Promoters/founders of companies

- Definition
- Duties
- Liabilities
- Benefits

Promoters

- As humans needs to be conceived and go through several stages of development before birth, companies too requires planning and other preliminary arrangements.
- These preliminary tasks are to be carried out by persons called ‘promoters’ (named founders under the old commercial code).

Promoters

- Promoters play an important role in the creation and development of public companies.
- It's important for promoters to understand their responsibilities and obligations, and act in the best interests of the company and its shareholders.

Founders

- They also go by the name:
  - ‘founder’
  - ‘organizer’
  - Incorporator
  - Projector
- Though agreed that promoters are indispensable for the formation of a company, **defining them seems to be a difficult exercise.**
- Despite the fact that identifying promoters is approached variously in different legal jurisdictions, there is a common element in

Founders/ promoters

- Generally, the promotional activities of promoters may be classified:
  - Discovery (finding business idea),
  - Investigation (studying economic feasibility of the idea) and
  - Assembly (bringing together the necessary personnel, property and money).
  - Legalization of the formation process

Founders/ promoters

- Hence, it stands for persons who are involved to carry out the necessary steps to form a company.
  - They framed the company,
  - Prepared the prospectus,
  - Found the directors and
  - Paid for printing, advertising and the expenses
    incidental to establishing the company.

Why do we need to know and regulate promoters?

- Naturally, the process of forming share company causes various legal transactions in which the promoters and subscribers are the primary actors.
  - For those who subscribe shares, the main reasons are the promoters as they could invite them to invest in the share company under formation.
  - The subscribers will benefit when the company is established and make profit and may suffer loss when the company goes nonpaying or is not established at all.
- ***In this instance, the investors need remedies against unwarranted actions of the promoters that may affect their interest.***

Why do we need to know and regulate promoters?

- **Secondly**, **prospective creditors of the company** would have interests in the success of the company formation process.
  - The promoters may rent offices, hire and train relevant workers, use professional expertise and may conclude other contracts.
- Further, creditors may also conclude contracts with the share company after its formation by relying on the statements made to the public about the company by founders.
- **Thirdly**, the company under formation may come up with its own interests against the promoters.
  - Promoters may sell their properties to the company by exaggerated price
  - They may also overvalue in kind contributions…etc

Why do we need to know and regulate promoters?

- Fourthly, promoters get some benefits and privileges after the company is formed.
- Rewarding the efforts made for the formation of the company is also something appealing which the law should recognize.
- **In sum, the company under formation and the promoters have no principal and agent relationship as a company has no legal existence before it is formed.**
- **So, it is incapable of entering into a contract itself and equally incapable of acting through an agent.**
- **As a result, rules are necessary to protect the subscribers, the creditors and the company under formation.**

Who are promoters?

- The old code refers them as founders. [Art. 307]. Under the new Code, founders are those who establish a company among themselves without offering shares for public subscription [Art.252].
- In a closed companies, the obligation of promoters is assumed by founder [Art. 252.3]
- Article 248 of the Commercial Code provides the lists of persons who shall be promoters.
- Accordingly, promoters;
  - May be one or more
  - Could be natural or artificial persons ;
  - Need not be a shareholder in the company .

Who are promoters?

- Specifically, promoter shall mean: (Art. 248)
  - a person who initiates the formation of a company by public subscription ;
  - invites persons to join the company by preparing a prospectus;
  - generally ***acts with the view to realizing the formation of the company***; and
  - is liable for damage sustained in connection with failure to establish the company, if the company is not formed.
- ***The list is not exhaustive, which means only exceptions could save you once you involved in formation process***

Who are promoters?

- The term '***acts with the view to realizing the formation of the company' is somehow vague.***
- Though this argument seems logical, there is a problem as it could be difficult to exactly fix what '*acts with the view to realizing the formation*' means.
- This provision permits one to consider many persons, even with so insignificant contribution in the formation process, as promoters.
- Whether a person is liable for damage sustained in connection with failure to establish the company could also serve as another metric to determine whether a person can be considered as promoter.
- The reason in taking persons who initiate or facilitate company formation as founders seems that some persons may convince investors to invest or deal with persons for the formation of the company.

Who are promoters?

- Art. 307 of the old Code describes persons who may qualify as founders. They are:-
  - Persons who sign the prospectus, (Art.307(3)).
  - Bring in contributions in kind, (Art.307(3))
  - Persons to be allocated a special share in the profits,
  - Persons who has initiated plans or facilitated the formation of the

Who are not promoters?

- **In most jurisdictions,** it is maintained that persons who **act merely in a professional capacity** or **employees acting within their employment contract** will not be founders unless they become involved in the **business side of formation.**
- In Ethiopia, Article 307(4) of the Commercial Code has provided no exception like this.
- However, the new Code excludes persons who based on a contract concluded with a promoter, for consideration, (248 (1 second sentence))
  - conducts a study necessary for the

Who are not competent to be promoters? (249)

- In most company laws, individuals who are not competent to be promoters of public companies are those who have a disqualifying history, such as:
  - Conviction for certain crimes, such as fraud or deceit
  - Bankruptcy or insolvency
  - Unlawful conduct in connection with promotion, formation, or management of a company
  - Disqualification by a regulatory authority
- Minors and individuals of unsound mind are also generally not considered competent to be promoters of public companies.
- The exact criteria for competency may vary

Who are not competent to be promoters? (249)

- A person that had been convicted of
  - Breach of trust,
  - Theft,
  - Robbery or
  - Any other similar criminal offense,
- In connection with his function as a promoter, director, manager, inspector, auditor or any other managerial positions in a business organization or in any other circumstance

Who are founders?

- Article 547(2) of the Code mentions another set of founders.
- Pursuant to Article 547(2), members of a Private Limited Company (PLC) who decide to convert the PLC in to share company will occupy the status of founder of the new share company.
- This is so because Article 544(5) of the Commercial Code states that rules related to formation of relevant business organization shall apply during conversion.
- As a result, the rules on founders are applicable in connection with conversion of a PLC to a share company.

Duties of Promoters

Can be categorized:

- Making disclosures about the company
- Securing necessary permits and licenses
- Securing financing
- Recruiting key personnel

Duties of Promoters

- In many jurisdictions, promoters have a fiduciary duty in relation to the company to be formed.
- By this, they owe duties of care and loyalty to their co-promoters, the company that is going to be formed and to others who have financial interests in the company.
- Among others the founders ,
  - shall sign memorandum and articles of association before applying for commercial registration.
  - make accurate statements to the public in respect to the formation of the company.
    - It is also a duty whose violation is punishable under Article 718 of the Ethiopian Criminal Code.
    - *This provision makes it clear that a founder, who is in a position to know the state of affairs of an undertaking, intentionally gives or causes to be given essential and untrue information to the public is punishable by imprisonment or fine.*

Duties of Promoters

- Further, promoters shall have:
  - Obligation to call a meeting of subscribers immediately after the audit of company formation has ended.
  - Obligation to have the formation of the company verified by external Auditors [Art. 261.1]
  - Obligation to a prospectus and make an offer to subscribers in accordance with relevant provisions. [Art. 259.1]
  - Obligation to verify the valuation of contribution in kind [art. 257.3]
  - Obligation to effect the registration of the company [265.2]

Liabilities of Promoters 250

Promoters of a public company can be held liable for various grounds generally including:

- Misrepresentation: Promoters can be held liable for making false or misleading statements in offering materials or other documents related to the public offering.
- Non-disclosure of material information: Promoters have a duty to disclose material information to the public, and can be held liable if they fail to do so.
- Failure to comply with securities laws: Promoters must comply with all relevant securities laws and regulations, and can be held liable if they fail to do so.
- Breach of fiduciary duty: Promoters can be held liable for breach of fiduciary duty if they act in a manner that is not in the best interest of the company or its shareholders.
- It is important to note that the exact grounds for liability may vary depending on the jurisdiction and the

Liabilities of Promoters 250

- The liabilities may be either contractual or extra contractual, crominal.
- In principle, promoters are jointly and severally liable **for the pre-incorporation commitments.** [Art.250]
- Promoters shall be jointly and severally liable to persons with whom they contracted, shareholders, and third parties with respect to the following matters:
  - commitments entered into for the formation of the company;
  - full subscription of the capital of the company and deposit of the paid-up capital in the name and to the account of the company;
  - valuation of contributions made in kind to the

Liabilities of Founders
250

- Accuracy of statements made to the public in respect of the formation of the company;
- Legality of the process followed in the formation of the company;
- Verification by an auditor of the formation procedure of the company;
- Where the company is not formed, refund of paid up contributions with interest to subscribers who demand that in accordance with this code; [see cum 254.3 & 4]
- All other matters connected with the formation process.
- In addition, the founders may incur criminal liabilities as per articles 718, 675 and 676 of

Liabilities of Promoters

- **In general, in addition to pre-incorporation commitments, even after formation of the company,** the commercial code impose liabilities on founders. Note that the liabilities under article 250 extend after company's formation for 5 to 10 years.
- Accordingly, the liabilities of the founders are generally of three types:

  For the company:
  - The founders owe the share company fiduciary duty as it is entirely in their hands during its formation.
  - If this duty is violated, they will be liable for the share company they have established.
- For subscribers
- For Creditors

Protections of Promoters

- Before the establishment of a company, promoters **may conclude contracts** expecting the company to enjoy the rights and perform the liabilities thereof.
- The Code provide cases whereby the founders can be free from liabilities they have incurred in their way to establish a company.

Protection of promoters

1. Commitments and Expenses for the Formation of the Company [251]

- Promoters may incur numerous expenses and enter into commitments with third parties in the process of company's formation.
  - If formed, the company shall take over such commitments from the promoters and refund the expenses;
    - so far as such commitments and expenses were necessary for the formation of the company; **or**
    - if approved by the general meeting of the subscribers/
- Where the company is not established for

Commitments and Expenses for the Formation of the Company [251]

- The unregistered company does not have legal personality so it can not own property, it can not sue or be sued so it can not be declared bankrupt, it can not enter into contractual or other juridical acts.
- All contracts entered by the promoters on behalf of unformed company will **remain personal transaction between the promoters and the third party** since the principal (the company) does not exist. [248.1] [250 (1a)] [251]

- For obvious reason, the above mentioned commitments and expenses will be taken only if the share company is established.
- This means that the founders would remain helpless where the formation of the share company is aborted.
  - The law prevents founders from claiming anything from the subscribers. [251.2]

Protections of Founders

2. ***Protection through Period of Limitation (250 (2))***

- In Ethiopia, period of limitation is the other mechanism to avoid liabilities of founders that might arise because of their involvement in the formation of share company.
- Claims for damages shall be barred after five years from the date when the aggrieved party knew:
  - Of the damage and
  - of the person liable.
- There shall be absolute limitation after ten years from the date when the act complained of took

Benefits of promoters/founders

- The mere success of the formation process alone cannot guarantee the founders realize the benefit provided for in the law.
- **In the first place, the rule is ‘no profit no benefit’.**
- On the other hand, in the eyes of the law, founders could hardly escape liabilities if there is any damage to persons due to the formation process of the company.
- The process of formation is generally **onerous and risky.**
- Therefore, after share company is established, it is fair to compensate promoters for their services in addition to taking their commitments and refunding expenses.

Benefits of promoters/founders

May benefit in two ways:

- Compensation arrangements
- Potential to build a successful company and create value for shareholders

Benefits of founders

- ***As per art. 253 (1),*** receive a share in **the net profits** in the balance sheet of up to 20%.
- But, such share.
  - May not exceed a period three years (1)
  - It shall be paid in cash, may not be paid by issuing shares (4)
- Specifics regarding **the amount of the share in profits**, **the manner in which the years payment is to be effected** are chosen and the like shall be provided for in the Memorandum of Association.
- The promoters may not receive, from the company, any other special benefit except the one under [Art. 253.1[
- However, the benefits that may be due to promoters in their capacity as shareholders shall not be

Benefits of founders

- The conditions under Article 253 of the Commercial Code are not the only conditions.
- In the old Code promoters can be entitled to the benefits only if their proposal receives the blessing of the subscribers pursuant to Article 321(3).
- The new Code Art. 263.5 provides that the subscribers meeting determines the share in profits allocated to the promoters.
- Since the subscribers meeting has the power to approve the final text of the memorandum of association, it can be said that the same meeting will determine and approve the share allocated to promoters.