

Analysis on the Position, Duties, Rights and Liabilities of Promoters

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Abstract:

There must be a process and it goes through various steps in order to start a company. The promotion is the initial step in the procedure. At this point, a person known as a promoter has the notion to run the company. It is necessary to complete a number of processes before a company can be incorporated. These tasks are carried out and the promoters play a vital role in establishing the company. A promoter develops the concept for a firm and determines why it is being formed. This article provides various information on the promoter's function in promotion. The article also seeks to provide a glimpse into the variety of tasks that a promoter must complete in order to establish a business. Promotion inside a corporation is not simple because it involves accountability. The promoters' obligations and liabilities are highlighted throughout the article. Additionally, it also seeks to inform about pre-incorporation agreements and their function in promotion. It finally focuses on the aspect of the promoter's salary and remuneration and the various methods in which they get paid. This article mainly focuses on the aspect of promotion and promoters.

Keywords: Promoters, section 2(69), rights and liabilities, legal position

Introduction:

The individual listed first in the chronological order of the company incorporation process is known as the promoter. The labour involved in corporate promotion is varied and requires a lot of late nights. The company's promoters are similar to the company's parents, who give birth to the business as a youngster. Promotion comprises the idea's inception, incorporation, flotation, and start of company. Promoters have a significant role in the incorporation process and nearly always everything needed to launch a business. The process of forming a corporation entails a coordinated team effort by multiple individuals under the direction of promoters in order to comply with laws, regulations, and authorities. A company is a type of business where the primary goal is to maximise profits. Business Ownership based on the business model selected by entrepreneurs who operate as sole proprietorship, Hindu company, limited liability partnership, undivided family, and firm. We are aware that the ideal legal structure for conducting business and commerce is a company because of wealth management, corporate finance, limited liability, and independent legal existence.

We are aware that we have the fundamental right to conduct business, which naturally leads to the fundamental right to establish a firm. However, the law must be followed if fraud is involved in promotion, if scams are carried out in promotion, or if positions are abused. In this article, we'll talk about every aspect of promoters and the promotion of business.

Who is a Promoter?

A promoter is a person who takes all the required steps to create an incorporated company, or who performs the preparatory work required for the formation of a corporation. As a result, a promoter is a company's initial point of contact and is responsible for guiding it through all basic legal compliances and other processes required for its incorporation under the Companies Act of 2013.

Promoters are essential to a company's establishment from the very beginning. The promoters of a company are the person or group of people who have the idea to launch a firm. They complete the procedures needed to set up the business.

The promoters of the business mould the organisation and subsequently the building blocks of the business. A promoter, however, is not the business's owner. The company's stockholders are its true owners, albeit the promoter assists in its founding and management.

Definition:

Section 2(69)

“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.¹

This term is the outcome of several SEBI rules as well as court rulings. According to this definition, a person is considered to be a promoter if their name appears in the prospectus or annual report, if they have direct or indirect control over the company's operations as a director or shareholder, or if they have authority over the Board of Directors; he is the company's promoter. Still, the Individuals working for the organisation in a professional capacity are not allowed to promoters, such as lead managers, merchant bankers, company secretaries, and solicitors, etc.

After reading over the definition, one could draw the conclusion that promoters are essential to the company's founding. The necessary subscribers are gathered, the Memorandum and Articles of Company are prepared, the application for incorporation is filed, capital is arranged through IPOs, private placements, public deposits and debentures, and external commercial borrowings, the first director of the company is appointed, the corporate office and registered office is established, and all pre-incorporation agreements are signed on behalf of the company to make production conducive, including purchasing land for a manufacturing unit, signing technology transfer agreements with foreign counterparts, supplying raw materials, employing suitable labour, and so on. They have a great deal of authority to accomplish things that are intra vires, which implies that promoters are qualified to find an enterprise that is supported by the rules of incorporation.

They are typically those who are engaged in the planning and conception processes throughout the early phases of the business. It is a truth that a person is a promoter or not. Promoters cannot be insolvent and

¹section 2(69) of the companies act 2013

undischarged. Both legal and natural persons may act as promoters. A person who offers technical support or services to someone engaged in the aforementioned activities without expecting payment is not considered a promoter.

Types of promoters:

One who comes up with the concept of forming a firm is known as a promoter. A promoter could be an individual, business, organisation, or combination of individuals. A company's promoters can be any of the following kinds:

Professional promoter: An adept at promoting a firm from its conception or start is a professional promoter. Once the company is well-established in the market, they give shareholders ownership of the company.

Financial promoter: A financial promoter is a person who has a substantial stake in the company and makes capital or financial investments. They advertise financial organisations or banks. Their objective is to evaluate the financial standing of the market and launch a business at the appropriate time.

Managing promoter: A managing promoter facilitates the establishment of a corporation. Following the formation of the corporation, they also receive managerial rights.

Occasional promoter: An occasional promoter is one whose primary responsibility is to raise capital for the business. Being in charge of two or three businesses, they don't regularly market the company and only get involved in business-critical issues.

Functions of a promoter:

Identification of Business Opportunity: The promoter must first determine whether there is a potential business opportunity in a specific industry that could be profitable in the near future. This could be an opportunity to take advantage of a new natural resource area or incorporating something fresh into the current framework. The advertiser can use the technical expertise of that specific field to find out this potential. When a promoter sees that there is room for growth in this specific company endeavour, then the concept is developed further.

Detailed investigation: At this phase, a number of variables are carefully examined and evaluated from a variety of angles in order to evaluate the business's profitability and long-term viability. The demand in the market, raw material availability, financial arrangements, transportation infrastructure, and supply method and so forth, are taken into account.

Approving & Naming Process: Once the business's structure has been determined, it's time to register the enterprise with a specific name. The "registrar of companies" authorises the company name. As though when choosing a name, it's crucial to remember that it shouldn't sound like something already in use. Steer clear of terms such as state, national, monarch, queen, etc.

Who Would Sign the Memorandum? An organization's constitution is found in its memorandum of association (MOA). The names of those who would sign this constitutional instrument are chosen by the promoters. Usually, the company's director is the first person to sign the MOA. The director has to give his written approval in the manner and format required by law.

Organisation of Funds or Resources: A firm cannot exist without sufficient capital, just as a human body cannot exist without food and water. Making the required capital arrangements is so crucial. The promoter determines the amount of capital needed and where it can come from. Bank loans, private equity,

initial public offerings, and other sources are among the many. A number of financial and legal experts are hired to ensure the capital arrangement is successful.

compiling required paperwork, such as the MOA and AOA: In addition to the company's charter, known as the Memorandum of Association (MOA), promoters must file a number of additional crucial documents with the registrar of businesses. It contains the Articles of Association, which handle all internal business matters, prospectus, certificate of incorporation, etc.

Some activities performed by promoters:

1. Coming up with the plan to create a company or appropriate corporation for the enterprise
2. Gathering the necessary number of subscribers;
3. Applying to the appropriate authorities for a Corporate Identity Number (CIN), Global Location Number (GLN), and PAN/TAN;
4. Obtaining the company's documents, such as the Articles and Memorandum, prepared, executed, and registered;
5. Locating bankers, brokers, and legal advisors;
6. Preparing and distributing the prospectus;
7. Raising capital through an IPO, private placement, debenture or public deposits, or external commercial borrowing;
8. viii. Due diligence and compliance with applicable laws and regulations pertaining to corporate financing and disclosures through annual and periodic reports to the Registrar of Companies, Regional Directors, SEBI, Ministry of Corporate Affairs, Foreign Investment Promotion Board.

Legal position of a promoter:

With the company he supports, a promoter maintains a fiduciary relationship—one that calls for confidence or trust. He has obligations to the firm that are unrelated to those of an agency or employee-employer relationship because he is neither the company's agent nor employee. Lord Cairns also noted this in **Erlanger V. New Sombrero Phosphate Co.**, where he also described the scope of a promoter's duty.²

Since the company is not yet established, the promoter is neither a trustee or agent of the business. His legal position can best be described as one of fiduciary duty towards the soon-to-be-formed firm.

Duties of promoters:

A promoter has specific obligations to the company as he represents it in a fiduciary role. Promoters have the same obligations as someone acting on behalf of someone without an employment contract: they must operate with reasonable care and refrain from deception. For fraud and deceit in the prospectus, he can face consequences.

Reveal any hidden profits:

The promoters' primary responsibility is to uphold company loyalty and refrain from unethical behaviour. When engaging in promotional activities, such as purchasing real estate and selling it for a profit without revealing it, they shouldn't make any unreported or concealed earnings. They are free to

² 878 3 AC 1218.

make these kinds of gains; the only requirement is that they have to disclose them. They have to provide all pertinent firm stakeholders with information about their earnings and profitability.

Declare all relevant information:

A promoter and the company have a fiduciary relationship, which is one based on trust and confidence. The promoter is required by law to provide all pertinent stakeholders with material information about the company's establishment and operations as part of their fiduciary obligation. Promoters have an obligation to provide all relevant information to the company's stakeholders. Since a company and its promoter have a fiduciary relationship, as was previously mentioned, failing to disclose any information about the company's activities could result in a fine of Rs. 50,000 or five times the benefit he received from the aforementioned act [under Section 102(5) of the Act].

- If the promoter sells the company his own property, he is allowed to declare this interest and conduct himself honestly throughout the transaction.

Such a declaration could be given:

- To the Company's Directors.
- in the Company's Articles of Association.
- in the company's prospectus.
- Directly to the current and prospective shareholders.

Act in the business's best interests:

Promoters ought to put the needs of the business ahead of their own at all times. When forming the company and conducting business, they must put the company's best interests first.

Declare all personal agreements:

There are numerous private transactions involved in the formation and establishment of a corporation. Nonetheless, the promoters are required to notify the stakeholders of such transactions. Promoters have an obligation to inform stakeholders of any private transactions and any profits made from them.

In relation to Prospectus:

A company's prospectus must contain a few specific reports and information. According to Section 62(1) of the Act, a promoter is responsible for compensating each subscriber for any loss or harm they may have suffered as a result of any false assertions made in the prospectus. A promoter who makes any false assertions in a prospectus may be fined Rs. 5,000 for each false statement in the prospectus, or they may be imprisoned for up to two years (in circumstances of serious fraud and successive offenses), as per Section 63 of the Act.

Rights of a promoter:**Right of indemnity:**

If multiple promoters collaborate, one may pursue a claim against the others for any damages or compensation that they paid while carrying out their obligations. If promoters make any false or deceptive claims or violate any other obligation, they will be held accountable both severally and collectively.

Right to receive expenses;

A promoter is entitled to reimbursement for any costs incurred by him informing the company, including advertising charges, hiring assistants, compliance fees, etc. This right, however, is not governed by a contract and is subject to the company's directors' judgment (assuming there isn't a formal contract between them). A neatly arranged set of receipts and vouchers must accompany the application for preliminary expenses.

Right to remuneration:

In theory, promoters cannot legally sue the company for compensation absent a written agreement to that effect. The company's directors have the power to pay the promoter compensation for the services they have rendered. Since the majority of promoters are also directors, they are typically compensated for their extra services to the business.

Right to recover proportionate amount from co-promoters:

Should the promoters make any undisclosed profits during the company's formation and one of them subsequently pays the entire sum to the directors, that promoter shall be entitled to recoup proportionate amount from co-promoters.

Liability of promoter:

- They are not allowed to deal for their own personal promotion or to secretly profit from corporate gains. When they make such gains, the promoters are obligated to compensate the firm.
- They may be held accountable for any losses or damages incurred by someone who subscribes for shares or debentures as a result of the company's fraudulent representations in the prospectus.
- If they make false claims in the prospectus, they face criminal penalties.
- In the event that there are reports alleging fraud in the company formation or promotion activities, they may be held accountable for a public inspection of private company documents.
- In addition, they are accountable to the business in cases when they violate corporate policies, embezzle company assets, or violate trust.

Liabilities Associated with Prospectus the Companies Act of 2013 and the ICDR Regulations of 2009 stipulate what information should be included in the offer document, or prospectus. A prospectus is a written piece that provides the financial data, issuance information, and general information prior to potential investors to assist them in making decisions on the subscription of shares in the specific business. The company's promoters are subject to both civil and criminal liability under section 34 and 35 if the prospectus contains any statements that are false or misleading in the manner in which they are included or in any context in which they are included. 35 of the Act, and as a result, they could face penalties under section 447 with incarceration for a duration that can range from six months to ten months, but it cannot be less than those years, in addition to being subject to a fine that will not be less than the total amount involved in the fraud, but which might go up to three times the total amount committed.

The entire basis for sections 34 and 35 is the case of *William Derry v. Henry Peek*. In this instance, a business applied to the British Board of Trade for a license to operate steam-powered tramways, hoping to be granted the company's prospectus for capital-raising claims that it has received a tramway operating license from steam-driven yet in reality, they were unsuccessful. The company's directors were not found guilty of deceit. According to Lord Herschell "I think they were mistaken in supposing that the consent of

the Board of Trade would follow as a matter of course because they had obtained their Act. It was absolutely in the discretion of the Board whether such consent should be given. The prospectus was therefore inaccurate. But that is not the question. If they believed that the consent of the Board of Trade was practically concluded by the passing of the Act, has the plaintiff made out, which it was for him to do, that they have been guilty of a fraudulent misrepresentation? I think not. I cannot hold it proved as to any one of them that he knowingly made a false statement, or one which he did not believe to be true, or was careless whether what he stated was true or false. In short, I think they honestly believed that what they asserted was true, and I am of opinion that the charge of fraud made against them has not been established.”³

But, when sued under section 35 for criminal culpability, such individuals are entitled to both general and specific defences. If they are providing professional services, if they stopped authorizing the matter, or if they don't know that the information in prospectus; they won't be held accountable.

Conclusion:

The promoters undoubtedly play a crucial part in the establishment and success of the company. Whether they are interacting with professionals or hiring staff, they assist in the most effective manner in the establishment of the business. To start a corporation, there needs to be a procedure that involves several steps. The first step in the process is the promotion. At this moment, the idea to manage the business belongs to a person known as a promoter. Before a corporation can be incorporated, a number of procedures must be fulfilled. The promoters are crucial in the establishment of the company and carry out these activities. A promoter formulates the idea of a company and establishes its purpose.

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³ (1889)14 AC 337