify or respond to supposed red flags, and as an execution only director it could not have been expected to scrutinize the proposed sale of property.

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However, a finding as to ostensible authority was not sufficient by itself to provide TCCL with a defence to the claim. That is because, whilst TCCL's conduct may have been reasonable vis-à-vis Mr Byington, it also needed to be reasonable vis-à-vis Spectacular. Thus, TCCL needed to establish that Mr Byington's conduct was attributable to Spectacular. As the Board explained, it was not sufficient to simply equate the two because Mr Byington was Spectacular's beneficial owner; a more principled explanation was required.

The solution arose in the form of the *Duomatic* principle, which is well known in company law. It provides that the shareholders of a company can bind it by making an informal but informed decision, provided it is *inter vires* the company. TCCL's argument was that by his conduct Mr Byington had bound Spectacular, thus completing the circle as regards the reasonableness of TCCL's actions.

The Privy Council accepted that argument, ultimately concluding that: "*By reason of that principle, the ostensible authority conferred by Mr Byington counts as ostensible authority conferred by Spectacular. Spectacular cannot be allowed to deny that it authorised Mr Costa to give the instructions to TCCL.*"

Various aspects of the Board's reasoning are particularly worthy of mention:

(1) It was clear that had Mr Costa been given actual authority, Spectacular would have been bound. The question was therefore whether the *Duomatic* principle could be applied to ostensible authority. The Privy Council saw no reason why not, and it is suggested that this must be right.

(2) Whilst there is an exception to the *Duomatic* principle in circumstances where the shareholder does not consent to the relevant act, it could not apply in this case. The Board was clear that "*the very concept of ostensible authority means that Mr Byington should not be allowed to deny that he consented to the giving of authority to Mr Costa.*" In other words, having set up and relied on the system used to give instructions to TCCL, Mr Byington took the risk of Mr Costa acting in a manner to which he would not have in fact consented.

(3) There was no scope for Spectacular to invoke the rule that the *Duomatic* principle cannot be used where there is relevant dishonesty. Neither Mr Byington nor TCCL had acted dishonestly, thus the application of the principle was not allowing the shareholder or director to defraud the company. Whether Mr Costa was acting dishonestly or not was irrelevant, because the system Mr Byington had set up necessarily involved a risk that Mr Costa would act dishonestly.

(4) The Privy Council also confirmed that the *Duomatic* principle applies as regards the consent of the ultimate beneficial owner where it is that person, rather than the registered shareholders, who takes all the decisions in relevant transactions (a conclusion which sensibly reflects the reality of control and relevant consent in such cases).

Having concluded TCCL was not in breach of its duties, the Privy Council had no difficulty in deciding that Citco, whose role and duties were somewhat more limited than those of TCCL, had not breached its duties by accurately passing on Mr Costa's instructions.

The Board also raised some doubts about some other conclusions reached in the courts below concerning the operation of s.80 of the International Business Companies Ordinance (Cap 291) (now replaced by s.175 of the BVI Business Companies Act 2004) which requires that shareholders as well as directors approve the sale of more than half of the company's assets which is not made in its usual or regular course of business. The lower courts had decided that the duty under s.80 was owed to Mr Byington rather than Spectacular, that the sale of Spectacular's assets was in its usual or regular course of business and (in the Court of Appeal) that the issuing of a power of attorney was not a disposition within that section. The Privy Council, whilst it did not need to decide the issue given its other conclusions and did not hear

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full oral arguments on the point, considered the first two conclusions to be wrong, and doubted the third. There is probably merit in these views which, although made obiter, could feature prominently in future cases on this issue.

In its final remarks, aside from eschewing any suggestion that BVI law imposes a lower standard of care on directors than in England, the Board returned to the message of common-sense justice which permeates the decision. Noting that the sort of arrangements put in place by Mr Byington might not be uncommon, it warned: "*A central message of the decision in this case is that the ultimate beneficial owner who chooses such arrangements takes the risk of being betrayed by an agent who is being used to convey instructions to the director. Although there may be claims by the ultimate beneficial owner against the agent, the ultimate beneficial owner, on facts comparable to this case, cannot throw the risk taken onto the director by instigating an action by the company against the director for breach of the director's duty of care. The courts will treat the ultimate beneficial owner – Mr Byington in this case – as having been hoist by his own petard.*"

A welcome message for those in the offshore professional corporate services industry no doubt; perhaps not so for those UBOs who wish to remain in the shadows whilst controlling companies.

Hugh Miall specialises in commercial litigation, civil fraud, company, insolvency and contentious trust litigation. He is regularly instructed in offshore litigation, often involving complex corporate structures.

Steven Thompson QC, instructed by Harney Westwood & Reigels, acted for the successful Respondents, Citco and TCCL before the Privy Council, as he had in the Eastern Caribbean Court of Appeal in 2018 and at trial before Justice Bannister in 2012.

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