ADMINISTRATION OF COMPANY

PROMOTERS

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Promoter

- Why discuss promoter?
    - *Satyam*
    - *Kingfisher*
    - *Jet Airways*
    - *PNB*
    - *Yes Bank*

Status of Promoter

- *W. A. Nos. 85 and 86 of 1963 (Mad), Palaniswami v. Nandi Transports (P.) Ltd.*

  *"A 'Promoter' therefore, is a **compendious** term given to **a person** who **undertakes, does and goes through all the necessary and incidental preliminaries, keeping in view the objects, to bring into existence an incorporated company**. This process leading to the genesis of a company may include a variety of things, not the least of them, I think, being some of the steps taken by a promoter to ensure commencement, within a reasonable time, of the business, for the carrying on of which the company is formed. He makes **purchase of moveable and immoveable assets, enters into contracts involving rights and obligations and applies to authorities for a variety of things, all on behalf of the company to be formed**."*

Promoter

Definitions under:

- Section 2(69) of the 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**

Promoter

- Regulation 2 (1)(za) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009:
  - "(za) "promoter" includes:

    (i) the person or persons who are n control o the issuer;

    (ii) the person or persons who are instrumental in the formulation of a plan or programme pursuant to which specified securities are offered to public;

    (iii) the person or persons named in the offer document as promoters:
  - Provided that a director or officer of the issuer or a person, if acting as such merely in his professional capacity, shall not be deemed as a promoter:
  - Provided further that a financial institution, scheduled bank, foreign institutional investor and mutual fund shall not be deemed to be a promoter merely by virtue of the fact that ten per cent. Or more of the equity share capital of the issuer is held by such person;
  - Provided further that such financial institution, scheduled bank and foreign institutional investor shall be treated as promoter for the subsidiaries or companies promoted by them or for the mutual fund sponsored by them;
- Regulation 2(1)(zb) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

Also,

- Regulation 2 (1)(s) of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

Promoter

Control

- Section 2(27) of the Companies Act, 2013:

  ”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;

- Accounting Standards (AS) as AS-18
  - Control may be direct or indirect either in the form or by virtue of:

    i. shareholding in the Company

    ii. management Rights in relation to the company

    iii. shareholders agreement

    iv. Voting agreement or in any other manner.

Promoter

Control

- Accounting Standard 21 (Consolidated Financial Statements)

AND

- Accounting Standard 23 (Accounting for Investments in Associates in Consolidated Financial Statements)

(a) The ownership, directly or indirectly through subsidiary (ies), of more than one-half of the voting power of an enterprise, or

(b) Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise so as to obtain economic benefits from its activities."

Promoter

Control

- Regulation 2(1)(e) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011:
  - 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.

CONTROLLING INTEREST

Subhakam Ventures (I) Pvt. Ltd. v. SEBI

Promoter

- Subscriber to the memorandum
  - *Phosphate Sewage Co. v. Hartmount [[1876] 5 Ch. D.394]*

- Official Receiver and liquidator
  - *Jubilee Cotton Mills Ltd. V. Lewis [106 [1924] AC 958 (HL)]*

Pre incorporation Contracts

- “Pre” “incorporation”
- Between the promoters or people who qualify as “promoter” subsequently and third parties;
- Usually made on behalf of the Company;
- With the view of acquiring:
  - Property (moveable/immoveable);
  - Rights for the Company;
  - Services;

Promoter & the Company

- *Weavers Mills v. Balkis Ammal*

were relied upon. It seems to us that neither of these sections is of assistance to it. These sections, as we think, contemplate transactions as between persons in existence. In any case, it seems to us that no trust as defined by S. 3 of the Act is brought about by the purchases made by the promoters. The legal position of a promoter in relation to his acts, particularly purchase of immoveable properties on behalf of the company under incorporation, is a peculiar one not capable of being brought into any established or recognised norms of the law as to its character as an agent or a trustee. But, at the same time, it is impossible, to our minds, to deny that he does stand in a certain fiduciary position in relation to the company under incorporation. When he does certain things for the benefit of it, as for instance, purchase of immoveable properties, he is not at liberty to deny that benefit to the company when incorporated. We are prepared to hold that in such a case the benefit of the purchase will pass on to the company when incorporated. 6 Halsbury's Laws of England, 3rd Edn, paragraph 194, says that a promoter stands in a fiduciary position with respect to the company which he promotes from the time when he first becomes until he ceases to be a promoter thereof. It is also pointed out that a promoter may acquire assets as a trustee for a company. Though the cases relied on for these propositions were of the year 1877 or there abouts, we we do not see why the principle of the dictum

Promoter & the Company

- *Weavers Mills v. Balkis Ammal*
  - The relationship between the Company and its promoter(s) is fiduciary
  - if the Company accepts the benefits of a pre-incorporation contract, then it must accept the burden too

Is the newly formed Company deriving any 'benefit'?

Legal Status…Pre-Specific Relief Act

- *Kelner vs Baxter:* Liability rests with the Promoter alone

    - Erle CJ: **No principal-agent relationship can exist before incorporation**. Company cannot take liabilities of pre-incorporation contracts through adoption or ratification since, the company was a stranger. Promoters are personally liable for obligations in pre-incorporation contracts.

Legal Status…Pre Specific Relief Act

- *Newborne v Sensolid:* Liability rests with the Promoter alone
- Facts: Newborne had entered into a contract with Sensolid Ltd. to supply tinned ham, later Sensolid refused to take further deliveries. <u>The contract was signed by Leopold Newborne underneath the words "Leopold Newborne (London) Ltd." not under the expression "on behalf of" Leopold Newborne (London) Ltd</u>.
- Held:
  - Rule of construction - promoters were only liable if it was intended in the circumstances that they were themselves to be parties to the contract.
  - Test of whether the promoter was intended to be a party to the contract.
  - Held - The manner in which the contract was signed by Leopold Newborne, it was intended to be a contract with the company and only the company. In other words, given the way in which it was signed it indicated that it was not intended that Leopold Newborne be a party to the contract himself.

Risk to both the promoter as well as the third party wrt the enforceability of pre-incorporation contractual obligations

Legal Status…Post Specific Relief Act

- The Company may ask for specific performance under
    - *Section 15(h): when the promoters of a company have, before its incorporation, entered into a contract for the purposes of the company, and such contract is warranted by the terms of the incorporation, the company: Provided that the company has accepted the contract and has communicated such acceptance to the other party to the contract.*
- Third Parties may ask for specific performance under
    - *Section 19(e): when the promoters of a company have, before its incorporation, entered into a contract for the purpose of the company and such contract is warranted by the terms of the incorporation, the company: Provided that the company has accepted the contract and communicated such acceptance to the other party to the contract.*

Vali Pattabhirama Roa v Sri Ramanuja Ginning and Rice Factory Pvt. Ltd.

Enforcement – How?

Adoption of contract by…

- Ratification
- Novation - ***Dadri Cement Co v. Bird and Co (P) Ltd*** *'a contract in existence, some new contract is substituted for it either between the same parties (for that might be) or different parties, the consideration mutually being the discharge of the old contract'*

Effect of Non-ratification in India

Personal Liability of the Promoter
& Possibility of Being Sued

Jurisdictional analysis

SEVEN SEAS
INTERNATIONAL LAWYERS

- Germany
  - Promoter allowed to make other promoters liable. Pre-incorporation associations treated like a partnership.
  - Theory of continuity - All obligations and rights accrue upon the company, as if under succession.

- Australia
  - Section131 of the Australian Corporation Act 2001 - Courts can interfere where contracts have not been ratified by the Company

Jurisdictional analysis

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- England
  - Ratification is not allowed
  - Novation permitted
- South Africa
  - Promoter is personally liable
  - Breach of dual warranty of statutory authority - One is that promoter has the obligation to incorporate the company within a reasonable period of time as well as for the company must ratify the contract

Jurisdictional analysis

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- USA
  - ***Goodman v. Darden***
  - ***RKO- Stanley WarnerTheatres, Inc. v. Graziano***
  - Position similar to India, strict liability unless the Company adopts

What are your thoughts?

- On the enforceability of pre-incorporation contracts in India?
- What is your opinion of the position vis-a-vis Germany and USA? (Two groups)
- What would your opinion be as a lawyer to the following Clients, represented by two groups of individuals in India:
  - **Group A** - Has submitted their applications to the RoC (New Delhi) for incorporating a Company and pending such incorporation, they wish to enter into a contract of hiring statutory compliance services for the newly incorporated Company and wish to avoid personal liability as well as be reimbursed eventually.
  - **Group B** – Is a Professional office equipment supplier, who is discussing a contract for hire purchase of some capital assets with an individual, who is claiming to be a 'promoter' for a company that is due for incorporation.

Promoter's Obligations & Liability

- *Fiduciary duty of care*
  - ***Darius Rutton Kavasmaneck v. Gardha Chemicals Ltd.***
  - ***Dhulia-Amalner Motor Transport ... vs Raychand Rupsi Dharamsi And Ors.***
- Sections 7(6), 35(1), 42(10), 56, 62(1)(c), 63, 102, 257, 284, 300, 478, 542, 543 of the Companies Act 2013

Remedies for the Company in case of infringement of Promoter’s Duty

- Remedies for the Company in case of infringement:
  - Revoke and recover
  - Recover of profit even though rescission is not claimed or not possible
  - Claim damages

As a lawyer

- Include the obligations in all the clauses which gives the basic structure to the company;
- State the proposed seat of business properly;
- Equal representation of all promoters (ideally);
- Voting rights;
- No authority to sign without consent of all promoters;
- Dispute resolution clause

THANK YOU

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