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## ***ABOUT US***

WHITE BLACK LEGAL is an open access, peer-reviewed and refereed journal provided dedicated to express views on topical legal issues, thereby generating a cross current of ideas on emerging matters. This platform shall also ignite the initiative and desire of young law students to contribute in the field of law. The erudite response of legal luminaries shall be solicited to enable readers to explore challenges that lie before law makers, lawyers and the society at large, in the event of the ever changing social, economic and technological scenario.

With this thought, we hereby present to you

# **CRITICAL ANALYSIS OF DUTIES AND FUNCTIONS OF PROMOTER WITH SPECIAL REFERENCE TO HIS POSITION IN INDIA**

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## **INTRODUCTION**

A company cannot be established in a single day. It has go through several stages to be incorporated. The workforce behind completion of such stages to be incorporated is Promoter. Company is nothing but an idea by the promoter in order to carry on a business. Promoter is the one who carry on the work of promotion i.e the works for the registration and flotation of a company. A promoter can be any one i.e individual, group of individuals, association, company etc. It is generally believed that the functions of the promoter end after incorporating the company and after the board of directors are appointed. But that's not true. His functions lasts till the winding up of the company.

The function and liability of a promoter was provided in Indian Companies Act, 1956 but it did not defined the term promoter and didn't considered his position in common law principle. Company Act, 2013 has specifically defined the meaning of promoter provided in Sec-2(69) of the act. This research work is mainly focused on the rights, duties and liabilities of a promoter in general and his position in Indian law in particular so as to have the clarity regarding the changes made by company act 2013 in constrast with the Indian companies act, 1956.

## **RESEARCH QUESTION**

1. What is the extent of rights, duties and liabilities of a promoter?
2. What is his position in India in current era?

## **RESEARCH OBJECTIVE**

1. To find out the general concept regarding his rights, duties and liabilities.
2. To have a clarity regarding his position in India in today's era.

## **SCOPE OF STUDY**

The research work is limited to the analysis of functions and rights of the promoter and his position in India.

## **RESEARCH METHODOLOGY**

Doctrinal Methodology has been followed in this research work. Analysis of statutes, legislations, judicial decisions etc. have been made to come to the conclusion regarding the question of research.

## **RESEARCH DESIGN**

The following study is done in an analytical and descriptive way, so as to provide clarity with each topic mentioned and discussed.

## **SOURCES OF DATA**

The study is completed with the help of secondary sources. The collection of data is from published articles, case laws, books, internet sources etc.



# **CHAPTER: THE CONCEPT OF PROMOTER**

## **Meaning and Definition**

Promoter is an individual or group of individuals who pitches the idea of a company based on the practicality and profitability of the same. He is the person who performs the major role in bringing out the registration of a company and to provide it a corporate personality. He carries out the whole regarding before incorporation of a company. He enters into contracts with investors, subscribers etc. in order to establish a profitable company. A company is nothing but an association of individuals to carry out the business and to share profit and loss among them.

As per sec-2(69) of the company act, 2013, A promoter is a person a) who has been named as such in prospectus of a company or in the annual return of the company, b) who has control over the affairs of the company, directly or indirectly, c) in accordance with whose direction the director or board of directors are bound to work. It is also provided in the definition that if a person is merely acting in the professional capacity, then he is not a promoter.

According to the case of **Twycross V. Grant**<sup>1</sup>, promoter is a person who undertakes to form a company and takes necessary steps to accomplish those projects. As per the case of **Whaley Bridge Calico Printing Co. V. Green**, promoter word has been given for business transaction.

## **Types of promoters**

1. Occasional Promoters: The main work of these type of promoters is the flotation of the company. They do not perform the works of promotion regularly but only at specific intervals. After accomplishing the same, they return back to their original profession.
2. Financial promoters: The main work of these type of promoters is to get the promotion work done related to financial matters.
3. Managing Promoters: They work for the management of promotion works.

## **Functions of a promoter**

1. A promoter's understanding of the concept behind company establishment is one of their primary responsibilities.
2. The company's promoter investigates the viability and practicability of the idea to see if starting the business will be profitable and possible.

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<sup>1</sup> 1872 2 C.P.D., A.K. Majumdar, & G.K. Kapoor, page 469, Taxmann's Company Law

3. The promoter gathers and arranges the resources necessary to turn the concept into reality after it has been imagined.
4. The promoter chooses the company's name and determines the terms of the company's Memorandum of Association and Articles of Association.
5. Where the company's headquarters will be located is a decision made by the promoter. The promoter also suggests individuals or organisations for critical positions. For instance, the promoter may first pick the company's bankers, auditors, and directors.
6. The promoter also prepares all the additional paperwork needed to incorporate a business.

### **Duties of a promoter**

The promoters have a number of fundamental obligations to the business. A promoter and the corporation have a fiduciary relationship, or relationship of confidence and trust. With this fiduciary responsibility in mind, the promoter has a duty to disclose all relevant information pertaining to the company's establishment. The promoter also has a duty to refrain from making any unreported profits while engaging in promotional activities like buying a property and selling it to the business for profit.<sup>2</sup>

### **Liabilities of promoter**

1. What must be included in the prospectus and which reports must be provided are both outlined in Section 26. If this clause is not observed, the shareholders may hold the promoter responsible.
2. The civil penalties for any misstatements in a prospectus are described in Section 35. The promoter may be held liable under this Section for any misleading statements made in the prospectus by a person who has subscribed for the company's shares and debentures on the basis of the prospectus. Any loss or injury incurred by a person who subscribes for shares or debentures as a result of the misleading claims made in the prospectus may subject the promoter to liability.
3. The criminal penalties for creating a prospectus with false statements are covered in Section 34. In addition to the civil obligations mentioned in the preceding two examples, the promoters may also be subject to criminal prosecution if the prospectus they produced contains false information. A two-year prison sentence, a fine of up to 5000 rupees, or both may be imposed as punishment.
4. According to Section 300, the court has the power to conduct a public investigation into any promoters who have been found responsible for fraud in the establishment or promotion of a firm.

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<sup>2</sup> Promotion, Legal Service India, [http://www.legalserviceindia.com/company%20law/com\\_1.htm](http://www.legalserviceindia.com/company%20law/com_1.htm)

The promoter, like every other director or officer of the company, may be held accountable for public examination by the court if the liquidator's report demonstrates fraud in the promotion or founding of the firm during its winding up.

### **Rights of promoter**

1. When more than one member promotes the business, the paid compensation and damages may be recovered from the other promoter(s) through litigation. Promoters are responsible for any fraudulent claims made in the prospectus as well as any hidden profits jointly and severally.
2. A promoter is entitled to compensation for legitimate upfront costs incurred in the formation of the business, such as marketing expenses, legal bills, and surveyor fees. The right to be compensated for the initial costs is not one granted by a contract. The company's board of directors has the final say. The cost claim should be accompanied with vouchers.
3. A promoter has no entitlement to compensation from the company unless there is a written agreement to the contrary. The promoters do not have any contractual rights against the company, even though the company's articles stipulate that the directors must pay them a specified amount for their services. This is merely an authority that the board of directors has been given. However, since the promoters are frequently the directors, they will actually receive payment for their work.

## **CHAPTER: POSITION OF PROMOTER IN INDIA IN RELATION TO COMPANY**

Promoters are in a fiduciary position with the company they are endorsing, which makes their judgments virtually legally obligatory. At the stage of pre incorporation contract, the company does not exist and hence a promoter cannot be said to be an agent of the company because at that point of time there is not existence of principal agent relationship as per Sec-230 of Indian contract act. After the company is incorporated, the principal agent relationship comes into existence which is condition precedent for existence of agency and because of such relation, a promoter is under certain fiduciary duties which he is bound to observe. Besides such duty, he is also duty bound in a fiduciary position with respect to those subscribers who subscribed the shares of the company at the time of its incorporation since the subscribers subscribed the shares because of the representation made by the promoter as regards to the company. So, it is the duty of a promoter to notify all the important information to subscribers and to the company including the profits received.

It is unethical for a promoter to have profits from the transactions he entered into in the name of the company and without revealing the same to the company. The law imposes duty on the promoter to reveal the profits he incurred by the transactions. The profits incurred by promoter is deemed will be deemed to be a valid one on the condition precedent that such news of such profit to be delivered to the company's board of directors (All) and the subscribers. It it to be noted that such information has to be brought to the notice of each of the directors of the company and not only to those few who have been nominated by the promoter himself. In case of latter situation, the profit incurred will not be deemed to be a lawful one.

## **BEFORE INCORPORATION**

It is a general rule that an entity cannot enter into a contract without having its existence as it will be hit by Sec-10 of Indian contract act but there's an indirect way through which a company can enter into a contract even before it was registered. But, no one can legally bound the company before it has come into existence through registration. Since pre- incorporation contracts are entered into before the company came into existence, so the law prescribes that a third party will enter into contract on the behalf of the company and that third party is the promoter . What company does after getting incorporated is that it ratifies the contract which was already entered into in order to be bound by it . So, it is necessary to sign a contract with a third party before the firm is incorporated. A pre-incorporation contract is therefore sine qua non for the proper establishment of a company. There has been a considerable change as regards to the legal status of the pre incorporation contract before and after the enactment of specific relief. So, it would be proper to analyse the legal validity of pre incorporation contract under two stages:

### **1. Status before the enactment of specific relief act, 1963**

- As stated above, as per sec-10 of Indian contract act, it is the condition precedent that the entity entering into the contract must exist at the time of making of such contract. As the name already states, pre incorporation contract is entered into before the company had its existence i.e before it was registered and hence such contracts cannot be enforced against the company. It is the promoter who enters into pre incorporation contract and he makes such contracts by pitching his ideas and making representations as required. It is quite possible that a company don't have any idea regarding the type of representation made by the promoter at the time of making contract and it would not be lawful if the company faces any loss or onerous situation because of the contract entered into by the promoter.<sup>3</sup>

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<sup>3</sup> Parker v. Modern Woodman 181 All. 214, 234., Taxmann's Company Law, P. 71-72

- Since the firm or company was not in existence at the time of pre incorporation contract, so as per Indian contract act, 1872, a company cannot ratify the contract entered before its incorporation. As per the facts of *Re English and Colonial Produce* case, a lawyer was appointed for necessary documentation for the incorporation of the company and he incurred the fees of the registration of the same. The lawyer performed all the necessary works that were required to form the company. When lawyer asked the company to indemnify him and remunerate him for the works he had done, the company argued that it is not bound to do so since it was not there when he did all these works and the same contention provided by the company was given in the judgement of the case.
- It is a general rule that only legal person can file a suit in the court. Since there was no existence of the company during pre incorporation stage, it cannot file the suit either. As per the judgement of *Natal land and colonisation company V. Pauline Colliery syndicate*<sup>4</sup>, the pauline company was not allowed to get the benefits from the pre incorporation contract. The reason that was put forward by the court was that at the time of contract, there was no existence of the company and therefore it cannot be allowed to have the benefit of the same. The facts of the case is that there was a contract between the Natal company and A( representative of syndicate) as regards to 3 years of lease for coal mining. After the company was registered, it demanded for the lease that A got through the contract but the Natal company refused since company was not there.

## **2. Status after enactment of specific relief act, 1963**

Before the enactment of specific relief act, it was next to impossible for the Promoters to give a legitimate value for the contracts they entered into before the incorporation of company as it was hit by Indian contract act. Because of such law prevailing at that point of time, people had fear to invest in the company and the subscribers were quite reluctant to enter into contracts. After the enactment of such an act, entrepreneurs got a boost and it would not be wrong to state that it was the genesis of the startups in India. Entrepreneurs started pitching their ideas in front of the investors and the investors themselves started showing interest in investing as they were now assured that the contract they are entering into is a valid one. It would be correct to state that for promoters, the Specific relief Act of 1963 was a relief.

Under the following parts of the special relief Act, provisions are made:

According to Sections 15(h) and 19(e) of the Specific Relief Act

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<sup>4</sup> (1904) AC 120



1. The promoter must have made the contract on the behalf of the company by adjudging such contract on the basis of it's profitability and the practicality
2. Such a contract should be supported by the criteria of incorporation.
3. The company has to ratify the pre incorporation contract once it is registered.
4. The other party must be communicated of the information regarding the approval of the contract by the company.<sup>5</sup>

Once the condition precedent as enlisted above is completed, the contract entered between the promoter and the other party will be deemed to be entered between the company incorporated and the other party. One thing that needs to be noted here is that before ratification of such contracts, the company is required to make some changes in the memorandum of association. It has to be mentioned that the contracts which are going to be ratified by the company, does not, in any situation, contravenes the objectives of the company and such contracts were entered for the profit of the company. So, until the contract is ratified by the company, the other party of the contract cannot enforce such contract against the company even though it has signed it during pre-incorporation stage.

It has to be noted that if the company does not ratify the pre incorporation contract then in that case, the promoter will be held responsible for the non-performance of contract. A company will ratify the contract only after scrutinising the whole regards as regards to its objectives and profits. Some of the cases provided below elucidates the same argument.

1. In the **Phonogram Limited v. Lane case**<sup>6</sup>, it was held by the court that the promoter is held liable for pre incorporation contract if the company is not established or if even after its establishment, it didn't ratified it.
2. In **kelner V. Bexter**<sup>7</sup>, Mr. Kelner entered into contract with the promoter as regards to the sale of wine. After the company was incorporated, it denied the contract and didn't ratified the same. So, the court concluded that in such case, the obligation lies upon the promoter only.
3. In **Newborne V. Sensolid**<sup>8</sup>, a different approach was adopted as regards to the pre incorporation contract. In this case, a contract was entered between an unformed company

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<sup>5</sup> K.S. Anantharaman, 'Lectures on Company Law & Competition Act (including Secretarial Practice)', p.49, Nagpur, LexisNexis Butterworths Wadhwa, (10th edition 2005).

<sup>6</sup> [1982] QB 938.

<sup>7</sup> (1866) LR 2 CP 174

<sup>8</sup> [1954] 1 QB 45

and the other party. At the later stage, the other party refused to perform its part. It was held by the court that until the company comes into existence, there's no value of the contract entered by it even if some person on behalf of unformed company signed the contract. Such contract is of no value.

There's a difference which this case created i.e with regards to the contract entered by the promoter and by an unformed company. In case of the former one, the obligation lies upon the promoter but if the contract is entered by the person (let's say director) on behalf of an unformed company, then the whole contract is deemed to be of no value. This judgement led to some confusion in the legal fraternity.

## **AFTER INCORPORATION**

As stated above, after the incorporation of the company, it is upon the company to decide whether it has to ratify the pre incorporation contract or to reject it. In case of the former one, the company will be bind by the contract and the burden then lies on it in case of any nonperformance of the contract. The ratification and the communication of such ratification as given under Sec-15(h) and Sec-19(e) of specific relief act, 1963 provides a relief to the promoter from all the obligations of the contract. As far as the remuneration of a promoter is concerned, he will get such remuneration once the company starts it's business and incur profits. Promoter also get profits through the shares which he has subscribed at the time of incorporation.

## **CONCLUSION**

The company law has seen a transformation in India in past several years. There has been a growing tendency of start ups and the entrepreneurs because of the leverage and the level playing field provided to the by the laws. As regards as any company is concerned, the first and the major role is played by the promoter. A promoter is the one who does all works related to the incorporation of the company starting from documentation, luring investors, naming the company etc. to appointment of directors, management of the affairs of the company etc. A company is nothing but a brainchild of the promoter. Promoters have to perform different roles and responsibilities which comes with the incorporation of the company. Much of relief has been provided by the specific relief act, 1963 to the promoter and since India's economy market is growing day by day, some developments can be seen in the upcoming future as regards to the promoter like making an exhaustive list for functions, duties and liabilities of the promoter.

Changes can also be seen as regards to the contract entered before the incorporation stage by other persons such as directors of the company.

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