
PROMOTERS UNDER THE COMPANY ACT, 2013

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ABSTRACT

“A promoter is the one, who forms a company with a given object and sets it going by taking the necessary steps. -Justice C.J. Cokburn.

This particular article gives an overview about who are the ‘Promoters’ under Company Law in India. To understand the ambiguous and vague definition of Promoters enshrined under sec 2(69) of Companies Act, 2013 the clauses have been explained comprehensively in a simpler form with the definition given by different jurists. The article brings forth the characteristics, rights and duties of the Promoters although the act does not talk explicitly about the rights and duties of the Promoters but through interpretation in different case laws regarding the same it has been recognized. The liabilities of the promoters as per Companies Act,2013 have been exhibited along with change in position regarding the liability of the promoters with respect to Pre incorporation Contract after the passing of Specific Relief Act, 1963 under Sec 15(e) and 19 (h). The legal position of Promoters in India under Companies Act, 2013 has been manifested clearly as Promoters not being trustee nor agent of the company supported by the case law and statements of different jurists. Various functions of the Promoters have been mentioned as promoters are the one who brings the company into existence so they can also be the 1st director of the company.

KEY WORDS: Companies Act,2013, Ambiguous, SECTION 2 (69), Rights, Duties, Pre incorporation Contract, Liabilities

I. INTRODUCTION

In the formation of a company, people who initially take the active part to give it a concrete shape are known as promoters in the commercial world. The term “promoters” is more familiar with the business than with law. It “involves the idea of exertion for the purpose of getting up and starting a company.”¹

The individuals who not only conduct the task of promotion, but also responsible for each and every affairs of the business are the **promoters of a company.**

A promoter of a company is a person or a group of persons who came together with the objective of setting up a business. The promoter can be an individual, a firm or an association of artificial legal persons. For being a promoter, it is not necessary to be a founder of a business; the person who arranges capital and assists in other important works can be equally regarded as a “promoter of a company”. In another sense the promoters may be called as **the Parents of a company** in the conception of whom a **company is born.**

II HYPOTHESIS

- Whether Promoters can escape from the liability with respect to Pre incorporation of contract after the passing of Specific Relief Act or not?

II. DEFINITION

As per section 2 (69) of companies Act, 2013 “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;²

¹ Dr. H.K. Saharay, Company Law 20(Universal Law Publishing 7th ed. 2016).

² The Companies Act, 2013 (18 Of 2013), S.2(69).

So, The definition of promoters can be analyzed in three parts. All the parts are separated by 'or' and are thus independent of each other, or mutually exclusive, meaning thereby that for being a promoter, a person may fall within any part of S.2(69). Part A So far as the first part [contained in sub-clause (a) of sub-section 69 of Section 2] is concerned, it lacks legal certainty in as much as instead of explaining the concept, it appears that it upholds as correct, the understanding of the concept garnered by the professionals practicing in the field of company law. Without carving out the essentials of the concept, it merely states that a person is a promoter if the name of that person is mentioned as a **'promoter' in the Prospectus** or in the **Annual Return** filed under **S. 92 of the Act**. It is drawn upon a sense of trust on the knowledge of the professionals, executives, and the people running a company as to their understanding of jurisprudence of company law regarding defining promoters. In Part B, the second independent clause of the definition of 'promoter', we find a little objectivity in the definition, as it hinges on the presence of **one's control** over the affairs of the company as a prerequisite for being classified as a promoter. Such control may arise out of the **position of that person as a shareholder, or a director or otherwise**. Undoubtedly, the definition also contemplates a person who may neither be a shareholder nor a director, and yet be a promoter if he has control over the affairs of the company. And at the same time, every shareholder or director need not be treated as promoter of the company if he does not exercise any control over the affairs of the company. In this context, it is notable to look into the definition of **'control' given under S. 2(27)** of the Act. As per the **section 2 (27) "control"** shall include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner; one gets clarity that if a person has a right to appoint the majority of directors or to control the management or policy decisions of a company, then he/she would be considered to be a promoter. But again What may be classified as control over management and policy decision is still ambiguous, uncertain, vague & definitely a matter of academic debate and interpretation. Part C The last part of the definition states that a promoter is a person – "(c) in accordance with whose advice, directions or instructions the Board of Directors of the company is accustomed to act". This is again vague and from the perspective of a person who is an outsider to the management of the company, this fact may not be evident very easily. So, applying the rules of literal interpretation on S. 2(69) of the Act, and reading all the parts of the definition together, a person may be a promoter of the company even without being a director or a shareholder, if he/she has been named so in the Prospectus

or Annual Return of the Company. Similarly, a person who has been stated to be a promoter in the prospectus of the company or the Annual Return of the Company, would be treated as a promoter even if he/she does not exercise any control over the affairs of the company or even if doesn't have any right of appointment of majority of the directors.³

III. Characteristics of a Promoter

Promoters are the one who pave the way for a company to stand on its own feet. Although a person may be a promoter even if he undertakes a lesser active role in the formation of a company. In *National LS Registration Bank v. Vellu Mudliar*⁴ it was said that any person who arranges subscribers (members), directors, places, shares or negotiates preliminary agreement may be called a promoter. But it was clearly said in *Tyrell V. Bank of London* by the Hon'ble house of lords that a person who merely acts in Professional capacity on behalf of the promoter like solicitor or a valuer or a chartered accountant who is paid by a promoter is not himself a promoter.⁵

There are various characteristics of a promoter of a company. Some of them are as follows-

- The promoter draws up the scheme and conceives the idea of formation of company and determines the future object of the company.
- He conducts an investigation regarding the objective and future prospects of a business.
- A promoter of a company can be an individual or a group of individuals who come together for attaining a particular purpose.
- The documentation and other incorporation formalities are conducted by the promoter.
- The promoter is the one who is liable for all the important affairs of the company.

IV. Functions of Promoters of a Company

In a company, a promoter needs to conduct numerous tasks which even start before the business comes into existence. These functions involve-

³ Shashank S Mangal, Meaning of Promoter under Companies Act, 2013, Tax guru, 22 Oct 2020 <https://taxguru.in/company-law/meaning-promoter-companies-act-2013.html> retrieved on 6-05-22

⁴ National LS Registration Bank v. Vellu Mudliar, AIR 1938 Mad. 192.

⁵ Dr. S. C. Tripathi, New Company Law, 37(2nd ed. 2019).

- **Identification of Business Opportunity:**

At the outset, the promoter needs to identify the opportunity in a particular type of business that may prove fruitful in the upcoming period. The opportunity may relate to exploiting a new area of natural resources or bringing something new into the existing structure. The promoter can figure out this opportunity with the help of the technical expert of that particular field. When a promoter realizes that this particular business venture has the potential to grow, then the idea is taken further.

- **Detailed Investigation or thorough research:**

At this stage, various factors are thoroughly studied and analyzed from various points of view to assess the profitability and long-term sustainability of the business. The market demand, availability of raw material, arrangement of finance, transportation facilities, mode of supply, etc., are taken into consideration.

- **Approval & Selection of Name:**

After deciding the structure of the business, now it is time to get the business registered with a particular name. The name of the business is approved by the “registrar of companies”. While deciding a name, it is important to note that it shouldn’t resemble an existing name and it should avoid words like national, state, king, queen, etc.

- **Who would be Signatories to Memorandum:**

The memorandum of association (MOA) is the constitution of a company. The promoters decide the names of the person who will be the signatories of this constitutional document. Normally, the first signatory of the MOA becomes the director of the company. The director needs to provide his written consent for the same as per the format prescribed by the Law.

- **Arrangement of Capital or assets**

Just like a human body can’t survive without food and water, similarly, a business can’t survive without adequate capital. So, it is very essential to make the necessary arrangements of capital. The promoter decides the capital requirement and the source from which this money can be obtained. The various sources include bank loans, private equity, Initial public offering, etc. For the successful arrangement of capital, various financial and legal professionals are

appointed.

- **Preparing necessary Documents like MOA & AOA**

Apart from the Memorandum of Association (MOA) which is the chartered of the company , promoters are required to deposit certain other important documents with the registrar of companies. It includes Article of Association (deals with all the internal affairs of the business), prospectus, incorporation certificate, etc.

V. Legal Position of Promoter in a Company

Although the legal position of the Promoter/ Promoters in respect of the company which is not in existence i.e., for acts done before incorporation of a company have nowhere been specifically or explicitly defined in the Companies Act, 2013. But through Judicial interpretation Promoter's position with respect of a company has been interpreted as :

In *Erlanger V. New Sombrero Phosphate Co.* ⁶ Lord Cairns explained that undoubtedly Promoters stand in a fiduciary position. Same principle was followed in the landmark Judgement of *Weavers Mills V. Balkis Ammal*⁷.

VI. Liabilities of Promoters

A promoter of the company is also burdened with some strict liabilities which are as follows-

(1) Liability for pre- incorporation contract

If the promoters enter into a Contract before the company comes into existence such contracts are called pre-incorporation contract for which company does not become liable nor ratifies so the promoters would personally be liable. In *Kelner V. Baxter*⁸ it was held that promoter is neither an agent nor a trustee of a future company. No one can act as an agent for the person who is not in the existence so before the company is incorporated a company cannot be sued for the contract done by the promoter on behalf of the company. **But there is a change in position regarding the liability after the passing of Specific Relief Act,1963.** As under the Specific Relief Act, 1963, under **section 15(h) and 19 (e)** promoter can shift his right and

⁶ Erlanger V. New Sombrero Phosphate Co., (1878) LR 3 App Cas. 1218, 1236.

⁷ Weavers Mills V. Balkis Ammal, AIR 1969 Mad. 462.

⁸ Kelner V Baxter, (1866) LR 2 CP 174: 15 LT 213: 15 WR 278.

responsibility towards company if it is warranted by the terms of incorporation.⁹

(2) Liability for misstatement in Prospectus

The format of filing a prospectus is given under Section 26 of the Companies Act, 2013. All the information relating to secretaries, auditors, legal advisors, bankers, trustees, statements given by the Board of Directors, etc., must be mentioned therein. However, if any of the important information is omitted from the prospectus, the promoter shall be held liable and will entail punishment as per Section 447 of the Companies Act, 2013.

(3) Criminal liability Under sec- 34 & Civil liability under Sec-35

As per Section 34, if any of the information mentioned in the prospectus is untrue or misleading, the promoter will be held criminally liable for the same under **section 447**.

Section 35 of the Act which talks about the civil liability for misstatement in the prospectus states that if a promoter makes false promises and induces any person to invest money in the company, then the promoter will be held liable for the deception and for the subsequent loss.

(4) If fault appears during winding up

If during the winding up of the company proceedings, any fault appears, the promoter of the company will be directly liable for the same.

VII. Duties of Promoter in a Company

Duties of the promoter may be grouped as: -

(a) Duty of Disclosure of Interest (Sec. 26).

A promoter should make full disclosure of all relevant facts to the company including any profit made & his personal interest in transactions with company. It is very much required as per section 26 of the Companies Act, 2013 that promoter's profit shall be disclosed in the prospectus itself.

(b) Duty Not to make secret Profit

⁹ Pre- incorporation contracts and the promoter liability, law teacher, 21st Sep 2021
<https://www.lawteacher.net/free-law-essays/contract-law/pre-incorporation-contracts-and-the-promoter.php>
retrieved on 9-05-22

A promoter must not make any secret profits out of the promotion of a company. He should account all the secret profits generated by the purchasing property or business himself and selling it to the company at higher price.

(c) Duty to repay or restore the money or property which has been misappropriated or Duty to make compensation (Sec. 340)

As per sec-340 of the Companies Act, 2013, the Tribunal may direct the guilty promoter to repay or restore the money or property of the company or to contribute such sum to the assets of the company by way of compensation where in the course of winding up it appears that a promoter who has taken part in the promotion or formation of the company has misused, misapplied or retained with himself the capital or property of the company.¹⁰

(d) Duty to disclose all the hidden facts

Everything should be revealed in the MOA & AOA of the company.

VIII. Rights of Promoters in a Company

There are various rights of promoters given under the law: -

Right of Indemnity

If in the formation of a company more than one promoter is involved, then one promoter can claim compensation or the damages from the others, in case of a breach of contract. It is important to note that all the promoters are jointly and severally liable for all the affairs of the company.

Right to Receive Legitimate Preliminary Expenses

It is the legitimate right of a promoter to receive all those expenses which he incurred from his pocket during the formation of the company. These expenses include – registration, documentation, advertisement, legal expenses, etc.

Right to Receive Remuneration

If the promoter is handling a managerial position in the company, he is also entitled to receive

¹⁰ Dr. S. C. Tripathi, New Company Law, 38(2nd ed. 2019).

remuneration from the company. However, there must be a contract of employment to that effect.

CONCLUSION

Hence It can be concluded that A promoter is a person who conducts all the activities ranging from the pre-incorporation stage to all the important affairs till the company is registered or have come into existence. They have numerous rights and duties including the right to indemnity, the right to receive preliminary expenses, etc., although companies are not bound always towards these rights of the Promoters. However, the hypothesis of this paper proved to be true as **there is a change in position regarding the liability after the passing of Specific Relief Act,1963**. As under the Specific Relief Act, 1963, under **section 15(h) and 19 (e)** promoter can shift his right and responsibility towards company if the contract is **warranted** by the terms of incorporation subject to the consent of another party.