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Avinash Kumar



Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC – NET examination and has been awarded ICSSR – Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and learning.

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ANALYSIS OF PROMOTERS IN THE CONTEMPORARY WORLD

AUTHORED BY - NAVEEN.M

INTRODUCTION

The formation of a company does not take place overnight. It involves various steps like promotion, Registration, Flootation, and the launch of a Business. For the commencement of every business, the primary stage is “Promotion.” Promotion refers to the entire process by which a company is brought into existence, from the development of the idea to form a company to the actual formation of the company. And the person who does “Promotion” is called a Promoters or Promoter Group. As per section 2(69) of the Companies Act, 2013, "promoter" means a person 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) who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; (or) by whose advice, directions, or instructions the Board of Directors of the company is accustomed to act. In simple words, a promoter or promoter group means any person, association, partner, or company that conducts all the activities ranging from the pre-incorporation stage to all the important affairs of the company.

Recently, the Securities and Exchange Board of India ('SEBI') has issued a consultation paper on redefining the definition of corporate 'promoters' and moving toward the concept of 'person in charge. This has led to the rise of questions on the rationality of this shift. So, in this research paper, we will be analyzing the concept of promoters & Promotion, its duties, and the rationale behind the suggestion of redefining the definition of corporate 'promoters' and moving toward the concept of 'person in charge. Firstly, we will be looking into the concept of promotion and promoters in detail. Then, we will be looking into many sub-topics like functions and the importance of promoters. We will also be looking into the duties and liabilities of a promoter. Last but not the least, we will be looking into the reason for redefining the term “Promoters” and the need to revisit it. We will also investigate the positive and negatives within the reform.

I. PROMOTERS: AN IN-DEPTH UNDERSTANDING

Let us first define the phrase "promotion" before attempting to grasp the term "promoter." Therefore, the term "promotion" is used widely to refer to the initial procedures done to register and list the firm. And those responsible for promotion are referred to as "Promoters. "In the corporate world, A promoter is someone who performs all essential preliminary work as a byproduct of the company's development or promotion. One need not have been involved in the company's inception to be a promoter; someone who later helped coordinate the "floating" of its capital will also be recognized in this capacity¹. The term "promoters" is defined in section 2 of Companies At, 2013. According to Section 2(69) of the Companies Act of 2013, a promoter is defined as "a person who has been named as such in a prospectus or is identified by the company in the annual return in Section 92, or who has control over the affairs of the company, directly or indirectly whether as a shareholder, director or otherwise; or in accordance with whose advice, directions, or instructions the Board of Directors of the company is accustomed to act²". In *Twycross v. Grant* (1877), Cockburn CJ defined a promoter as someone or a person who agrees to organize or orchestrate a corporation concerning a certain project, to get it started, and to take the essential actions to carry out that enterprise³. So, in simple words, a promoter is like the parent of the company. They come up with the idea of how to structure the company with the prior knowledge and experience they gained from the corporate world, plan and form the objectives of the company, bring in the best directors for running the company, and bring in the best investors for the development and flotation and looks after all the documentation required for starting the company. In short, they are like the bird which builds the best nest for its babies.

II. PROMOTERS: TRACING THE ORIGIN

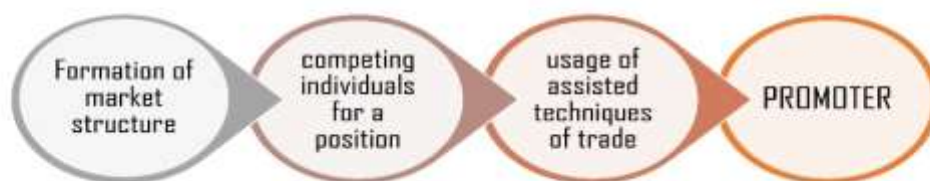
To understand where it all started, we must look back at the pages of the history of mankind. When man started settling after the agricultural revolution took place, some people started cultivating certain products. The hunter-gatherers were the people who produced animal products. But the problem was that they were not able to obtain agricultural products. Likewise, the people producing agricultural products were not able to obtain animal products. Hence, as a solution to this problem, there started the practice of exchange of materials between individuals. However, not every man could have the same level of skill and talent. Some men

¹ *Lagunas Nitrate Company v. Lagunas Syndicate* [1899] 2Ch. 392, P. 68

² Section 2(69) Companies Act, 2013

³ Sarah Worthington, *Text Cases & Materials in Company Law* 498 (11th ed 2013)

made high-quality products, and those men were considered specialists. This specialization of the individuals created a demand for one product from other specialized persons. With an increase in population and the efficacy of the techniques used in production, several individuals started competing with one another for occupying the market for themselves. However, capturing the market is not as simple as said. The implementation of many techniques of trade was essential for this. And here came Promoter into the picture. Just like other specialists, the promoter was also a specialist in capturing the market. And people started seeking them. And this was how promoter originated. And then, these evolved over the years.



III. TYPES OF PROMOTERS

Based on the classification of the nature of work they perform, and the number of individuals who perform, these promoters are broadly divided into four types: They are Professional Promoters, Occasional Promoters, Financial Promoters, and Managing Agents as Promoters of a company.

1. Professional Promoters:

If we take professional promoters, as the name suggests, these individuals fall under the category of specialists who are deeply expertized in the field of foundation and promoting of a company right from the induction stage of that company and sometimes during the formation of a company and that period. At the onset of the firm and its taking over a particular position in the market as its own, the promoter hand over the accounts, working, and all other furnishings that it had done on the company to the original shareholders of the company as their work got over after the firm establishment of the company in the market. In India, many such professional promoters indulge in such kind of activity. One cannot deny the role that they play in the incubation of a company from its scratch and is very vital for its growth.

2. Occasional Promoters:

These types of promoters would not function as done by professional promoters, as these types of promoters are the ones comprised of persons who are not into stuff like active promotion of a business as a routine function in their lives. Usually, the responsibilities of promoting 2-3 companies are only vested in promoters of this type. As a simultaneous way of understanding this type, these people are involved and coordinate among themselves alone in the promotion activities of a company and take part in the events or significant serious affairs of the company and about the activities of the business.

3. Financial Promoters

As the name suggests, this is a category of promoters who are involved in the promotion of the company from a more financial perspective like those who indulge in investing of capita of any form including money and are entitled to hold a position in the company like an extensive palisade in the corporation. These promoters tend to ask for and get superpowers like voting rights on their hand which results in a strong influence on their part for the daily day functioning of the activities related to the business of a company. For example, institutions related to finance like banks such as the State Bank of India, or insurance companies like the Life Insurance Corporation, etc. also act as promoters of some infamous companies.

4. Managing Agents as Promoters of a company:

This is an obvious category of promoter where these agents are always used in moving new companies into the markets of a nation, say, India, for which as a return, they get the managing agency rights.

IV. PROMOTERS: THE FUNCTIONS

A Promoter plays a very important role in the formation of a company. But nothing in this world shall function efficiently without the concerned person doing his functions properly. Behind every importance, there lies a function, which is ought to be carried out properly. Likewise, the Promoters also have their own set of functions to be carried out. In their capacity as Promoters, they perform some functions to incorporate and develop a company. The functions of the Promoters are not vast, yet does have a crucial effect on the company's growth and development.

the first Function of the Promoter is to conceive an idea for the formation of a company by

exploring all the possibilities. The formation of the company does not work which can be done overnight. It needs a lot of planning beforehand. As the promoter of the company, he/she should come up with a suitable idea for the formation of the company.

The Promoter's next function is to create a blueprint for the company and choose the company's corporate objectives or goals. A company without a favorable blueprint and objectives is something equal to stagnant water. All it could bring is the downfall of the company. Hence, the promoter has the responsibility to create a blueprint that helps in the development of the company and forms a suitable object for the company.

The Promoter's next function is to draught the company's prospectus, articles of association, and memorandum of association. Additionally, it is the promoter's responsibility to finance all initial costs and locate the best and most competent investors to support the business. The Promoter also has the responsibility to make agreements with suppliers, legal consultants, and other individuals required or needed for the company's Flotation.

Another function of the promoter is to decide on which place the headquarters or the registered office should be placed. The promoter should search for the most suitable place for the registered office, which could foster the development of the company and help in gaining maximum profit.

Along with all these functions, the promoters also have other functions like looking after the documentation process, naming the company, registering it, and selecting the apt directors for the company. So, these are the main functions of Promoters. Besides this, there are other functions too which are minute in nature.

V. PROMOTERS: THE DUTIES AND RESPONSIBILITIES

The Companies Act of 2013 talks about the liabilities of a promoter throughout the Act. The liabilities are stated across different sections of the Act like Sections 34, 35, and section 339⁴. But when it comes to the duties of the promoters, the act does not have anything to say about it. There is not even a single section discussing the duties of the promoter. And this led to the misuse or abuse of the position by the promoters. There are many instances where the

⁴ G.K. Kapoor & Sanjay Dhamija, Company Law and Practice, Pg.113.

promoters, taking advantage of the loopholes, have misused their position by laundering the company's money for their benefit. Hence, intending to stop this, the Indian courts came up with their derived law discussing the duties of the promoters.

1) **Duty to disclose secret profits**

This duty was emphasized for the first time in the case of *Gluckstein v. Barnes*⁵. In this case, it was held by the court that a promoter must inform the company's shareholders of the financial profit he made through the process. The promoter is bound with the duty to disclose whatever profit he/she had made. It is not that the promoters cannot make a profit at all, but the rule is as simple as that he should disclose the profit. In simple words, no secret profit should be made. For example, if X, who is the promoter of company Y, buys land for the company for 1 crore and sells it with a profit of 20 lakhs to the company, then he is duty-bound to disclose the profit he made. However, the consent to gain this profit lies with the company only. It is just like the need for the principal's consent for the agent's profit. However, the promoter is not duty-bound to reveal the profit if they are selling their own land. (Land bought before entering the role of promoting)⁶

2) **Duty to disclose interest**

The next duty that lies on the promoter is the duty to disclose his/her interest in a transaction. Just like the duty to disclose the profit, the promoter also must reveal whether they have any interest in the transaction that is made for the company. The promoter is duty-bound to disclose, both interest and profit, to the directors' board or the investors⁷ of the company. In the case of *Erlanger v. New Sombrero Phosphate Co*⁸, the court held that if a promoter fails to declare his interest in the contract with the company, it is a breach of the promoter's duty, and the company may withdraw the contract and demand the money to be reimbursed.

3) **Duty to disclose the legal actions**

The next duty of the promoter is to mention if there is any legal action against the promoters, in the prospectus. Every promoter is bound with the duty to reveal the presence of any legal proceedings that have been brought against them in the five years prior to the year in which the

⁵ *Gluckstein v. Barnes* (1900) AC 240

⁶ G.K. Kapoor & Sanjay Dhamija, "Company Law and Practice", Pg.155, P.4

⁷ *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899) 2 Ch. 392

⁸ (1878) 3 App Cas 1218, 48 LJ Ch 73, 27 WR 65, [1874-80]

firm releases the prospectus⁹.

These are the duties laid down by the courts. However, the absence of clear legislation stating the different duties of the promoter has always been a point of emergence of issue. Hence, there is a need for the Indian legislation to revisit the Companies Act and incorporate the duties of the promoters in it.

VI. PROMOTERS: THE LIABILITIES

The Indian Judiciary system does not have any problem when it comes to discussion about the liabilities of a promoter. As aforementioned, unlike the duties of a promoter, the liabilities of a promoter are mentioned through different sections in the Companies Act. The Companies Act of 2013 holds the promoters accountable for any misconduct or any other actions such as earning secret profits and providing false information in the company's prospectus.

The liabilities are as follows: -

1) “Criminal liability for misstatements in the prospectus”- Section 34

Section 34 of the Companies Act talks about the criminal liability for misstatements in prospectus. Section 34 states that “Where a prospectus, issued, circulated or distributed under this Chapter, includes any statement which is untrue or misleading in form or context in which it is included or where any inclusion or omission of any matter is likely to mislead, every person who authorizes the issue of such prospectus shall be liable under section 447”¹⁰. Section 447 which talks about the punishment for fraud states that any person liable under section 447 shall be imprisoned for at least 6 months, extendable to 10 years, and shall also pay a fine.

We all know the fact that drafting a prospectus is one of the functions of the promoter. So, logically, the promoter could be the person who could have drafted, and hence liable. So, the promoter will be liable for any misstatement in the prospectus.

2) “Civil liability for misstatements in prospectus”- Section 35

Section 35 of the Companies Act, 2013 talks about civil liability for misstatements in prospectus. According to section 35 of the Companies Act, the promoter has the liability to pay compensation to those people who purchased stocks based on a false statement, omission, or

⁹ Harpreet Kaur, “Promoters and Corporate Governance Under the Companies Act, 2013 And Allied Acts In India”, 53-70, 2017

¹⁰ Section 34, Companies Act, 2013

inclusion on the prospectus by the promoter and subsequently incurred loss or injury.

3) **Liability to attend the tribunal**

Section 300 of the Companies Act, 2013 says that “where an order has been made for the winding up of a company by the Tribunal, and the Company Liquidator has made a report to the Tribunal under this Act, stating that in his opinion a fraud has been committed by any person in the promotion, formation, business or conduct of affairs of the company since its formation, the Tribunal may, after considering the report, direct that such person or officer shall attend before the Tribunal on a day appointed by it for that purpose, and be examined as to the promotion or formation or the conduct of the business of the company or as to his conduct and dealings as an officer thereof.”. In simple words, if the tribunal directs the promoter to attend before the tribunal at a specific date based on the Company Liquidator’s report, then the promoter is liable to attend it.

4) **Liability for fraudulent conduct of business**

Section 339 of the Companies Act states that if any activities to defraud the creditors are done during the shutting down of the company, then the person shall be liable for fraudulent conduct. Section 340 states that if a person is found guilty of misfeasance or a breach of trust, or has misdirected or kept any unaccounted corporate property, shall be held liable. These two sections shall apply to the promoters also. the promoters are liable under sections 339 and 340 of the Companies Act.

VII. SEBI’S RECOMMENDATION: A NEEDED REFORM?

India has implemented several initiatives to encourage economic activity, including Start-up India, incentive programs tied to production, etc, resulting in the enhancement of the economic outlook of our country. The Securities and Exchange Board of India (SEBI) recently recommended four additional reforms with the same intent to fundamentally alter the business climate in India. The four reforms were:

- a) Reduction of the minimum promoter contribution’s lock-in periods
- b) Rationalization of the 'Promoter Group' definition
- c) streamlining group company disclosures
- d) Replacing the concept of a "promoter" with that of a "person in control"

In this chapter, we could not be focusing on the first three reforms, rather could be focusing only on the fourth reform mentioned above; the reform shifting the concept of the promoter to

the “person in control.”

Nothing in this world is stagnant. Everything is subjected to evolution and transformation as time flows, with the corporate world not being an exception. Over the decade, the corporate landscape and business trends have transformed a lot. But I believe, the transformation has only resulted in the concept of promoters and promoter groups becoming less prevalent and a burden to the shareholders. Business trends demonstrate the existence of promoters since they are categorized as such even when they do not have a commensurate financial stake. Even though shareholders are the ones who make the financial investments in the firm, it seems as though promoters receive an excessive amount of weight in corporate governance because of the unique advantages and preferential treatment that the legal system affords them. As a result, the SEBI reform to change the definition of "promoter" to "person in charge" is both required and beneficial.

There are a lot of issues pertaining to the concept of promoters. As mentioned earlier, the corporate world has developed so much that companies have started to develop and survive without a promoter itself. Companies like Zomato and Larsen are some of the companies which do not have promoters or promoter groups. For such companies, the laws related to promoters by itself is not relevant. Also, there are many instances where the promoter's permission is needed for initiating a process in the company. For example, Regulation 31A states that the process of reclassification of the promoter can only commence at the demand of the promoter. Such rules completely paralyze the working company and its board of directors from even thinking about reclassification. In short, the role of the promoter is just like an honorary post. It does not have much use, and it stands as an obstacle any many instances. Hence, I could say that the reform is needed and useful.

VIII. SEBI'S REFORM: THE JOURNEY AND THE OBSTACLES AHEAD

As I mentioned before, the reform to change the definition is much needed and useful. By doing this reform, Promoters' accountability needs can be lowered, providing them with greater relief concerning disclosures and other duties and responsibilities that is bound to them. Also, after this reform, the management and governance of the company could be must easier, as it could be done by the person in control, with no requirement of getting any permission from the promoter of the company. To say in simple words, there could no longer be any promoter-

dependent process, and hence the process could be easier. Also, due to this reform, compliance requirements will be much easier, due to which, more private firms will step forward to get in as listed companies, expanding the securities market. This will encourage foreign investment even more. However, every positive shall always have some negative impact within it. Likewise, there are a few obstacles in this case also.

The first barrier is the potential uncertainty surrounding the transitional phase, which may undermine stability and the business process. Also, the drafting part is very crucial. Drafting should be done with utmost preciseness and accuracy, such that no loopholes are present. A vague definition could result in misuse and abuse by using loopholes. Also, it could result in a situation where different courts come up with different interpretations, resulting in chaos. Hence, it must be rigidly read while carefully stipulating their rights to bring it into compliance with global best practices. Also, when the definition of promoters is changed, it should be clearly stated upon whom the liability falls.

VIII. CONCLUSION:

Promoters are equal to the founders of the company. Right from the naming of the company, to the documentation part, most of the jobs required to establish a company lie on the promoter only. They play a very crucial part in building the foundation of the company. They have their own set of duties and liabilities. The liabilities of a promoter are listed in the Companies Act itself, through many sections like sections 34, 35, 39, 40, etc. however, when it comes to the duties of the promoter, the act has not mentioned anything. However, the courts have derived their version explaining the duties of the promoters.

Recently, the Security Exchange Board of India came up with some reforms related to promoters. They came up with a total of 4 reforms, out of which, one reform was to change the definition of promoters to “person in control”. I believe that this reform is much needed because, in the changing world, promoters have become less prevalent, and their presence has started to become a burden. Hence, a new definition is needed. However, that is not as easy as we think. The drafting should be done with utmost accuracy. Even a slight mistake could result in a total collapse, creating chaos. Hence, I could say, that reform is needed, but is not needed urgently. By taking enough time, precise drafting should be made.

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