

---

## PROMOTERS ROLE IN A COMPANY

---

Kanishka Rathore, Rajasthan School of Law for Women, Jaipur, Rajasthan

### ABSTRACT

In order to carry out a business or undertaking, a group of like-minded individuals may come together to form a company. This involves several stages, with the promoter playing a crucial role in conceptualizing the idea, finalizing the name, registering, and completing formalities. However, promoters must also be aware of their responsibilities and duties. They are accountable for any false or misleading statements and must fully disclose their contribution sources. They may be held responsible for any misrepresentation in the prospectus that causes loss to investors. Even pre-incorporation contracts hold promoters personally liable. Promoters must act in the best interest of the company and avoid personal gain at the company's expense. They have a fiduciary duty to establish trust and credibility, creating and shaping the company. When using shareholder funds to buy a property, all relevant information must be disclosed, and it is unethical to receive a commission or bonus from the seller. The promoter's main duty is to disclose their position, profit, and interest in the property being bought or sold. If there is no autonomous Board of Directors, they must disclose to all shareholders. The Companies Act 2013 defines a promoter as someone who has control over the company's affairs, directly or indirectly, and is not acting merely in a professional capacity. . In conclusion, the researcher has identified Definition of a company and its origin, importance of acknowledging and promoting a company, the role of promoters and their responsibilities, rights and duties of a promoter, including disclosure, avoiding secret profits, and fulfilling obligations related to the prospectus, liability of a promoter in cases of misstatements, fraud, and pre-incorporation contracts, the fiduciary position of a promoter and their duty to act in the best interests of the company and definition of a promoter according to the Companies Act 2013.

**Keywords:** board of directors, companies act 2013, fiduciary relation, promoters.

## INTRODUCTION

The word —Company<sup>1</sup> is derived from the combination of latin words ‘Com’ means together or with and ‘Panis’ means bread meaning thereby taking meals together. In proper parlance, a company denotes an association of likeminded persons formed for the purpose of carrying on some business or undertakings. The word ‘Company’ has no strictly technical or legal meaning. The Companies Act 2013 (18 of 2013) defines ‘Company’ as follow: in this act, unless the context otherwise requires- Section 2(20) —company means a company incorporated under this Act or under any previous company law<sup>1</sup>. Presently the company abound in the national economy. Ranging from the small family or partnership concern to the faceless multinational corporation, they provide the structural framework of the modern industrial society.

Creating a company requires several stages to be followed, whether it is public or private. People need to acknowledge the company, especially in the case of a public one, as more people knowing about it will raise more investment and capital. To promote the company, various channels such as television, the internet, and newspapers are used, but it is important to avoid puffery statements, falsification, and exaggerations. This stage is crucial for the company and must be done with circumspection. Promoters, who can be individuals, corporate, syndicate or groups of responsible people, come in at this stage to start the process of forming the company until incorporation. The promoter is responsible for conceptualizing the idea, finalizing the name, getting it registered, filling up important documents, and completing all formalities. Once all the formalities are done, the promoter hands over the company to the directors. The Companies Act, 2013 contains a statutory definition of the promoter Section 2 (69) —promote 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

---

<sup>1</sup> <https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf> (last visited on 6-10-2023)

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;<sup>2</sup>

According to SEBI

A promoter is

- (a) Any person who is control of the targeted company.
- (b) Any person named as promoter in any offer document of the target company or any act shareholders pattern filed by the target company with the stock exchanges pursuant to the listening agreement, whichever is earlier.<sup>3</sup>

Lindley explained the term ‘promoter’ as used in connection with companies as a —a person who involves the idea of exertion for the purpose of setting up and starting a company or what is called floating off, and also the idea of some duty towards the company imposed by or arising from the position which the so-called promoter assumed afterwards towards it”<sup>4</sup>. In *Bosher v. Richmond Land Co. (1892)*<sup>5</sup>, the term Promoter ‘has been defined as a person who brings about the incorporation and organization of a corporation. He brings together the persons who become interested in the enterprise, aids in procuring subscriptions, and sets in motion the machinery which leads to the formation itself. In the case *Tengku Abdullah v Mohd Lattiff Bin Shah Mohd – Gopal Sri Ram JCA* said —A promoter is one who starts off a venture-any venture-not solely for himself for others, but whom he may be one.<sup>6</sup>

## RIGHTS AND DUTY OF A PROMOTER RIGHT

1. Right to recover proportionate amount from co-promoters - If the promoter of a corporation earns any profits that were not disclosed during its establishment and one of them proceeds to pay the entire amount to the directors, that individual has the right

---

<sup>2</sup> <https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf> (last visited on 6-10-2023)

<sup>3</sup> SEBI ( Substantial Acquisition of Shares & Takeovers) Regulation, 1997

<sup>4</sup> Lindley, J. in *Emma, Silve : Mining Co.Ltd. V. Lewis & Son. (1879)* 4 CPD 396.

<sup>5</sup> Va 455:16 SE 360

<sup>6</sup> (1996) 2 ML3 265

to reclaim a proportionate portion of the funds from their fellow promoters.

2. Right of indemnity - In situations where multiple promoters are collaborating, one of them can request compensation or damages from the others for any payments made during the fulfillment of their duties. It is important to note that each promoter is accountable for any false or misleading statements, as well as any other violations of their responsibilities, both on an individual level and as a group.
3. Right to receive preliminary expenses - a promoter of a company is entitled to reimbursement for any expenses you incur while carrying out your promotional activities. This can include a range of expenses such as advertising costs, fees paid to professional assistants, compliance fees, and more. However, it's important to keep in mind in accordance with standard business practices, a promoter is not entitled to claim promotional expenses without a legally binding contract in place. Similarly, preliminary expenses cannot be recovered without the existence of a valid contract. It is important for promoters to ensure that all necessary legal documentation is in order to avoid any potential disputes and to ensure transparency in their operations - *Re. English & Colonial Produce Company*<sup>7</sup>. Another interesting case that defines the right of preliminary expenses is *Malhado v Porto Alegre Railway Co*<sup>8</sup> in this case, it was determined that promoters are entitled to receive the expenses they incurred during the formation and registration of the company, as outlined in the articles. While the articles may specify a fixed sum to be paid to the promoters, the company only comes into legal existence after receiving its certificate of registration. Therefore, the promoter cannot sue the company for payment as stated in the article provision until registration is complete.
4. Right of remuneration - under the legal framework, it is not permissible for promoters to coerce a company into remunerating them, unless an agreement explicitly states so. The onus falls on the company's Directors to determine whether or not the promoter's services merit compensation. Typically, promoters also hold positions as directors and may be compensated for their supplementary contributions to the company.

---

<sup>7</sup> (1906) 2 Ch. 435 CA

<sup>8</sup> (1874) LR 1 CP 503

## DUTY

1. Duty of disclosure - a promoter must uphold their duty of disclosure and inform all stakeholders of any important information concerning the company. This duty is based upon the fiduciary relationship between the company and its promoter. Failure to disclose any relevant information or profits made by the promoter can result in a penalty of Rs. 50,000 or an amount equivalent to five times the benefit gained from the act, as outlined in Section 102(5) of the Companies Act 2013. However, it is important to note that if a promoter sells their property to the company, they may disclose all their interest and act in good faith during the transaction to the board of directors.<sup>9</sup> Promoters can fulfill this disclosure obligation by informing the Directors of the Company, including it in the Articles of Association of the Company, adding it to the company's prospectus, or directly informing existing and potential shareholders. By doing so, promoters can ensure transparency and trust among all parties involved.
2. Duty not to make secret profits - as a promoter hold a fiduciary duty to act in the best interests of the company. This includes refraining from any actions that may result in personal gain at the expense of the company, whether it be through direct or indirect means. Engaging in such behavior would breach the trust and confidence placed in the promoter by the stakeholders, and may lead to legal consequences. If any undisclosed profits are discovered, the stakeholders have a legal right to demand that you return them. It is important to maintain transparency and avoid any conflicts of interest to uphold legal obligations as a promoter.
3. Duty as regards Prospectus - Companies must include certain essential facts and reports in their prospectus. As per Section 62(1) of the Companies Act 2013, the promoter of a company is legally responsible for compensating any individual who has subscribed to the prospectus and has suffered loss or damage due to any untrue statements mentioned therein.

Furthermore, Section 63 of the Companies Act 2013 states that if a promoter makes any misleading statements in the prospectus, they may face imprisonment for up to two years (in cases of serious fraud and repeat offenses) or may be charged with a

---

<sup>9</sup> Erlanger v New Sombrero Phosphate Co. (1878) LR 3 AC 1218

penalty of Rs. 5000 for each false statement included in the prospectus. Companies must ensure that their prospectus is accurate and truthful to avoid any legal repercussions.

### **LIABILITY OF A PROMOTER**

1. As required by Section 26 of the Companies Act 2013, the sources of the promoter's contribution must be fully disclosed in the prospectus as prescribed. Failure to do so may result in the company terminating its contract with the promoter.
2. Furthermore, Section 34 of the Companies Act 2013 holds the promoter responsible for any misstatements in the prospectus. However, if it is proven that the statement or omission was not significant, or that the promoter had a reasonable belief that the statement was true or necessary, they will not be held criminally liable.
3. According to Section 35 of the Companies Act 2013, a promoter is held accountable for any misrepresentation made in the prospectus that leads to loss or damage suffered by investors who subscribed to it. The promoter is obligated to compensate every individual who was affected by such losses or damages.

As per the judgement passed by the Madras High Court in the case of Prabir Kumar Misra v. Ramani Ramaswamy<sup>10</sup>, it has been established that a promoter's actions and contracts made on behalf of the company during the pre-incorporation stage can hold them liable, even if they are not a signatory to the Memorandum/Articles of Association, a shareholder, or a director. This liability is applicable to both the company and third parties involved and is based on the promoter's conduct as an agent or trustee of the company. It is imperative for promoters to exercise caution and prudence during the pre-incorporation stage as their actions can have legal ramifications.

4. Similarly, Section 300 of the Companies Act 2013 stipulates that a promoter can be subjected to a public examination by the Tribunal, if the Official Liquidator's report during the winding up of the company reveals any fraudulent activity committed by the promoter during the formation and promotion of the company.

---

<sup>10</sup> [2010] 104 SCL 174

5. As per the provisions of Section 340 of the Act, in the event of winding up proceedings, if it comes to light that any individual who was involved in promoting or establishing the company has indulged in any fraudulent activity or has unlawfully retained any property or funds, or has breached the trust placed on them, the Tribunal is empowered to direct them to restore or reimburse the company's assets along with interest at a prescribed rate. Additionally, the Tribunal may also require them to compensate the company for any loss suffered due to their misdeeds, as deemed appropriate and just.
6. When individuals who are promoting a new company enter into a contract before the company is formed, these contracts are referred to as pre-incorporation contracts. It is important to note that the company is not held responsible for these contracts, nor does it validate them. Instead, the promoters themselves are held personally liable for these agreements.

In the landmark case of *Kelner v. Baxter*<sup>11</sup>, it was concluded that a promoter is not considered to be an agent or trustee of a future company. As a result, no one can act as an agent for a non-existent entity, which means that a company cannot be sued for contracts made by the promoter on behalf of the company before it is incorporated. However, it is worth noting that there has been a change in the position regarding liability following the passing of the 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 it is warranted by the terms of incorporation.<sup>12</sup>

## **PROMOTER FIDUCIARY POSITION IN THE COMPANY**

In the latter part of the 16th century, there was an emergence of a new term called "fiduciaries," which came from the Latin word "fiducia" which means trust. This term pertains to something or someone that instills trust and credibility. In a corporate setting, a promoter holds a fiduciary position. The responsibilities and duties of a promoter in relation to the company have been elaborated on by Lord Cairns in *Erlanger v New Sombrero Phosphate Co*<sup>13</sup> in the following words: They stand, in my opinion, undoubtedly in a fiduciary position. They have had in their

---

<sup>11</sup> (1866) LR 2 CP 174; 15 LT 213; 15 WR 278

<sup>12</sup> Pre- incorporation contracts and the promoter liability, law teacher, <https://www.lawteacher.net/free-lawessays/contract-law/pre-incorporation-contracts-and-the-promoter.php> retrieved on 8-10-23(last visited on 910-2023)

<sup>13</sup> (1878) LR 3 AC 1218

hands the creation and moulding of the company; they have the power of defining how, and when, and in what shape, and under what supervision it shall start into existence and commence to act as a trading corporation<sup>14</sup>. In the realm of promoting a company, promoters tend to possess a significant advantage over the business they are promoting. As a result, they are often entrusted with fiduciary responsibilities and are expected to act as agents in a court of law. —The promoter is in the situation akin to that of a trustee of the company and his dealings with it must be open and fair<sup>15</sup>. As a promoter, it is crucial to provide all relevant information about a property if it intends to use shareholder funds to buy it and receive payment. Failure to disclose details about the property's worth or your personal interest in the sale could lead to the transaction being voided, or the company seeking reimbursement for any losses incurred. It is generally considered unethical to receive a commission or bonus from the seller in connection with the sale to the company, as it violates the trust of the shareholders. In short, the chief duty of the promoter as a fiduciary agent is to disclose to the company his position, his profit and his interest in the property which is the subject of purchase or sale by the company<sup>16</sup>. However, as observed through further experiences, it may not always be practical for promoters to establish an autonomous Board of Directors for a company. This is particularly true when a private or public company, such as *Salomon & Co*<sup>17</sup><sup>18</sup>, is made up entirely of family members, thus making it impossible to form an independent Board of Directors. In such circumstances, promoters must disclose their interests and profits to all shareholders of the company, instead of limiting information to a select few. This point was underscored by the House of Lords in their renowned decision in *Gluckstein v Barnes*<sup>18</sup>. The Companies Act 2013 defines

"promoter" in Section 2(69), which states that —promote 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

---

<sup>14</sup> *ERLANGER V. NEW SOMBRERO PHOSPHATE CO.* (1874-80) ALL ER REP. 271  
<https://dullbonline.wordpress.com/2017/06/30/erlanger-v-new-sombrero-phosphate-co-1874-80all-er-rep-271/>(last visited on 9-10-2023)

<sup>15</sup> *Morawetz, Corporation*, S.546. *Omnium Electric Palaces Ltd v Baines*, (1914) 1 Ch 332:109 LT 964 (CA), they are not trustees in the real sense of the word because the company may not be in existence as a legal person.

Fiduciary position emerges from agency.

<sup>16</sup> *Omnium Electric Palaces Ltd v Baines*, (1914) 1 Ch 332:109 LT 964 (CA)

<sup>17</sup> (1897) AC 22

<sup>18</sup> AC 240; 69 LJ Ch 385; 82 LT 393 :16 TLR 321: 7 Mans 321.



that nothing in sub-clause (c) shall apply to a person who is acting merely in a professional capacity<sup>19</sup>.

## **CONCLUSION**

A promoter is responsible for conducting activities from pre-incorporation to the registration of a company. They have rights and duties, including the right to indemnity and preliminary expenses, but companies are not always bound to these rights. The Specific Relief Act of 1963 allows a promoter to shift their rights and responsibilities to the company under certain conditions. Promoters are important for the existence of a company and can be shareholders or directors, but their role ends after incorporation. Promoters are in a fiduciary relationship with the company and must maintain transparency. The Company Law in India holds promoters individually liable for misconduct or misfeasance. Pre-incorporation contracts may become operable if ratified by the company and not against the objects stated in the Memorandum of the Company.

---

<sup>19</sup> <https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf> (last visited on 9-10-2023)