PROMOTERS AND THE PRE - INCORPORATION CONTRACTS IN SELECTED COMMONWEALTH JURISDICTIONS

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1.0 INTRODUCTION

Companies or corporation do not just spring up out of thin air, humans actually kick start the formation of these companies. When an individual has an idea for a new business venture, he or she may set about interesting others in the venture and persuade them to contribute capital to a company to be incorporate for the purpose of carrying on the venture. The individuals or humans who do such are called promoters. A person who acts in a professional capacity is not a promoter. A company is born only when it is duly incorporated. For incorporating a company various documents are to be prepared and other formalities are to be complied with, all this work is done by promoters. The question that comes to mind is who is a promoter.

In this paper, I shall look into who is a Promoter, the duties of a promoter, remuneration of a promoter, limitation of action, pre-incorporation contract as well as the position in India.

1.1 WHO IS A PROMOTER?

According to the Online legal Dictionary, a promoter or promoters are people who for themselves and on behalf of others, organize to form a corporation. They issue a prospectus, obtain stock subscriptions and secure a charter. Promoters stand in a fiduciary relationship to the proposed company and must act in good faith in all their dealings for the proposed corporation.[1] The Black's Law Dictionary defines a promoter as a founder or organizer of a corporation or business venture; one who takes the entrepreneurial initiative in founding or organizing a business or enterprise.[2]

The Companies and Allied Matters Act defined a promoters as any person who undertakes to take part in forming a company with reference to a given project and to set it going and who takes the necessary steps to accomplish that purpose, or who with regard to a proposed or newly formed company, undertakes a part in raising capital for it, shall prima facie be deemed a promoter of the company; provided that a person acting in a professional capacity for persons engaged in procuring the formation of the company shall not thereby be deemed to be a promoter.[3]

In USA, the Securities Exchange Commission Rule 405 (a) defines promoter as a person who, acting alone or in conjunction with other persons directly or indirectly takes the initiative in founding or organizing the business.

The activities of a promoter are so varied that no comprehensive definition of the term has ever been formulated, though judges from time to time offered broad guidelines. Instances are in *Whaley Bridge Calico Printing Co. v. Green*[4] Bowen L. J said:

[1] The free dictionary (promoter) www.legal-dictionary.thefreedictionary.com accessed on the 27 March 2019
[2] Bryan Garner, *Black's Law Dictionary*, 7th edition (1999, West Group)
[3] Companies and Allied Matters Act 2004 CAP C. 20 LFN, Section 61
[4] (1880) 5 QBD 109

"The term promoter is a term not of law, but of business, usually summing up in a single word a number of business operations familiar to the commercial world by which a company is generally brought into existence."

The Court in *Twycross v. Grant,* Cockburn CJ observed that a promoter is 'one who undertakes to form a company with reference to a given project and to set it going and who takes the necessary steps to accomplish that purpose[5]. Also in the Nigerian case of *Adeniji v. Starcola Ltd.,* Kazeem J. described a promoter as a person who undertakes to take part in forming a company or who with regard to a proposed or newly formed company undertakes a part in raising capital for it is prima facie a promoter of a company provided he is not acting in a professional capacity.[6]

In *Lagunas Nitrate Co. v. Lagunas Syndicate,*[7] it was stated that "to be a promoter one need not necessarily be associated with the initial formation of the company; one who subsequently helps to arrange floating of its capita will equally be regarded as a promoter."

Till the time company has been incorporated it cannot contract or enter into any other act in the law. Nor, once incorporated, can it become liable on or entitled under contracts purporting to be made on its behalf, prior to incorporation,[8] for ratification is not possible when the ostensible principle did not exist at the time when the contract was originally entered into. Hence preliminary arrangements will either have to be left to mere "gentlemen's agreements" or the promoters will have to undertake personal liability. Which of these courses will be adopted depends largely on the demand of other party. If our village grocer is converting his business into a private company of which he is to be managing director and majority shareholder he will obviously not be concerned to have a binding agreement with anyone.

In such a case a draft sale agreement will be drawn up and the main object in the company's memorandum will be to acquire his business as a going concern and for this purpose to enter into an agreement in the terms of a draft already prepared and for the purpose of

[5]*Twycross v. Grant* (1877) 2 CPD [469 at 541] (Cockburn CJ)
[6]*Adeniji v. Starcola* Ltd (1972) 1 SC [202] (Kazeem J.)
[7] [1889] 2 Ch. 392 (p. 428, C.A).
[8] Kelner v. Baxter (1866) L.R. 2 C.P. 174

identification signed by…….. When the incorporation is complete the seller will ensure that the agreement is executed and completed.[9]

If, however, promoters are arranging for the company to take over someone else's business, the seller will certainly, and the promoters will probably, wish to have a binding agreement immediately. In this event the sale agreement will be made between the vendor and the promoters is to cease when the company in process of formation is incorporated and enters into an agreement in similar terms, which once again, will be referred to in the memorandum. Agreements of this nature will be a necessary feature of nearly, every incorporation, and not only must the promoters make full disclosure to the company but, in addition, the company must give particulars of them in any listing particulars or prospectuses. Generally speaking, all material contracts must be disclosed unless entered into more than two years previously and in particular all those relating to property acquired or to be acquired by the company

It could therefore be said that to be a promoter one need not necessarily be associated with the initial formation of the company: one who subsequently helps to arrange floating of its capital will equally be regarded as a promoter. However, a person assisting the promoters by acting in a professional capacity does not become promoters themselves. The relationship between a promoter and the company that he has floated must be deemed to be fiduciary relationship from the day the work of floating the company starts and continues up to the time that the directors take into their hands what reins to be done in the way of forming the company. A person, group of persons or even a company which takes all the necessary steps to create a company, put it into shape and get it going are termed as promoters as long as such a person is not acting in his professional capacity. Thus, a solicitor, who prepares on behalf of the promoters the primary documents of the proposed company, is not a promoter. Similarly an Also, it could be said that the Promoter undertakes and goes through all the necessary & incidental requirements of the proposed company in order to bringing it into existence as an incorporated company. Thus, the status of the promoter is generally terminated when the Board of Directors has been formed and they start governing the company.[10]

[9] Gower and Davies on Principles of Modern Company Law 7th Ed. (2003) By Sweet & Maxwell Page 98
[10] Mohit. Daulatani: 'Position of a promoter in establishing a company' www.legalservicesindia.com/artice/1775/Position-of-a-promoter-in-establishing-a-Company.html accessed on 27 March 2019.

POSITION OF PROMOTER

A promoter is not an agent for the company which he is forming because a company cannot have an agent before it comes into existence. He is usually not treated as a trustee for the company.[11]

2.0 DUTIES OF A PROMOTER

Section 62 (1-3) of CAMA[12] states the duties of promoters thus

1. A promoter stands in a fiduciary relationship to the company and shall observe the utmost good faith towards the company for transaction with it or on its behalf and shall compensate the company for any loss suffered by reason of his failure so to do.

2. A promoter who acquired any property or information in circumstances in which it was his duty as a fiduciary to acquire it on behalf of the company shall account to the company for such property and for any profit which he may have made from the use of such property or information.

3. Any transaction between a promoter and the company may be rescinded by the company unless, after ful disclosure of all materials facts known to the promoter, such transaction shall have been entered into or ratified on behalf of the company-

a) by the company's board of directors independent of the promoter; or

b) by all members of the company; or

c) by the company at a general meeting at which neither the promoter nor the holders of any shares in which he is beneficially interested shall vote on the resolution to enter into or ratify that transaction.

1. A promoter is duty bound to act in good faith on behalf of the company he is setting up as he has a fiduciary relationship to the company. The *Erlanger v. New Sombrero Phosphate Co*.,[13] H. L. Lord Cairns said, the promoters

[11] Omnium Electric Palaces Ltd v. Banes [1914] 1 Ch. 332, Edinburgh Northern Tramways Co. Mann (1986) 23 R. 1056

[12] Companies and Allied Matters Act Cap C20 Laws of Federal Republic of Nigeria

"Stand…….undoubtedly in a fiduciary position. They have in their hands the creation and molding 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 begin to act as a trading corporation……I do not say that the owner of property may not promote and form a joint-stock company and then sell his property to it, but I do say that if he does he is bound to take care that he sells it to the company through the medium of a board of directors who can and do exercise an independent and intelligent judgment on the transaction."

2. The promoter must account for any profit made or acquired in the course of his duty to the company.
3. The transaction between the promoter and the company can be rescinded by the company-except where after full disclosure by the promoter, such transaction is ratified on behalf of the company by either an independent board of directors (i.e., independent of the promoter) or a general meeting at which such promoter cannot vote.
4. There is no limitation period for a company to sue a promoter under this section but the court may give relief from liability to the promoter if it deems it equitable to do so.[14]
5. He is not entitled to remuneration either for services rendered as a promoter or even for promotion expenses but the Articles of Association allows directors to pay.

2.1 **LIMITATION OF ACTION**

There is no limitation period for a company to sue its promoter but the court may give relief from liability to the promoter if it deems it equitable to do so[15] as provided by *Section 62 (4)* Companies and Allied Matters Act thus;

. This helps to ensure that the promoter acts in good faith.

REMEDIES FOR BREACH OF DUTY

[13] (1878) 3 App. Cases, 1218 at 1236
[14] Section 62 CAMA
[15] Orojo, J. O. Company Law and Practice in Nigeria (3rd edition, Mbeyi & Associates 1992)

Where a promoter fails in discharge of his duties to the company, the following remedies could be enforced against such a promoter.

1. Rescission of Contract: Where a promoters has sold his own property to the company and fails to disclose the profit made to the company. The company may rescind the contract and sue to recover the purchase-money paid. In *Erlanger v. New Sombrero Phosphate Co.*,[16] A syndicate of which E was he head, purchased an island in the West Indies said to contain valuable mines of Phosphates for E55,000. E formed a company to buy this island and a contract was made between X, a nominee of the syndicate and the company for its purchase at E110,000. Held as there had been no disclosure by the promoters of the profit they were making, the copany was entitled to rescind the contract and recover the purchase money from E and the other members of the syndicate.

2. Account for Profit:

3. Sue for Damage of breach of Fiduciary duty:

2.2 REMUNERATION OF PROMOTERS

Promoters like all workers are entitled to be paid. Promoters under the common law position have no right to sue for their remuneration since they entered into contract with a non-legal entity.[17] Currently in Nigeria, the promoter can sue for his remuneration by virtue of *Section 72* of Companies and Allied Matters Act as long as his contract is ratified once the company becomes legally in existence.[18] Section 72 (2) Companies and Allied Matters Act provides

> Prior to ratification by the company, the person who purported to act in the name of or on behalf of the company shall, in the absence of express agreement to the contrary be personally bound by the contract or other transaction and entitled to the benefit thereof.

3.0 PRE-INCORPORATION CONTRACTS

[16] See n. 13
[17] *Re English and Colonial Produce Company*(1906) 2 C H [435] CA
[18] *Garba v. Sheba* (supra)

As we all know that a promoter enters into pre-incorporation contracts to help his objective of bringing the company into existence along with other duties. The question that flows from this line of thought is this, What then are pre-incorporation contracts?

Pre-incorporation contracts just as the name implies are agreements (contracts) entered into by the promoters of a new company who form the company by filing its Articles of Incorporation[19]. This pre-incorporation contract is slightly different from ordinary contracts in the sense that it is a bilateral contract (between two parties) but has the features of a tripartite contract (contract between three parties).The promoter enters into the contract with the interested party (making it a bilateral contract) but it helps the prospective company which is not a party to the contract[20].

The law is that company is not bound by a pre-incorporation contract and it cannot ratify such contract without the consent of the other party.[21] The court went further to state that

> A pre-incorporation contract is generally made by the promoters of the company with the intention that such contracts would be ratified or adopted, or otherwise take over on incorporation. In such a situation a valid contract

Since the promoter is going into pre-incorporation contracts on behalf of the company, one might think that in any "eventuality" if I may borrow that word commonly used in Nigerian pidgin parlance to describe an unforeseen circumstance where the contract breaks down and there is an action in court, who then is liable? Is it the promoter or the prospective company? The answer to this question is seen in *Kelnar v. Baxter*[22] where it was held at common law that a pre-incorporation contract was not binding on the (prospective) company because there was no principal who was legally in existence on behalf of whom an agent could have contracted.

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[19] David Carnes, 'What is a pre-incorporation contract?' (Demand Media) <www.smallbusiness.chron.com/html> accessed 27 March 2019.

[20] Law Teacher, 'Pre-incorporation Contracts and the promoter' <www.lawteacher.net/free-law-essay/contract-law-pre-incorporation-contracts-and-the-promoter.php> accessed 26 March 2019.

[21] Transbridge Company Ltd. V. Survey International Ltd (1986) NWLR (PT 37) 576

[22] *Kelnar v. Baxter* (1867) L. R. 2 CP [174]

This was also the decision in *Edokpolor & co. ltd. v. Sam Edo Wire Industry ltd.*[23]. It should be noted that where the promoter enters into the contract using the proposed name of the company then there is no contract all[24]. This was also the decision in *Newbourne v. Sensolid (Great Britain) ltd.*[25]. Currently in Nigeria, succor has come to promoters by virtue of *Section 72* of Companies and Allied Matters Act which has given the promoter an equitable remedy which is away from the common law position that only a promoter is liable (to be sued on pre-incorporation contracts).

> *Any contract or other transaction purporting to be entered into by the company or by any person on behalf of the company, prior to its formation, may be ratified by the company after its formation and thereupon the company shall be bound by and entitled to the benefit thereof as if it has been in existence at the date of such contract or other transaction had been a party thereto*[26]

This means that once the company becomes legally in existence, ratifies the pre-incorporation contracts, the company then becomes bound by the terms of the contract as if it was the one who signed such contract. It is only after ratification that the company becomes bound. See *Garba v. Kic ltd.*.[27] *Section 72* of Companies and Allied Matters Act is in line with the Specific Relief Act 1963 of India.

The Specific Relief Act 1963 has gone a step further in protecting a promoter from liability (based on pre-incorporation contracts) through certain provisions within it i.e. *Sections 15 (h)*& 19 (e). *Section 15 (h)* gives a stranger the right to sue. The stranger in the sense being the company when it is legally in existence and *Section 19 (e)* introduced novation of contracts into pre-incorporation contracts. Novation of contracts is simply making a new contract based on the same terms as the pre-incorporation contract[28]. The court in *Onegbedan v. Unity Bank Plc,*[29] state the nature of contract by novation thus

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[23]*Edokpolor & co. ltd. v. Sam Edo Wire Industry ltd.* (1986) 17 NSCC [1084]
[24]*Kelnar v. Baxter*(supra)
[25]*Newbourne v. Sensolid (Great Britain) ltd* (1954) 1 Q. B. [45]
[26] Companies and Allied Matters Act 2004 CAP C. 20 LFN, Section 72
[27]*Garba v. Kic ltd.* (2005) 5 NWLR part 917 [page 160]
[28]Specific Relief Act 1963 *Sections 15 (h)*& 19 (e)

Contract by novation is a form of assignment in which by consent of all parties thereto, a new contract is made and substituted for an existing contract. Hence, one of the essentials of a new contract that is novation is the consent of all the parties must be obtained. However, such consent need not be in writing; it may be inferred from the conduct of the parties, without express words. Novation is a transaction by which with the consent of all the parties concerned, a new contract is substituted for the one already made. The new contract may be between the original parties e.g where a written agreement is later incorporated in a deed or between different parties e.g where a new person is substituted for the original debtor or creditor.

See *Howard v. Patent Ivory Manufacturing*[30]**.** All these serve as reliefs to the liability of the promoter.

The following are examples of pre-incorporation contracts;

1. Promoters/Directors Service Contract
2. Shareholders Agreement
3. Joint Venture Agreement
4. Payment of Promoters expenses
5. Conversion of Partnership to registered company
6. Takeover of business, or purchase of property

3.1 THE INDIAN CONCEPT OF PROMOTERS AND PRE-INCORPORATION CONTRACTS

India being a British Commonwealth nation just like Nigeria has its laws fashioned out from the English Laws. It therefore means that though there's a slight difference, in legal system between Nigeria and India, the meaning of a promoter in Nigeria and India still remains the same as the essential features of who a promoter is cuts across both legal systems as commonwealth countries.

[29] [2015] All FWLR PT 766, 557
[30]*Howard v. Patent Ivory Manufacturing* (1888) 38 Ch. D [156]

The new Company Act, 2013 of India[31] in section 2 (69) of the Act, 2013 defines the term 'Promoter', to mean a person-

(a) who has been named as such in a prospectus or is identified by the company in the annual return 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.

From the above provision of the Act of Parliament of India, one can see that it is similar to the provision in the Companies and Allied Matters Act for who a promoter is.

The court in the case of *Bosher v. Richmond Land Co.,*[32] the term Promoter has been defined as:

> "A Promoter is 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 subscription, and sets in motion the machinery which leads to the formation itself."

As earlier stated in this work, the passing of the Specific Relief Act of India has aided promoters and the incorporated company in pre-incorporation contracts. The position in India before this Act of Parliament was passed was that promoter generally found it very difficult to carry out the work of incorporation of a company. Since contracts prior to incorporation were void and also could not be ratified, people were reluctant to either supply any goods or services for the purpose of incorporation of a company. The Promoter on his path felt cautious in

[31] Companies Act 2013
[32] Va 455: 16 SE 360

accepting personal responsibility.[33] The Specific Relief Act, 1963 as acted as a relief to the promoters. The Specific Relief Act provides under the following sections: Section 15(h) and 19(e) of the Specific Relief Act as follows:

The contract should have been entered into by the promoter for the purpose of the company.

The terms of incorporation should warrant such contract.

The company should accept the contract after incorporation.

Such acceptance should be communicated to the other party to the contract[34]. So, preliminary contract enforced by the promoter prior to incorporation of the company will be treated as contract between two individuals who are in existence i.e. the incorporated company (no longer the promoter) and the contracting party that entered into contract with the promoter.

After the company comes into existence, the company can ratify or adopt the contract, and this would bind the company and not the promoter. Under the Specific Relief Act 1963, section 15(h) and 19(e) the promoter can shift his right and responsibility to the company, if it is warranted by the terms of incorporation i.e. if stated in the terms of incorporation (memorandum and articles of association).[35] This is quiet similar in Nigeria with the *Edokpolor and Company Ltd. v. Sem-Edo Wire Industries* case[36].

In the old Companies Act of 1956, there was no static definition of promoter although it was mentioned in various section e.g Section 62, 69, 76, 478 and 519. Section 62 of Companies Act 1956 defines 'Promoter' for the limited purpose of that section only. Section 62 (6(a)) defines the expression 'promoter' to mean a promoter who was a party to the preparation of the prospectus or of a portion thereof containing the untrue statement, but does not include any person by reason of his acting in a professional capacity the formation of the company, but in the new Companies Act, 2013 Section 2 (69) gave the definition of promoter.

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[33]Suman, K. S. 'Position of Promoter in India: Critical analysis', (Academik, 4 April 2015) http://www.lawctopus.com/academike/position-promoter-india-critical-analysis/ (accessed 27 March 2019)
[34]Nagpur, '*Lectures on Company Law & Competition Act (including Secretarial Practice)*' (10th ed, LexisNexis Butterworths 2005) 49
[35]Suman, K. S. 'Position of Promoter in India: Critical analysis', (Academik, 4 April 2015) http://www.lawctopus.com/academike/position-promoter-india-critical-analysis/ (accessed 27 March 2019)
[36]*Edokpolor& co. ltd. v. Sam Edo Wire Industry ltd.* (supra)

4.0 **CONCLUSION**

This work notes that a promoter kick starts the formation of a company and a company or corporation can also be a promoter. A promoter is liable for pre-incorporation contracts because the company the promoter is working for is not legally in existence. Promotes should therefore act in good faith and ensure that their pre-incorporation contracts are ratified when the company becomes legally in existence.

Also, the Nigerian legislature should protect the promoter from liability; ratification of a pre-incorporation contract should also be done by the newly incorporated company within a specific time frame. and also in terms of protection of remuneration and also give the prospective company some form of legal right to sue by including certain aspects of India's Specific Relief Act 1963 like Ss. 15 (h) and 19 (e) to boost our Companies and Allied Matters Act. The third party who enters into a contract with the promoter should also be given some form of protection in the Companies and Allied Matters Act.