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AN APPRAISAL OF THE POSITION OF PROMOTERS, PRE-INCORPORATION CONTRACTS AND COMPANY CONTRACTS UNDER NIGERIAN LAW

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Abstract

This paper appraised the position of promoters, pre-incorporation contracts and company contracts within the Nigerian legal framework. It examines the Critical role of promoters in the formation of companies, the legal implications of pre-incorporation contracts and the contractual obligations of the company after incorporation. Promoters Play a pivotal role in the formation of companies in Nigeria. They are the individuals or entities responsible for initiating the incorporation process, identifying the business opportunity and bringing together the necessary resources, including capital, expertise and personnel. Promoters are instrumental in drafting the company's constitution, securing regulatory approvals, and laying the groundwork for the company's operations. However, their actions and decisions during the pre-incorporation stage can have significant implications for the company's future successes and the right and obligations of various stakeholders. Using doctrinal method of research, this paper appraises the legal framework surrounding promoters, pre-incorporation contracts, and companies contracts under Nigerian law. The paper finds that the Nature of pre-incorporation contracts, though bilateral, is different from ordinary Contracts, for it has the features of a tripartite contract. The paper recommended for more comprehensive and coherent legislation, as well as more regulatory oversight and enforcement mechanism.

Key words; Promoters, Pre-incorporation, Contracts, Company.

1.1 Introduction

Generally, the idea of forming a company is conceived by a person or group of persons who, in furtherance of this idea, take necessary steps to incorporate the company.[1] They may, for instance, have to source for funds, find directors, Acquire properties, prepare prospectus and may also have to pay for all expenses incidental in bringing the company into existence. These groups of persons are often referred to as the promoters of the prospective company.

In order to get the benefit of 'corporate personality', it is fundamental for "an association of persons" to be incorporated under the companies and Allied Matters Act.[2] After the incorporation of such association of persons, the company comes into existence and can start its business operations. The simple reason for this is that before incorporation the company does not have any legal personality and can, therefore, not enter into a valid contract or engage in any business.

It would, therefore, be a matter of inconvenience that such an association of persons cannot perform any official business in the name of the company before its incorporation, although they may have to make arrangement for office, source for funds, and acquire properties etc. in order to do away with these inconveniences, the promoters can enter into agreements in the name of the prospective company before incorporation. Generally, the promoters are obliged to bring the company into existence and to ensure its successful running. In order to accomplish this obligation, the promoters may enter into some contracts on

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[1] Asomugha, E.M (1994) *Company Law in Nigeria Under the Companies and Allied Matters Act,* Toma Micro Publishers Limited, Lagos, P.61
[2] Cap C20, LFN 2004 (as amended).

behalf of the prospective company.[3] These types of contracts are often referred to as "pre-incorporation contracts".

Though pre-incorporation contracts entered into by promoters on behalf of the prospective company are generally binding on the company upon incorporation, the problem however, the company's liability is limited to the extent of the assets and resources it has access to upon incorporation.

The aim of this paper, therefore, is to appraise the position of promoters, pre-incorporation contracts and company contracts under Nigerian law. In order to achieve this aim, reference will be made to the provisions of the Companies and Allied Matters Act, case laws and the views of some scholars on the subject which are, no doubt, diverse and multifarious.

1.2 Meaning of a Promoter

A promoter is described as a person 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.[4] This definition has also been codified by the Companies and Allied Matters Act thus:

> 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 proposed or newly formed company, undertakes a part in raising capital for it, shall, *prima facie*, be deemed a promoter of the company.[5]

It must be stressed, however, that a person acting in a professional capacity, for instance, a solicitor or an accountant, is not deemed to be a promoter[6]. But if the

[3] Orojo, J.O (2008) *Company Law and Practice in Nigeria*, 5th edition, Lexis Nexis Butterworths, p.71
[4] *Twycross v. Grant* (1877) 2 CPD 469 at 549. See also *Garba v. Sheba International (Nigeria) Ltd.* (2002) 1 NWLR (pt. 748), 372 at 401
[5] Section 61 of Companies and Allied Matters Act (CAMA), Cap. C20, LFN 2004
[6] Ibid

solicitor or an accountant did more by way of helping his client to obtain directors for the company, he would be regarded as a promoter. Similarly, a solicitor may become a promoter where he joined his client in negotiating a property for the proposed company at a profit[7].

1.2.1 Status of a Promoter

A promoter cannot be regarded as an agent of the company[8]. The reason for this simply is that there is no principal in existence.[9] A promoter is also not a trustee of a company he promotes. It is trite that before a trust is said to exist there must be the property, the trustee and the beneficiary.[10] Similarly, the relationship between a promoter and the company he promotes is not predicted upon a contract. This is because contract presupposes the existence of two legal persons.

It is, therefore, safe to assert that a promoter stands in a fiduciary position to the company he promotes.[11] Consequently, the law imposes certain duties on the promoter. These include duty to act in utmost good faith in any transaction entered into on behalf of the company[12]. He is also under an obligation not to make any profit out of information obtained by the promoter in his capacity.[13] Where the promoter is in breach of this, he is under an obligation to indemnify the company.[14]

The duty to make disclosure of any profit accruing to a promoter is also imposed by a statute in Nigeria. Thus, the company is allowed to rescind the transaction with the promoter at any time unless where after full disclosure of all material

[7] *Tyrrel v. Bank of London* (1862) 10 HL, Case 26.
[8] *Twycross vs. Grant (supra)*
[9] *Kelner vs. Baxter (1866)* L.R.2 C.P 174
[10] Kodilinye, G. (2005) *An Introduction to Equity and Trust in Nigeria*, Spectrum Books Ltd, Ibadan, p.57
[11] Section 62(1) CAMA
[12] Ibid
[13] Ibid, Section 62(2)
[14] *Erlanger v. New Sombrero Phosphate Company* (1878) 3 AC, 1218 at 1236

facts known to the promoter, the transaction has nevertheless been entered into or ratified on behalf of the company[15]. Such ratification must be made by either:

a. The company's board of directors independent of the promoter; or
b. All the members of the company; or
c. The company at a general meeting at which such promoter cannot vote[16].

It is interesting to note that where a company rescinds the transaction undertaken by the promoter on its behalf, the promoter will be under obligation to pay an amount equal to the profit made.[17] In addition to this remedy, the company may sue the promoter for damages for breach of his fiduciary duty. Likewise, there is no limitation period for the company to sue the promoter but the Court may give relief from liability to the promoter if it deems it equitable to do so in the circumstance.[18]

1.2.2 Remuneration of Promoters

Although a great skill, energy and ingenuity may be required and employed in the promotion exercise, a promoter is not entitle to remuneration for his promotion services and the expenses incurred on behalf of the company unless there is a valid contract to that effect.[19] But since, under the common law, pre-incorporation contracts are not binding on, or enforceable by, or against the company, it may be difficult for promoters to have an enforceable contractual right to remuneration for their services and indemnity for their expense. It is, however, submitted that this difficulty is more real in theory than in practice because recovery of preliminary expenses and remuneration does not present much difficulty.

Unlike the common law position, a promoter can now recover remuneration by action against the company if the contract is ratified or adopted by the company

[15] Section 62(3) CAMA
[16]Ibid.
[17] *Erlanger v. New Sombrero Phosphate Company (supra)*
[18] Section 62(4) CAMA
[19] *Re-English and Colonial Produce Company* (1906) 2CH 435 CA

after incorporation, since by law such a contract or transaction can now be ratified.[20] Usually, the Articles of Association of the Company may contain a clause to the effect that all pre-incorporation expenses be paid by the company. In other words, the Company's Articles of Association may include a provision authorizing the directors to pay all pre-incorporation expenses to the promoter although this does not go to the extent of constituting a contract between the company and the promoter.

It is noteworthy that the remuneration of a promoter may take various forms. The promoter may purchase a property and sell it to the company at a profit or he may negotiate a sale on commission. He may, in lieu of payment of remuneration and expenses, take shares of the company which are credited as fully paid-up, or be given an option to subscribe for shares at a particular price within a specified limit.[21] In all these cases, it is important that there is full disclosure of same by the promoter to the company and also by the company in the prospectus.[22]

Interestingly, where a promoter is convicted of any offence pertaining to the promotion of the company, such a person may be ordered by the Court not to hold any position as a director or be involved, in any way, in the management of the company for a period not exceeding 10 years except with the leave of the Court[23]. This is in order to ensure integrity of the promoters in the promotion of the company.

1.3 Pre-Incorporation Contracts

More often than not, some preliminary contracts are entered into by the promoter before the company becomes incorporated. As the formation of these contracts involve various discussions at different stages by more than one person pre-

[20] Section 72, CAMA
[21] Orojo, J.O., op.cit, p.73
[22] Section 50(1), Third Schedule, paragraph 10(1)(c) of Investment and Security Act (ISA), Cap. 124, LFN 2004
[23] Section 254 (1) (3) and (4) of CAMA

incorporation contracts become inevitable. Therefore, pre-incorporation contracts are contracts purportedly made by promoters on behalf of the company before it is incorporated.[24]

Under the common law, the general principle is that pre-incorporation contracts are not binding on the company. This is so because a promoter who enters into a contract on behalf of a company which has not been incorporated will be personally liable on those contracts as the company cannot have an agent before it comes into existence. It is equally impossible for the company to ratify or adopt any such contract.[25] Not only is a company not liable on pre-incorporation contract, it cannot, legally speaking, sue on it[26].

The above was the position of the law in Nigeria before the coming into force of the Companies and Allied Matters Act (CAMA).[27] However, from the inception of CAMA, the law now permits a company to ratify pre-incorporation contracts after its incorporation as if it were in existence when the contracts were entered into.[28] Upon ratification, the company becomes bound by and is entitled to the benefits arising from the contract.[29]

It must be stressed that despite the provisions of Section 72 of CAMA which permits ratification of pre-incorporation contracts, the promoters remain liable before such ratification unless there is contrary agreement.[30]

Although Section 72 of CAMA does not prescribe the form the ratification should take, it is submitted that since a company can contract under the Act using the same method available to a natural person,[31] ratification by the company may take

[24] *Sparks Electrics Nig. Limited v. Ponmile* (1986) 2 NWLR (pt. 23) 519 at 525
[25] *Kelner v. Baxter (supra).* See also *Shonibare v. Mansour* (1968) L.L.R, 1
[26] *Trans-Bridge Company Ltd. V. Survey International Ltd.* (1986) 4 NWLR (pt. 37), 576. See also *Edokpolo & Co. Ltd & Ors. V. Sam-Edo wire Industries Ltd* (1984) 7 S.C., 119
[27] Cap. C 20 LFN, 2004. See also *Calligara v. Giovanni Ltd.* (1961) 1 All N.L.R 534
[28] Sec. 72, CAMA
[29] Ibid
[30] *Okafore v. Ozenwa* (1992) 4 NWLR (pt. 237) 611 at 623
[31] See Section 71, CAMA

any of those forms. Alternatively, where the company does not intend to go through the process of ratification after incorporation, the company may enter into a new contract on the same terms and conditions as that entered into prior to its incorporation.[32]

It must also be pointed out that upon ratification, the law merely treats the company as if it has been in existence at the date of such contract and had been a party thereto. The theoretical basis of the power of ratification which companies are given under section 72 of CAMA is obviously predicated on agency principle by which a principal has the legal competence to ratify unauthorized acts of his agent. It is submitted that the power of ratification endowed upon incorporated companies under section 72 of the Act is co-existence with that exercisable under normal agency relationship. Therefore, ratification may be express or implied.

The question whether or not the insertion of a pre-incorporation contract in the object clause of a memorandum of a company would make it binding on the company came up in the case of *Edokpolor & Co. v. Sam-Edo wire industries.*[33] The court held, inter alia, that the inclusion of the terms of the pre-incorporation contracts in the memorandum of association of a company is an indication of a strong desire that the proposed company after incorporation should execute the terms of the agreement so included.

On when can pre-incorporation contract be binding, the Court held in the case of *Garba v. Kic Ltd*[34] that before a company can become bound by any contract or transaction entered on its behalf before its formation, there must be evidence of ratification by the company upon its formation. Before such ratification, any

[32] *Edokpolor & Co. Ltd vs. Sam-Edo wire Industries Ltd* (supra)
[33] Supra
[34] (2005) 5 NWLR (pt.917 160 at 167

person claiming to have entered into a pre-incorporation contract on behalf a company prior to its incorporation is presumed to have done so personally.[35]

By and large, matters usually covered by pre-incorporation contracts include, but not limited to, joint venture agreements, shareholders agreements, and contracts for payment of promoter's expenses, Directors service contracts, contracts for the acquisition of business or property, among others.[36]

Interestingly, where pre-incorporation agreements are made part of the memorandum of association of a company, e.g. joint venture or other formation agreements, they supersede the memorandum of association, which ordinarily is the supreme document of operation for an incorporated company.[37]

1.4 Company's Contracts

A company can enter into contracts of various types in furtherance of its business or objects. But being an artificial person, it is capable of contracting only through its human organs, officers and agents and within its powers and objects.

By law, every company upon incorporation shall have the powers of a natural person of full capacity.[38] One of the acts which a natural person of full capacity may perform includes entry into contracts. An incorporated company, therefore, is empowered also to enter into any contract which a natural person can validly enter into. The provision of section 38(1) of CAMA is further amplified by another provision of the Act which allows a company to enter into all forms of contract.[39]

At common law, there is no special form required for the creation of contracts. However, three types of contracts are recognized at common law, namely:

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[35] *ET and EC Nigeria Ltd v. Nevico* (Nigeria) Ltd (2004) 3 NWLR (pt.860) 327 at 347
[36] Chigozie, V. (2013) *Promotion of Companies and Pre-incorporation Contracts*, available at www.wingrass.blogspot.com, accessed on 16/1/2016 at 8: 44 pm.
[37] *Edokpolor & Co Ltd v. Sam-Edo wire industries Ltd (supra).*
[38] Section 38(1), CAMA
[39] Ibid, Section 71(a), and (c)

a. Contracts under seal (contracts by Deed);
b. Contracts in writing (contracts under hand); and
c. Parol contracts (oral contracts).[40]

The above types of contracts are also recognized by the provisions of section 71 of Companies and Allied Matters Acts (CAMA).

1.4.1 Contracts under Seal

Pursuance to the provision of CAMA, a company may contract under seal[41]. A contract under seal is one which is not only in writing but is also by deed. The company's common seal or official seal, as the case may be, must be affixed.[42] By law, certain contracts are required to be under seal. They include, but not limited to:

(a) Contracts for the conveyance of land;
(b) Leases exceeding three years; and
(c) Appointment of an Attorney whose duty or duties include the execution of Deeds for the company.[43]

By virtue of Section 22 of the Land Use Act,[44] the consent of the Governor of a State must be obtained to validate transactions relating to land made by Deed. Where a contract is created under seal by the company, the common seal must be affixed in accordance with the formalities laid down by the Articles of Association of the Company. For instance, it must be attested by two directors or a director and the company's secretary.[45] Similarly where a company executes a deed, the

[40] Asomugha, E.M. op.cit, p.145
[41] Section 71(1) (a) CAMA
[42] Ibid, Sections 74 and 75(1)
[43] Ibid, Section 76(1)
[44] Cap. L.5 LFN 2004
[45] Schedule I, Article 2 of Table A, Part I of CAMA

seal affixed to the document must bear the name of the company.[46] The company is equally allowed to vary these requirements in its Article of Association.[47]

Be that as it may, regardless of the form of the contracts entered into by the company, it will be void unless it is validly executed.[48] For instance, the appellation of the company as limited, unlimited or limited by guarantee, as the case may be, must be included. It must be stressed, however, that a person acting pursuant to the company's authority can make, accept or endorse a bill of exchange or promissory notes on behalf of the company provided such transaction is done in the name of the company.[49]

In order to facilitate business operations every company is required by section 74 of CAMA to have a common seal, the use of which is to be regulated by the Articles of Association. Where a company is permitted by its Articles or objects in its memorandum to carryout business in foreign countries, the company can make provision for official seal[50]. An official seal is a replica or facsimile of the common seal with the addition on its face the name of the Country where it is to be used.

Like a natural person, a company may appoint an Attorney or Attorneys to act on its behalf either generally or for specific matters.[51] Failure to use the common seal when necessary renders the agreement ineffectual.[52]

Where a company is required to authenticate any document, it will suffice if such document is signed by a director and a secretary or any authorized officer of the company[53]. The common seal of the company will not be affixed. In other words,

[46] *Western Nigerian Finance Corporation v. West Coast Boulders* (1971) 1, UILR, 93
[47] Section 34(1), CAMA
[48] Ibid, Section 29(1) –(5)
[49] Ibid, Section 73(1). See also *Metallimpex v. A.G. Leventis & Co. Nigeria Ltd.* (1976) 2.S.C. 91
[50] Section 75(1), CAMA
[51] Ibid, Section 76(1)
[52] *African Development Corporation Limited v. L.E.D.B* (1966) NCLR 438
[53] Section 77, CAMA

failure to affix the common seal of the company on the authenticated document is not fatal.

By and large, service of Court processes to the company is regulated by the rules of Court. Other documents of service may be affected on the company by delivery at the registered office or the head office of the company as the case may be.[54]

1.4.2 Written Contracts

An incorporated company can also enter into contracts which are merely evidenced in writing.[55] There are specific contracts which are required by law to be in writing. They include:

a. Bills of exchange;
b. Promissory notes;
c. Contracts for the transfer of shares in public companies;
d. Contracts for marine insurance; and
e. Hire purchase contract.[56]

Failure to adopt the prescribed method will render any of the above listed contracts void, and if it is a marine insurance contract it will be inadmissible in evidence.[57] For any contract in writing, the signature on behalf of the company will include the company's official stamp.

1.4.3 Parol Contracts

A company can equally enter into parol (oral) contracts in furtherance of its business. The Act provides that contracts on behalf a company may be made, varied or discharged, as the case may be, by parol.[58] The effect of the above is

[54] Ibid, Section 78
[55] Ibid, Section 71(a)(b)
[56] Section 2(1), Hire Purchase Act, Cap H4, LFN 2004
[57] Section 3 (1) Contract Law, Cap.25, Laws of Western Nigeria. See also Section 4, Statute of Fraud 1677
[58] Section 71(1)(c), CAMA

that a company may contract orally in those cases in which a natural person can so contract.

By virtue of section 71(2) of CAMA, contracts made on behalf of the company pursuant to the section, whether by deed, in writing or by parol shall be effectual in law, and shall bind the company and its successors and all other parties thereto, their heirs, executors and administrators.

1.5 Conclusion

This paper appraises the position of promoters, pre-incorporation contracts and company's contracts under Nigerian Law. It is shown that a promoter connotes any individual, association, syndicate, partnership or a company, which takes all the necessary steps to form a company and to set it going. In the course of taking steps to form a company, the promoter may enter into agreements for the benefit of the prospective company. These agreements are known as "pre-incorporation contracts."

Based on the above, the paper finds as follows:

1. The nature of the pre-incorporation contract is slightly different with ordinary contract. The bilateral in nature, it has the features of a tripartite contract. This is because the promoter enters into a contract with an interested party which becomes a bilateral contract between them. But the remarkable part of this contract is that it helps the "prospective company" who is not a party to the contract;

2. the dichotomy between the status of the promoter in relation to pre-incorporation contracts and the existence of a fiduciary relationship is paradoxical and illogical. How can there be a fiduciary relationship

between an existing person and a non-existing person? In the words of Justice Karibi White J.S.C. (as he then was), "it is a legal absurdity";[59] and

3. an incorporated company is regarded as a legal person endowed with all the powers of a natural person, with powers to carry out all the objects set out in the memorandum of the company. Being an artificial person, therefore, it can enter into all forms of contracts, whether contracts by deed, written contracts or parole contract, just like a natural person. This the company can do through the instrumentality of its human organs, officers and agents.

Based on the above findings, the paper proffers the following recommendation:

1. There is the need to balance the competing interests of promoters on one hand, the company, and the third party stakeholders on the other;
2. There is a clear need for comprehensive and coherent legislation, as well as more robust regulatory oversite and enforcement mechanism; and
3. Policymakers and legal practitioners should work together to address the ambiguities, inconsistencies, and challenges that plague this area of the law, with the ultimate goal of promoting transparency, fairness, and efficiency in the company formation process.

[59] Karibi-White, J.S.C (1988) "Some Reflections on Company Law Reform", *Nigerian Business Law and Practice Journal,* Vol .1, p.32