



The Indian Journal for Research in Law and Management

Open Access Law Journal – Copyright © 2024

Editor-in-Chief – Dr. Muktai Deb Chavan; Publisher – Alden Vas; ISSN: 2583-9896

This is an Open Access article distributed under the terms of the Creative Commons Attribution-Non-Commercial-Share Alike 4.0 International (CC-BY-NC-SA 4.0) License, which permits unrestricted non-commercial use, distribution, and reproduction in any medium provided the original work is properly cited.

“CONSTRUING THE PERPLEXITY OF PRE-INCORPORATION CONTRACTS IN THE INDIAN SCENARIO”

ABSTRACT:

This paper primarily focuses on the validity and the enforceability aspect of the pre-incorporation contracts in India across time. It makes an effort to analyse the concept of pre-incorporation agreements and highlights the differences between the aforementioned agreements and the ordinary agreements after incorporation and the role and liability of the promoters before and after the ratification of the contract. A comparative analysis of the standpoint of English law and Indian law is taken into consideration for a better analysis of the concept.

A number of legal theories and concepts such as Agency and Novation are scrutinized in the Indian context to probe into the validity of the pre-incorporation contracts.

OBJECTIVES:

1. To identify whether pre-incorporation contracts are valid and enforceable in the Indian context.
2. To determine the role of the Promoter and to check whether they are personally liable for any breaches or violations of pre-incorporation contracts.
3. To investigate the global aspect relating to Pre-Incorporation contracts.

KEYWORDS:

Pre Incorporation Contracts, Promoter’s liability, Principal-Agent, Novation, Corporation, Ratification, Specific Performance, Enforceability.

METHODOLOGY:

The research methodology utilized for this research paper is Doctrinal and Descriptive in nature. Primary reliance was given to the Articles, Research papers, Journals and Case-laws which acted as a secondary source of information.

EXPECTED OUTCOMES:

1. Grasping the concept of the enforceability of pre-incorporation contracts and its relevance in the Indian context.
2. An understanding of nuances that are faced by the promoters in case pre-incorporation contracts are deemed to be invalid.
3. Identifying the distinctions between the Indian law and the English law with respect to Pre-Incorporation contracts.
4. Gaining an insight into the aspect of specific performance for pre-incorporation contracts by way of case-laws and precedents.
5. Delving into various legal theories and concepts that come out as an exception to the pre-incorporation contracts.

TENTATIVE CHAPTERS:

1. Introduction to the Concept of Pre-Incorporation Contracts and Promoters
2. Development of Pre-Incorporation Contracts Over Time in Indian and English Jurisdictions
3. Validity and Enforceability as per Legislative and Judicial Precedents
4. Liability of Promoters in Pre-Incorporation Contracts
5. Applicability of Specific Relief Act and other legal theories on Pre-Incorporation Contracts
6. A Comparative Analysis of Pre-Incorporation Contracts in the English Law and Indian Law
7. Remedies to Address the Legal Gaps with respect to the liability of the Promoter

INTRODUCTION

The paper delves into an in-depth analysis of the validity and enforceability of pre-incorporation contracts within the legal framework of India. The paper begins by describing the fundamental concept of pre-incorporation contracts and underscores the key distinctions that set them apart from ordinary contractual agreements and ambiguity surrounding the precise definition of a "promoter" as observed across diverse statutes and legal provisions in India.

The paper also looks at pre-incorporation contracts from the standpoint of English law, highlighting the important claim that a newly established company cannot be held accountable for such commitments. It emphasises how crucial it is to comprehend that, under English law, promoters are personally responsible for any breaches or violations of pre-incorporation commitments.

Regarding pre-incorporation contracts and the crucial function performed by promoters, the legal environment in India presents distinctive impediments and prospects. One such challenge concerns the feasibility of ratifying a pre-incorporation contract versus determining whether novation is the more suitable method for facilitating the transition from promoter to corporation. Merely adopting such contracts on behalf of a corporation may not be adequate to fully absolve the promoter of all liabilities. The intricate nature of this legal situation provides an opportunity to present a persuasive case for the total elimination of promoter liability following the organization's execution of the contract. There exists a need to highlight the complex characteristics of pre-incorporation contracts and the changing function of promoters within the Indian legal system.

CONCEPT OF A PROMOTER-

In the context of a company, a promoter refers to an individual or a collective entity that assumes the responsibility of conceptualizing, developing, and coordinating the creation and first operational activities of the organization. Promoters assume a pivotal role in the realization of a company proposal.

Certain attempts have been made by the Judiciary to define the term 'promoter'. Cockburn C.J., in the case of *Twycross v. Grant*¹, described a 'Promoter' as "one who undertakes to form a company concerning a given project, and to set it going, and who takes the necessary steps to accomplish that purpose".

A corporation encompasses many categories of promoters- Financial promoters, technical promoters, Managerial promoters, Entrepreneurial promoters, Professional promoters, etc.

ROLES AND RESPONSIBILITIES OF A PROMOTER-

The primary function of a promoter within an organization entails the initiation, development, and establishment of the firm.² Promoters do a multitude of tasks, encompassing:

¹ Twycross v Grant(1877) 2 CPD 469

² A.K.Majumdar & G.K.Kapoor, Taxmann's Company Law And Practice, (24th Edition)

- **Conceptualization** is the process of recognizing and formulating a business idea or opportunity.
- **Capital procurement** refers to the process of acquiring the necessary funds and investments to establish a corporation.
- **Business Planning** involves the development of a comprehensive business plan that delineates the objectives, strategies, and financial forecasts of the organization.
- The management of legal compliance involves the handling of several legal elements, including but not limited to registration, permits, and adherence to regulatory standards.
- **Team Building:** The process of forming a cohesive group of employees and executives to serve as the foundation of an organization.
- **Risk assessment** is a crucial process that involves the identification and subsequent mitigation of possible hazards.
- **Networking** refers to the process of establishing and cultivating significant contacts within a certain business.

LIABILITIES OF A PROMOTER-

The promoter may incur legal responsibility for any misrepresentations contained within the prospectus, instances of fraud, or the dissemination of false material throughout the process of incorporating the firm. According to the legal framework in India, promoters are obligated to fulfill their fiduciary obligation towards the firm and its shareholders. If individuals are deemed culpable for their actions, they may be subject to various consequences, such as penalties, monetary sanctions, or even incarceration. Promoters must adhere to ethical principles and comply with statutory obligations to safeguard legal safeguards and foster the prosperity of the company that they develop.

LEGISLATIVE PROVISIONS ACROSS THE GLOBE-

❖ UNITED KINGDOM

The Companies Act of 2006 in the United Kingdom governs pre-incorporation contracts.

Section 51 of the Act outlines the primary obligation for an individual or promoter entering into a contract on behalf of an unincorporated business. The Promoter is personally obligated by the terms of the contract unless otherwise stated. The business is prohibited from being a party to a pre-incorporation contract before its formal incorporation. Upon incorporation, the firm can ratify the contract, shifting contractual responsibilities from the promoter to the firm. The legal responsibility of the individual persists until the company formally approves and validates the contract.

Section 52 pertains to the legal responsibility of an promoter entering into a pre-incorporation contract before the firm's official establishment.

❖ SOUTH AFRICA

Section 71 of the South African Companies Act provides a company with the power to ratify the pre-incorporation contracts entered into by the promoters. It talks about the agent or the

trustee for a company that has entered into a contract that is yet not formed or incorporated. Such contracts will become binding on the company automatically provided that the company's memorandum has the clause regarding adoption obligation or ratification in respect of such contracts.

The South African section has radically altered the doctrine of *Kelner v. Baxter* in its bearing upon pre-incorporation contracts, by exonerating the promoter irrespective of whether the company was or was not in existence at the time of the contract, excluding warranty of authority if the other party knew at the time of the contract that he had no authority.³

❖ ISRAEL

According to **Section 6(c) of the New Agency Law, 1965** "a body corporate may ratify an act done on its behalf prior to its establishment, and the provisions of this section shall apply in such a case".⁴ The particular law gives the power to the company to allow ex post facto ratification of the acts not authorized and to ensure preservation of the rights of other party so long he was unaware of the ratification.

❖ GERMANY-

According to **Section 41** of the Aktiengesetz, 1965, the promoter or any other person who acts in the name of the company or on its behalf will be personally liable. If the company assumes any contract or obligation made in its name prior to the registration, the assumption must be communicated to the other party within three months from the date of registration.

❖ INDIA-

Indian law has evolved over time regarding pre-incorporation contracts, with cases such as *Seth Sobhag Mal Lodha v. Edward Mills Co. Ltd and CIT v. City Mills Distributors (P) Ltd*⁵ ruling that a company cannot be liable to pay tax on income earned by a non-registered firm. However, these cases have faced criticism and have been overruled due to the failure to consider the Specific Relief Act, of 1963. **Section 15(h) and 19(e)** of the Act allow plaintiffs to obtain specific performance when promoters enter into a contract for the company's purposes before incorporation.

The **doctrine of Novation of Contract** is recognized by Indian law, allowing companies to replace the liability of the promoter with their own. The Supreme Court of India has stated that the term "warranted by the terms of incorporation" must not involve anything ultra vires of the company's object.

The Madras High Court broadened the scope of the principle of novation in *Weavers Mills Ltd. v. Balkies Ammal*⁶, where the Madras High Court and applied the principle of equity.

³ 7 Peak Lode Gold Mining Co. Ltd. v. Union Government 1932 T.P.D. 48, at p. 51 (per Greenberg J.). Cf. Semer v. Retief & Berman, 1948 (1) S.A. 182. See: Ex parte Vickerman, 1935 C.P.D. 429; Alberts v. Fick (1935) S. Afr. L.J. 219

⁴ Section 6(c)

⁵ 1996 SCC (2) 375

⁶ AIR 1969 Mad 462

Under **Section 230** of the Indian Contract Act, a promoter cannot be held liable under a pre-incorporation contract, as an agent is not personally bound by the contract entered for their principal.

COMPARITIVE ANALYSIS OF THE LAWS-

❖ INDIA AND UNITED KINGDOM-

India- In the Indian context, it may be seen that the consideration of the rights of the other party is somewhat limited due to the requirements outlined in the Specific Relief Act and the permissibility of unilateral contracts. The legal responsibility of a corporation is considered fulfilled upon notifying the third party. A corporation has the option to assume liability through both the novation of a contract and the explicit ratification of said contract⁷.

United Kingdom- However, in the United Kingdom, the explicit approval of the third party is required. Conversely, in the United Kingdom, just the process of novation is deemed necessary for assuming obligation. India and the United Kingdom have a common approach when it comes to including a newly established firm as a contracting party through the process of novation.⁸

❖ INDIA AND SOUTH AFRICA-

South Africa- In the realm of South African law, the inclusion of a clause in a company's memorandum is deemed necessary to facilitate the automatic ratification of pre-incorporation contracts. The terms such as 'trustee' and 'agent' are explicitly referenced for the promoter who acts on behalf of the company. In South Africa, it is a requirement to submit a copy of the contract to the registrar when applying for business registration.

India- The legal framework in India does not explicitly state the automatic ratification of a contract. India also does not give recognition to the use of terms such as 'trustee' and 'agent' and there is no such requirement for submission of a copy of the contract to the registrar.

❖ THE SIMILARITY BETWEEN INDIA AND GERMANY-

In Germany, the promoter bears personal culpability in the event that the firm fails to assume the contractual obligations or liabilities undertaken by the promoter, a situation that bears some resemblance to the legal framework in India.⁹

⁷ Laxmi Dwivedi & Varun Byreddy, *PRE-INCORPORATION CONTRACTS: A LEGAL PUZZLE IN INDIA*, V NLIU LAW REVIEW, 37–63 (2022)

⁸ Abhijit Debnath, What Is the Status of Pre-Incorporation Contracts in India with Respect to Validity and Enforceability? How Does It Compare with the English Law Position?, 5 INDIAN J.L. & LEGAL Rsch. 1 (2023).

⁹ Joseph H. Gross, Liability on Pre-Incorporation Contracts: A Comparative Review, 18 MCGILL L. J. 512 (1972)

JUDICIAL PRECEDENTS:-

❖ INDIA-

The case of *Ranjit Ukey v. Tatyia Tukaram Patil* (2001) in India established the principle that a pre-incorporation contract, which is a contract entered into by the promoters before the company is formally incorporated, can be approved by the business after incorporation. This ratification results in the company assuming liability for the contract.

The legal case of *Maskara Brothers Private Ltd. v. Venkatesan* (2002) established the principle that in situations when a business is incorporated and chooses not to ratify a pre-incorporation contract, the promoter of the company retains personal liability.

❖ UNITED KINGDOM-

The legal precedent set by the case of *Newborne v Sensolid* (GB) Ltd [1954] signifies that in instances when a contract is entered into by a promoter before the incorporation of a business, the promoter has personal liability for the contract, unless there exists a mutually agreed upon provision to the contrary.

The decision of *Kelner v Baxter* (1866) reinforced the notion that people assuming the role of a non-existent company have personal liability for pre-incorporation contracts until the company is officially incorporated and decides to accept the terms of the contract.

ENGLISH PRECEDENTS

According to English law, a newly formed corporation cannot take on the obligations of the promoter with regard to any agreements entered into prior to the company's incorporation. In other words, the company is unable to ratify a pre incorporation contract because, even for ratification, the company must have had legal capacity when the contract was executed, which was not the case when it came to a pre incorporation contract. Ratification of a pre incorporation contract is therefore prohibited.

If it appears that the promoter is acting on behalf of the unincorporated company, then he will be held personally liable for the actions of the company. However, if the contract is carried out in the name of the unincorporated company and the promoter merely authorizes the signature, then the promoter does not bear any responsibility in the event that the company violates the terms of the agreement. This is due to the fact that both parties were aware that the promoter was not the individual who was signing the contract.

***Kelner vs. Baxter*¹⁰**

In this case, the promoter acted as the company's representative when signing a contract on behalf of the unincorporated business. The contract was duly executed by the promoter on behalf of the prospective company, utilizing the company's designated name which was

¹⁰ Kelnar vs Baxter, <https://lawcasesummaries.com/knowledge-base/kelner-v-baxter-1866-lr-2-cp-174/>.

intended to be established. The company was never established, and the other party petitioned the court to make the agreement legally binding. The court decided that because the company did not exist at the time when the contract was signed, it was null and void; this meant that the contract could not be enforced unless the promoters were held personally liable. Both parties were aware that the company was going to be formed, and because of this, it was agreed upon that the promoters of the company would be held personally liable in the event that the company was not formed. It was also stated there was no way for a third party to be held accountable for the rights and obligations that were outlined in the contract.

Newborne vs. Sensolid¹¹

The court made the observation that the directors authenticated the signature of the company but did not act as agents of the company themselves due to this the contract was held invalid.

Phonogram v. Lane¹²

The court reached to a decision that the promoters of the company were deemed personally accountable and legally liable for the breach of contract perpetrated by the company. It also stated that because the company in question did not exist at the time the contract was being drawn up, there was never a contract to begin with, and the promoter is unable to claim that this is in fact one of his contracts. It's a well-known fact that the promoter signed a contract on behalf of a company that did not even exist at the time.

The above-mentioned legal precedents suggest that a company is not required by law to fulfill the obligations of contracts entered into by the company's promoters. Even after it has been incorporated, a company is unable to ratify a contract because there is no principal-agent relationship because the principal did not exist at the time the contract was being executed. This means that the company cannot ratify the contract. The individuals who played a crucial role in the establishment of the company will assume personal liability for any transgressions or breaches committed by the company. A pre-incorporation contract cannot be ratified under English law because the company did not have the legal capacity to carry out the terms of the agreement before it was incorporated.

INDIAN PRECEDENTS

The approach that Indian law takes toward pre-incorporation contracts has undergone consistent change over the course of legal history.

Sobhag Mal Lodha v. Edward Mills Co. Ltd.,¹³

In this case the Supreme Court stated that a suit filed against a company to enforce a pre-incorporation contract will be wholly ineffective unless the firm is registered and the plaintiffs have been shown to be partners in the firm. This was stated in the context of the case.

CIT v. City Mills Distributors(P) Ltd¹⁴

¹¹ *Newborne vs. Sensolid*, <https://vigilantescholar.org/2022/09/newborne-v-sensolid-great-britain-ltd-1953-1-qb-45-1953-2-wlr-596/>.

¹² *Phonogram v. Lane*, <https://www.oxfordreference.com/display/10.1093/oi/authority.20110803100343123>.

¹³ *Sobhag Mal Lodha v. Edward Mills Co. Ltd.*, <https://indiankanoon.org/doc/1716446/>.

¹⁴ *CIT v. City Mills Distributors(P) Ltd*, <https://indiankanoon.org/doc/817594/>.

The Supreme Court Held that Since the assessee company did not exist when the income was earned hence the assessee company is not required to pay tax on the income because it was not in existence at the time the income was earned.

Lindsay International Pvt. Ltd. & ... vs Laxmi Niwas Mittal & Ors¹⁵

But It is essential to take into account the fact that the cases that were just reviewed have been the subject of criticism and in some instances have been overruled by later court decisions that dealt with factual scenarios that were very similar. This is due to the fact that the courts that heard the aforementioned cases did not take into account the Specific Relief Act of 1963. Section 15(h) and Section 19(e) of the Specific Relief Act of 1963 are the provisions that are pertinent to this discussion.

The Specific Relief Act, Section 15(h), grants the plaintiff the right to obtain specific performance when the promoters of the company have entered into a contract for the purposes of the company prior to the incorporation of the company. This provision allows the plaintiff to obtain specific performance. The only requirement is that the company accept the contract, and that acceptance needs to be communicated to the other party. This is the only requirement. The relief that can be sought against the aforementioned parties and individuals is outlined in Section 19(e). In accordance with the provisions mentioned above, a pre-incorporation contract will be considered valid if it has been executed on behalf of the proposed company and if its terms are consistent with those set forth in the incorporation documents. It is the responsibility of the company to let the third party know that it has accepted their terms of the contract.

Weavers Mills Ltd. v. Balkies Ammal

The case was brought before the Madras High Court, and it marked a significant development in legal understanding as it broadened the scope of the novation principle. The fact of the case is as such that the company's promoters had already purchased various properties on the company's behalf. After the company was officially established it proceeded to construct buildings on the aforementioned properties.

Here the court applied the concept of equity and came to the conclusion that it is possible for a company to be held liable for the actions of its promoters even if the promoters have not explicitly transferred ownership of any properties to the company and even if the company is benefiting from the promoters' actions.

Jai Narayan Parasrampurua v. Pushpa Devi Saraf¹⁶

In this case the court observed that the mere reason that that the pre-incorporation transaction involved in a contract is not mentioned in the articles of the company, does not reflect that the company has not adopted such a transaction. The mere fact that the company sues for a declaration of ownership of a property that was purchased for it before it was incorporated is evidence enough to show that the company made the decision to go through with this transaction.

¹⁵ Lindsay International Pvt. Ltd. & ... vs Laxmi Niwas Mittal & Ors, <https://indiankanoon.org/doc/193161743/>.

¹⁶ Jai Narayan Parasrampurua v. Pushpa Devi Saraf, <https://indiankanoon.org/doc/1414476/>.

IMPACT ON PROMOTERS IN CASE OF RATIFICATION OF CONTRACT-

Common Law Countries-

In American Jurisprudence, the concept of Adoption of Contract takes place wherein the pre-incorporation contracts come into existence and become binding as soon as the company is incorporated. By acknowledging and accepting the advantages of the contractual agreement, the corporation inherently assumes the role of a party to the contract and take away the liability of a promoter.

As per English law, the ratification of contracts executed prior to incorporation is not acknowledged by English law. Rather it facilitates a legal process referred to as novation, through which the corporation takes on the role of the promoter, thereby causing the parties involved to be replaced. The process of replacing the contractual parties is referred to as "*novation*"¹⁷ The courts have recognised this theory of novation, which was initially proposed by legal scholar Williston, as a valid legal principle in contracts.¹⁸

The primary function of novation is to release the promoter from any additional obligations that may have resulted from the contract in place prior to the incorporation. This signifies the transfer of all contractual obligations and responsibilities from the promoter to the corporation. This legal doctrine establishes a clear framework for the management of pre-incorporation contracts in the English legal system. Its purpose is to guarantee that contractual obligations are accurately ascribed to the relevant party and to provide promoters with legal safeguards as they transfer their responsibilities to the company after its due incorporation.

Indian Law-

The question is left open and multifaceted judgments and opinions have been passed in this regard which on a case-to-case basis determine the validity of the Pre-Incorporation contracts. In the Indian legal context, the mere adoption of a contract by a corporation does not guarantee the complete relief of the promoter from their liabilities. The liability of the promoter must be completely eliminated once the company gets incorporated if looked at from the lens of fairness and equity as once the company adopts the contract, the natural expectation is that the promoter no longer wishes to be personally bound, as the primary feature of incorporation is to establish limited liability. Therefore, the sole liability of the promoter even after the due incorporation of a company must be abolished as the promoter no longer holds a personal interest in the contract and the company now acts as a separate legal entity that is entirely separate from that

¹⁷ **Novation** is a legal concept used in contract law to describe the replacement or substitution of one of the parties to a contract with a new party. This substitution essentially creates a new contract in place of the original one, and the new party takes on the rights, duties, and obligations of the party they are replacing. Novation is often used to transfer contractual relationships or liabilities from one entity to another while preserving the terms and conditions of the original contract.

¹⁸ Aysha Aazmy Moideen, *Validity of Pre- Incorporation Contracts: Solving the riddle of a defectively incorporated contract*, 1 ILE MULTIDISCIPLINARY JOURNAL , 47–54 (2023)

of the promoter and hence, it would be unjust to hold the promoter liable even after the ratification from the company.

This approach would not only reduce the burden on one party but also ensure a more equitable distribution of benefits and liabilities among all parties involved.

It would also restrict the third party's ability to choose any of the involved parties such as either the company or the promoter as severally or jointly as liable under the contract.

IMPACT ON PROMOTERS IN CASE OF NON-RATIFICATION OF CONTRACT-

Common Law countries-

The common law placed significant emphasis on the intention of the parties while adjudicating the contract as that could be seen in the case of *Kelner vs. Baxter and Newborne vs. Sensolid*. In the event that the promoter claimed to be acting on behalf of the corporation, it resulted in personal liability being imposed upon him for the contract. In the event where the contract is executed under the name of the future company and the promoter just verifies the authenticity of the signature, the promoter is relieved of any responsibility or legal obligation. The rationale behind this decision was founded on the parties' purpose, specifically on the party or parties they rely upon when entering into a contract.

The personal liability of the promoter can be mitigated by interpreting a pre-incorporation agreement as a revocable offer or a "*gentleman's agreement*"¹⁹. In this scenario, if the offer is not rescinded, the corporation can accept the contract upon adoption. One notable benefit for the promoter, as per this particular understanding of the contract, is that they are absolved of all rights or obligations associated with the deal, as long as there was no fraudulent purpose or violation of guarantee of authority.

Indian Law-

The concept of promoter liability in contractual agreements remains unresolved in Indian law, primarily due to the absence of any specific legislation addressing this matter and a lack of judicial rulings that provide clear guidance on the scope of this issue.

According to **Ramaiyya's review**²⁰, it is indicated that the provisions outlined in **Section 230 of the Indian Contract Act**²¹ establish that a promoter cannot be held legally responsible for a pre-incorporation contract. This is due to the fact that, as stated in Section 230 of the Indian Contract Act, an agent is not personally obligated by the contractual agreements made on behalf of their principal. Therefore, after the incorporation of the company, the promoter is legally prohibited from initiating legal action or being subject to legal action if the company declines to validate the contract, unless there is a valid claim based on the principle of quantum meruit or violation of warranty of authority.

¹⁹ A **gentleman's agreement**, is an informal agreement or understanding between two or more people, is a non-binding agreement. A gentleman's agreement, unlike a formal contract, is usually not legally enforceable in a court of law. These agreements are frequently founded on trust, honour, and the parties' mutual commitment to completing their mutual duties, but they lack the legal elements required for a binding contract, such as consideration and the purpose to form legal relations.

²⁰ A. Ramaiya, Guide To The Companies Act,(17th Edition), 2010, Lexis Nexis

²¹ Section 230 of The Indian Contract Act,1972, Indian Kanoon, <https://indiankanoon.org/doc/1154110/>.

The principle of *quantum meruit* suggests that if a promoter has provided services to another party and those services have been acknowledged and accepted by the other party, then the promoter has the right to pursue legal action based on the terms of the contract. However, it is argued that this stance is erroneous as it presupposes an agent-principal relationship. The decision to hold a promoter personally accountable would be contingent upon the parties' intentions, as there is currently no existing regulation mandating such liability.

The invalidity of a pre-incorporation contract can be inferred from the principles of Indian jurisprudence, even in cases when it is not explicitly stated.

IMPACT ON THIRD-PARTY IN CASE OF NON-RATIFICATION OF CONTRACT-

There have been numerous instances in which the third party has been placed at a disadvantage as a result of the contract being rendered null and void due to the company's lack of legal capacity as it has not been incorporated which brings with it an element of uncertainty.²²

Nevertheless, the common law has endeavoured to offer a protective barrier to third parties in this context. In the case of *Goodman vs Darden*²³, the court had held that there existed a need to safeguard the third party. In the present case, it was mutually acknowledged by both parties that the corporation did not exist at the time the contract was formed. It was observed that the corporation, despite its non-existence, accepted the contract, and the promoter, acting on behalf of the corporation, directed all payments received under the contract to the corporation. Nevertheless, the court proceeded to determine that the third party's intention was not to absolve the promoter from their own obligation for entering into the contract on behalf of the yet-to-be-formed company.

The awareness that the contract was entered into before incorporation suggests that the third party did not intend to absolve the promoter of their liability, hence preventing the contract from being adopted by the corporation. This legal case acts as a *supra* and has established the fact that the mere adoption of a contract by a corporation does not absolve the promoter of all personal culpability.

REMEDIES TO ADDRESS THE LEGAL GAPS-

The legal framework pertaining to pre-incorporation contracts and the involvement of promoters in India poses distinct issues that necessitate meticulous examination and possibly legal modifications. Given the lack of a clearly defined legal framework, it is crucial to acknowledge and rectify the current legal void by implementing solutions that provide transparency, impartiality, and equality for all interested parties.²⁴

A potential resolution to address the existing disparity and resolve the concerns pertaining to pre-incorporation contracts involves revising the provisions for ratification or adopting the principle of novation. At present, the existing framework of Indian contract law lacks a clear-cut process for addressing pre-incorporation contracts, hence resulting in ambiguity and

²² Prasad Raj Singh, Promoter and Pre-incorporation Contract, 6 ASIAN JOURNAL OF INTERNATIONAL LAW, 1-2 (2011), available at : http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1938065, accessed 9 October 2023.

²³ *Goodman vs Darden*, <https://casebriefsco.com/casebrief/goodman-v-darden-doman-and-stanford-associates>.

²⁴ M.J. Whincop, *Of Dragons and Horses : Filling Gaps in Pre-incorporation Contracts*, (1998) 12 JCL 223-225.

potential legal obligations for individuals involved in promoting such arrangements. The inclusion of provisions in the legislation that clearly permit ratification or novation in such circumstances would establish a definitive and legally binding framework for the transfer of contractual responsibilities from promoters to companies.

Within the current legal framework, the act of a promoter adopting a contract on behalf of a corporation does not ensure the promoter's absolute exemption from responsibilities. The incorporation of a company does not absolve promoters from potential personal liability, thereby imposing a substantial responsibility on them.

Gaining insights from practices observed in other jurisdictions might offer significant perspectives in addressing the challenges associated with pre-incorporation contracts within the context of India. Countries such as Germany, Australia, and South Africa have successfully enacted progressive measures to tackle the issue of promoter liability.

UNITED STATES-

The automatic ratification of pre-incorporation contracts upon company formation in the United States has shown to be an advantageous strategy, particularly in cases when the contract confers advantages upon the firm.

GERMANY-

The Theory of Identity, often known as the theory of Continuity, has proven to be effective in addressing these concerns within the context of Germany. The aforementioned view regards the post-incorporation company as a continuation of the pre-incorporation organisation, wherein rights and liabilities are transferred seamlessly without the requirement of express acceptance or ratification. This method serves to reduce the potential legal responsibility of promoters and provides third parties with more assurance in their contractual engagements with the company.

Implementing a comparable framework of Continuity in India has the potential to offer a viable resolution for mitigating promoter obligations and safeguarding equity in contractual associations. Therefore, all parties engaged in pre-incorporation contracts would derive advantages from this arrangement.

CONCLUDING REMARKS-

It's crucial to understand that a specific statutory provision is still required to further clarify the legal context. It is imperative to rectify the existing legal void pertaining to pre-incorporation contracts in India in order to establish a framework that promotes transparency, impartiality, and equality in contractual dealings. The comprehensive resolution of this intricate matter involves the amendment of the law to incorporate provisions for ratification or novation, the elimination of promoter liability upon the company's acceptance of the contract, and the adoption of successful practises observed in other legal jurisdictions. By implementing these measures, Indian contract law can be brought in line with modern company practises and uphold principles of fairness and equity.

Pre-incorporation contracts are enforceable and lawful in India but its matter of urgency the Indian legislature to take into account adding a special statutory provision to the Companies

Act. This would create a more thorough legal framework for pre-incorporation contracts as well as lessen the burden on the courts.
