

Promoter

Meaning of Promoter

A promoter is a generic term associated with the person who starts a business. In common parlance, this person is also referred to as the founder of the business. A promoter typically is responsible for raising capital, targetting initial leads and chasing initial business opportunities, entering into the initial contracts for the business formation and incorporating the company.

The Substantial Acquisition of Shares Takeovers (SEBI) Regulation states that the promoter is:

- (a) any person who is in control of the target company
- (b) any person named as promoter in any offer document of the target company or any shareholding pattern filed by the target company with the stock exchanges pursuant to the listing agreement, whichever is later;

In the old Companies Act, 1956 there was no static definition of promoter although it was mentioned in various section, but in the new Companies Act, 2013 Section 2(69) defines promoter.

Position of promoter in Companies Act, 1956 and in different Statues

The expression 'promoter' has not been defined under the Companies Act, 1956, although the term is used expressly in sections 62, 69, 76, 478 and 519. Section 62 of Companies Act, 1956 defines 'promoter' for the limited purpose of that section only. Section 62(6)(a) defines the expression 'promoter' to mean a promoter who was a party to the preparation of the prospectus or of a portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity in procuring the formation of the company.

In **Twycross v. Grant** promoter was described as "one who undertakes to form a company with reference to a given project, and to set it going, and who takes the necessary steps to accomplish that purpose."

In USA, the Securities Exchange Commission Rule 405(a) defines promoter as a person who, acting alone or in conjunction with other persons directly or indirectly takes the initiative in founding or organizing the business enterprise.

In **Lagunas Nitrate Co. v. Lagunas Syndicate** [1889] 2 Ch. 392 (p. 428, C.A.), it was stated that "to be a promoter one need not necessarily be associated with the initial formation of the company; one who subsequently helps to arrange floating of its capital will equally be regarded as a promoter.

The difficulties in defining the term led the judges to state that the term promoter is not a term of art, nor a term of law, but of business.

Position of promoters in Companies Act, 2013

The new Companies Act, 2013 has defined promoter in Section 2(69) as;

“promoter” means a person—

- a) who has been named as such in a prospectus or is identified by the company in the annual return referred to in section 92; or
- b) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or
- c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act:

Provided that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity;

A person who acts in a professional capacity is not a promoter. Thus a solicitor, who prepares on behalf of the promoters the primary documents of the proposed company, is not a promoter. Similarly an accountant or a valuer who helps the promotion in his professional capacity is not a promoter. But any such person may become a promoter if he helps the formation of the company by doing an act outside the scope of his professional capacity.

A person cannot; however become a promoter merely because he signs the memorandum as a subscriber for one or more shares.

In conclusion, it may be said that word “promoter” is used in common parlance to denote any individual, syndicate, association, partnership or a company which takes all the necessary steps to create and mould a company and set it going.

3. Duties of Promoter

The promoters occupy an important position and have wide powers relating to the formation of a company. It is, however, interesting to note that so far as the legal position is concerned, he is neither an agent nor a trustee of the proposed company. But it does not mean that the promoter does not have any legal relationship with the proposed company. The promoters stand in a fiduciary relation to the company they promote and to those persons, whom they induce to become shareholders in it.

Following are the major Duties of the promoter:

3.1. Duty to disclose secret profits

A promoter is not forbidden to make profit but to make secret profits. He may make a profit out of promotion with the consent of the company, in the same way as an agent may retain a profit obtained through his agency with his principle's consent.

A promoter is allowed to make a profit out of a promotion but with the consent of the company.

3.2. Duty of disclosure of interest

In addition to his duty for declaration of secret profits, a promoter must disclose to the company any interest he has in a transaction entered into by it. This is so even where a promoter sells property of his own to the company, but does not have to account for the profit he makes from the sale because he bought the property before the promotion began. Disclosure must be made in the same way as though the promoter was seeking the company's consent to his retaining a profit for which he is

accountable.

3.3.Promoter's duties under the Indian Contract Act

Promoter's duties to the company under the Indian Contract Act have not been dealt with by the courts in any detail. They cannot depend on contract, because at the time the promotion begins, the company is not incorporated, and so cannot contract with its promoters. It seems, therefore, that the promoter's duties must be the same as those of a person, who acts on behalf of another without a contract of employment, namely, to shun from deception and to exercise reasonable skill and care. Thus, where a promoter negligently allows the company to purchase property, including his own, for more than its worth, he is liable to the company for the loss it suffers. Similarly, a promoter who is responsible for making misrepresentations in a prospectus may be held guilty of fraud under section 17, of the Indian Contract Act and consequently liable for damages under section 19 of the Act.

3.4.Termination of Promoter's Duties

A promoter's duties do not come to an end on the incorporation of the company, or even when a Board of directors is appointed. They continue until the company has acquired the property or business which it was formed to manage and has raised its initial share capital and the Board of directors has taken over the management of the company's affairs from the promoters. When these things have been done, the promoter's fiduciary and contractual duties cease.

3.5.Remedies available to the company against the promoter for breach of his duties

Since a promoter owes a duty of disclosure to the company, the primary remedy in the event of breach is for the company to bring proceedings for rescission of any contract with him or for the recovery of any secret profits which he has made.

3.5.1. Rescission of contract

So far as the right to rescind is concerned, this must be exercised on normal contractual principles, that is to say, the company must have done nothing to show an intention to ratify the agreement after finding breach involving non-disclosure or misrepresentation.

3.5.2. To recover secret profit

If a promoter makes a secret profit or does not disclose any profit made, the company has a remedy against him.

4. Liabilities on Promoter

A promoter is subjected to liabilities under the various provisions of the Companies Act.

- Section 26 of the Companies Act, 2013 lay down matters to be stated in a prospectus. A promoter may be held liable for non-compliance of the provisions of the section.
- Under section 34 and 35, a promoter may be held liable for any untrue statement in the prospectus to a person who subscribes for shares or debentures in the faith of such prospectus. However, the liability of the promoter in such a case shall be limited to the original allottee of shares and would not extend to the subsequent allottees.
- According to section 300, a promoter may be liable to examination like any other director or officer of the company if the court so directs on a liquidator's report alleging fraud in the promotion or formation of the company.
- A company may proceed against a promoter on action for deceit or breach of duty under section 340, where the promoter has misapplied or retained any property of the company or is guilty of misfeasance or breach of trust in relation to the company.

The Madras High Court in **Prabir Kumar Misra v. Ramani Ramaswamy** [2010] 104 SCL 174, has held that to fix liability on a promoter, it is not necessary that he should be either a signatory to the Memorandum/Articles of Association or a shareholder or a director of the company. Promoter's civil liability to the company and also to third parties remain in respect of his conduct and contract entered into by him during pre-incorporation stage as agent or trustee of the company.

5. Status of pre-incorporation of contracts

The promoter is obligated to bring the company in the legal existence and to ensure its successful running and in order to accomplish his obligation he may enter into some contract on behalf of prospective company. These types of contract are called 'Pre-incorporation Contract.

Nature of Pre-incorporation contract is slightly different to ordinary contract. Nature of such contract is bilateral, be it has the features of tripartite contract. In this type of contract, the promoter furnishes the contract with interested person and it would be bilateral contract between them. But the remarkable part of this contract is that, this contract helps the perspective company, who is not a party to the contract.

One might question that 'why is company not liable, even if it a beneficiary to contact' or one might also question that 'doesn't promoter work under Principal-Agent relationship. Answer to these entire questions would be simple. The company does not in legal existence at time of pre-incorporation contract. If someone is not in legal existence then he cannot be a party to contract.

Before the passing of the Specific Relief Act 1963, the position in India, regarding pre-incorporation contract, was similar to the English Common Law. This was based on the general rule of contract where two consenting parties are bound to contract and third party is not connected with the enforcement and liability under the terms of contract. And because company does not come in existence before its incorporation, so the promoter signs contract on behalf of company with third party, and that is why the promoter was solely liable for the pre-incorporation contract.