WHO IS A PROMOTER IN CONTROL OF A COMPANY

The term ‘Promoter’ is common in the corporate sector and also common parlance. However it is to be noted that the term ‘Promoter’ has not been defined under the Companies Act, 1956 (Act) and other legislations relating to corporate affairs. It is also to be noted that although the term is used under various provisions of the Act, Section 2 dealing with definitions has not defined the term. Section 62 of the Act dealing with civil liability for misstatements in the prospectus has defined the expression ‘Promoter’ under Sub Section 6 to mean a party to the preparation of the prospectus or any portion thereof. It can therefore be presumed that any person named as Promoter in the prospectus would by default and in terms of the aforementioned sub section be deemed the Promoter of the company.

Notwithstanding the definition in the sub section (6) of Section 62, it must be borne in mind that the definition is restrictive and is meant for purposes of prospectus only. In such a scenario the term ‘Promoter’ remains undefined in so far as the companies that do not seek public shareholding and especially as relating to private limited companies.

It is also further relevant to note that the term has also not been defined in any of the provisions of the English Act based on which the Indian Companies Act, 1956 has been formulated.

In Official Liquidator vs Velu Mudaliar (1938 – 8 Company Cases – 7/10) the Madras High Court has held that the term Promoter means that person who originates the scheme to form a company, is responsible to draft the Memorandum and Articles of the proposed company, executes and registers the same, etc. In other words the Promoter is deemed to be the person who is responsible for the formation of the company and consequently would include the subscribers to the Memorandum and Articles of Association of a company.

However, subsequent to incorporation of the company the person responsible for formation/incorporation of the company cannot be deemed Promoter merely because he is a subscriber to the Memorandum and Articles of Association of the company if he is not responsible or liable for any of the activities of the company. Most professionals undertake incorporation of corporate entities for and on behalf of their clients to avoid undue delay in procurement of the required signatures and definitely cannot be considered or treated as Promoters of the company merely based on their subscription to the Memorandum and Articles of Association of a company.

Therefore the Promoter after incorporation of the company takes on a wider responsibility of being the person regulating the operations of the company which has been formed and if the subscriber to the Memorandum merely assists in the incorporation of the company, it is to be noted that such subscriber is acting only in a fiduciary capacity and therefore cannot be deemed or accepted as a Promoter of the company.

The term ‘Promoter’ and ‘Promoter Group’ have been defined in Chapter VI of Securities Exchange Board of India (SEBI) Guidelines 2000. SEBI Guidelines states that
Promoter/Promoters includes the person/persons who are in over all control of the company, persons who are instrumental for the securities of the company to be offered to public and the person/persons named as Promoters in the prospectus. The Promoter Group includes all associates and immediate relatives of the Promoter, subsidiary/holding company, in the case of the Promoter being a company, all persons collectively holding 10% and more of the share capital of the company as associates/relatives of the Promoter, etc.

In view of the fact that the term ‘Promoter’ has been defined only in limited legislations relating to companies the conclusion that can be drawn to define a Promoter would be to include and mean that person who is in overall control of the company, regulates the management of the company, plans or formulates the future growth of the company, etc, and not merely the person who was merely instrumental for the incorporation of the company.

The next question that has arisen for consideration is the relevance of the term ‘Control’ and in relation to the term ‘Promoter’. ‘Control’ is defined only under Securities and Exchange Board of India (Substantial Acquisition of Shares and Take Over) Regulations, 1997. In terms of Regulation 2 (c) it is to be noted that control includes the right to appoint majority of the Directors on the Board of the company to control the management and policy decisions of the company either by virtue of shareholding or managerial rights or arising out of any shareholders agreement, voting agreements or in any other manner.

From the definition as detailed above, it can be deducted that mere shareholding even if majority shareholding does not automatically vest control of the company on the person holding the majority of the shares. The management of the company and policy decisions of the company should be under the control and guidance of the person/persons stated to be in control of the company. The right to appoint majority of the Directors provides such control to the extent that a company is managed by its Board of Directors and the right to appoint the Board is indirect control over the management and affairs of the company.