

## “Corporate Law: Winding Up of a Company”

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**OBJECTIVE:** The purpose of this research paper is to analyse the laws of winding up of a company in India.

To determine relevant questions in the process of the winding up.

**LITERATURE SURVEY:** This research paper is prepared using the secondary sources. Books, Internet websites, landmark case laws are thoroughly used.

**RESEARCH QUESTIONS:** 1. It is to find out whether the petition for winding up can be filed for recovery of debts and interests thereon.

2. To find whether the secured creditors hold pari pasu charge in favour of workmen in distribution of payments.

**ABSTRACT:** This research paper deals with Indian Laws of winding up of a company. Section 2 (94 A)<sup>1</sup> defines winding up as winding up under this act or liquidation in Insolvency and Bankruptcy Code. This paper will only be dealing with laws under Companies Act, 2013. Since a company is considered as a juristic person<sup>2</sup> in the Indian law an analogy has been drawn with the death of a company with the death of man. Just as a man makes will and disposes of his property by way of transfers, a liquidator is also appointed<sup>3</sup> in the liquidation of company to take custody and dispose all the assets of the company<sup>4</sup>. Then the role of directors and employees cease to exist. All the records and documents are to be handed over to liquidator. If any person contravenes with the direction of liquidator he shall be liable for default and punished as per the Act. Here, the powers and jurisdiction<sup>5</sup> of the tribunal holds utter importance because it is the National Company Law Tribunal (NCLT) which deals with cases of companies in India. Only after the order of tribunal the company is wound up. Therefore, this paper is divided into chapters dealing with role of liquidator, role of tribunal in the procedure to wind up the company supporting landmark case laws and analysing the laws.

**KEYWORDS:** Companies Act, 2013, Role of NCLT, Winding up.

**INTRODUCTION:** A death of a company may be compared to the death of a man. When a man dies he winds up all its affairs of his life and leaves his life. In corporate law winding up

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<sup>1</sup> Companies Act, 2013

<sup>2</sup> Mohan Lal Ghosh v. East India Wires Ltd [2004 (118 CC 322)]

<sup>3</sup> S. 275 of Companies Act, 2013

<sup>4</sup> S. 283 of Companies Act, 2013

<sup>5</sup> S. 280 of Companies Act, 2013

of a company is collecting all the assets and liquidate them so as to make the company cease to work.

**“Winding up is a proceeding by means of which the dissolution of a Company is brought about & in the course of which its assets are collected & realised; & applied in payment of its debts; & when these are satisfied, the remaining amount is applied for returning to its members the sums which they have contributed to Co. in accordance with AOA”.**<sup>6</sup>

According to Indian Law Companies Act, 2013, winding up of a company can be done by two methods which are voluntary and involuntary. The voluntary winding up contains petitions to the company tribunal by members or creditors whereas the involuntary contains winding up by the court.<sup>7</sup> Reasons for winding up are when

- i. a company is not able to pay its debts,

In *Reliance Infocomm Ltd v. Sheetal Refineries Private Ltd*<sup>8</sup> the Andhra Pradesh High Court interpreted the term “inability to pay debts” as a situation where the company is commercially insolvent that is, its debts and liabilities to pay are more than its assets to run the company.

- ii. the company has passed a special resolution to wind up the company by the tribunal,
- iii. if the company has acted against the integrity and sovereignty of India, the security of the state, friendly relations with foreign state, public order, decency, morality,
- iv. tribunal has ordered for winding up,
- v. on application by registrar or any other person authorised by Central Government with the opinion that there has been fraudulent affairs, unlawful objectives of the company or the persons involved are guilty of fraud, misfeasance or misconduct,
- vi. the financial statements or annual returns of five consecutive financial years is not submitted to registrar,
- vii. it is just and equitable in the opinion of tribunal to wind up the company.<sup>9</sup>

In *Takshila Hospital Ltd. v. Dr. Jagmohan Mathur*<sup>10</sup>, the petitioners and others filed a case for winding up of Takshila Hospital Ltd. on the grounds of just and equitable and various malpractices and misdeeds affairs going in the management. It the opinion of the Company Law Board that there is no prima faice case for the winding up of the company and advised to file a case under section 392. The petitioners reluctantly filed another petition under section 397. The board was on the issue that when once the winding up petition is pending can the petitioners proceed under section 397. It was held that the when the petitions under section 397 is made after the winding up petition it is that latter petition that is geld to be invalid.

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<sup>6</sup> Halsbury’s Laws of England, Vol. 6 (3<sup>rd</sup> Edition), page no. 535

<sup>7</sup> Section 272 of Companies Act, 2013

<sup>8</sup> (2008) 142 Comp Cas 170 AP

<sup>9</sup> S. 271 of Companies Act, 2013.

<sup>10</sup> (2002) 4 WLC 609

*In Re: German Date Coffee Co.*<sup>11</sup>, the case relates to the situation where the company's objectives provided to sell coffee with Spanish Patent but the company was selling the coffee with German Patent because they could not get Spanish Patent. The company had lost its fundamental substratum and therefore was just and equitable to be wound up.

## 1. LIQUIDATOR

1.1.**APPOINTMENT:** Tribunal at the time of passing the winding up order appoints the company liquidator for the purposes of winding up from a panel of insolvency professionals maintained under IBC. A liquidator shall be appointed on the basis of task required to be performed, experience and qualification and size of the company. As the liquidator is appointed he shall file a declaration in 7 days disclosing his conflict of interest or lack of independence with the company, this obligation will run throughout the term of his appointment.<sup>12</sup>

1.2.**REMOVAL AND REPLACEMENT:** NCLT may by order remove company liquidator for the following reasons by giving a reasonable opportunity to liquidator of being heard. The reasons for removal may include misconduct, fraud or misfeasance, inability to act as liquidator, conflict of interest or lack of independence and professional incompetence or failure to exercise its powers and functions by taking due diligence. NCLT may recover for the loss or damages caused by the liquidator by passing an order as it thinks fit. NCLT may appoint another liquidator on the events of death, resignation or removal of the provisional or company liquidator.<sup>13</sup>

1.3.**POWERS AND FUNCTIONS:** A company liquidator is given wide powers because all the functions of liquidations and directions of NCLT have to be carried by him. CL has a power to constitute a Winding up Committee (WUC) to assist and monitor the liquidation proceedings the committee comprises of official liquidator, a professional nominated by NCLT and nominees of secured creditors. All the meetings of the committee shall be convened by CL and proceeds for following functions:

- Taking over assets.
- Examination of statement of affairs.
- Recovery of property, cash or any other assets and benefits derived from them.
- Sale of assets.
- Finalisation of list of creditors and contributories.
- Settlement of claims, compromise and abandonment.
- Payments of dividends
- Any other direction given by NCLT from time to time.

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<sup>11</sup> (1882) Ch. D 169

<sup>12</sup> S. 275 of Companies Act, 2013

<sup>13</sup> S. 276 of Companies Act. 2013

On monthly basis CL will present a report on the minutes of the meeting to NCLT till the final report is submitted. The final report will be approved by WUC and then presented before NCLT for dissolution order.<sup>14</sup> The reports will also contain the manner in which the company was promoted and steps to maximise the value of assets and if there is any fraud in the opinion of the liquidator and all other matters which must be brought to the notice of NCLT.<sup>15</sup> It is the duty of the CL to make quarterly reports regarding the progress of WU.<sup>16</sup>

**1.4.DUTIES:** The following are the duties of the company liquidator in the process of winding up:

- Carry on the business of company in most beneficial manner.
- To do all acts and execute all deeds and receipts in the name of the company.
- To sell moveable and immovable properties of company in public auction.
- To sell whole undertaking as a going concern.
- To raise money requires on the security of the assets of the company.
- To defend or prosecute for any suit civil or criminal on behalf of the company.
- To settle claims of creditors, employees or any other claimant in respect of their priority.
- Inspection of records and returns of company in the register of ROC.

In *Ramakrishna Industries case*<sup>17</sup>, the issue was that the company had already put an application for appointment of provisional liquidator and two applications for restraining the company from borrowing money. The court granted the application of provisional liquidator and as for the other applications an interim order was passed which was challenged on the ground that unless the petition is heard no orders can be granted. The court in this case held that the orders were not in error and good in law.

*Rajratna Narainbhai Mills Ltd v. New Quality Bobbin Works*<sup>18</sup>, after the order of WU by NCLT if there is any transactions not done in bona fide manner and without the approval of the NCLT will not be binding on the Liquidator. Transactions made without the approval of NCLT shall be null and void in the eyes of law.

## **2. ROLE OF NCLT:**

**2.1.POWERS:** After receiving the application for winding up under section 272 the tribunal has powers to dismiss, make any interim order, appoint provisional liquidator, or order for winding up or any other order as it deems fit.<sup>19</sup> The tribunal also must give a reasonable opportunity to the company to represent any

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<sup>14</sup> S. 277 of Companies Act, 2013.

<sup>15</sup> S. 281 of Companies Act, 2013.

<sup>16</sup> 2. 288 of CA, 2013.

<sup>17</sup> [1988] Comp Cas 425.

<sup>18</sup> (1973) 43 Comp Cas 131.

<sup>19</sup> S. 273 of Companies Act, 2013.

objections. But if the tribunal is of the opinion that there lies any alternate remedy rather than winding up then it should not order for winding up.<sup>20</sup>

**2.2. JURISDICTION:** The jurisdiction of tribunal is limited to the company related matters. It can neither interfere in the matters of civil courts nor does any civil court has power to do so. The company related matters are suit proceedings, claims by or against the company or petition under section 233 or section 262. any matter relating to any question of law or fact of business actions, benefits, rights or privileges etc.<sup>21</sup>

**2.3. POWER TO DIRECT LIQUIDATOR ON ITS REPORT:** On careful perusal of the report the tribunal if satisfies may fix a time limit for the completion of WU process. After giving a reasonable opportunity to creditors and contributories order sale of company as a going concern or part thereof. If there is any fraud or any criminal act committed in the company the tribunal may direct the liquidator to file a criminal complaint against persons involved in that act. It may also order to protect, preserve and enhance the assets of the company.<sup>22</sup> An Advisory committee for the inspection of books of accounts and other documents can be set up and meetings shall be convened by the CL. <sup>23</sup> The tribunal has the power to arrest any person who is in the possession of any useful information and documents and is about to leave India or trying to conceal his properties and seize such documents relevant to the matter.<sup>24</sup> At last, if tribunal thinks that it is just and equitable to wind up the company it shall order for the dissolution of company and it will be carried out accordingly.<sup>25</sup> Any appeal from such orders can be challenged in NCLAT which is the competent authority<sup>26</sup>.

One of the questions which are much disputed is that whether in the petition of winding up of company can the petitioners claim for the debt and its interest thereon? The answer to this question can be given by case of *Jyothi Ltd. v. Boving Fouress Ltd.*<sup>27</sup>. Jyotji Ltd had supplied generators to the respondent company. The company failed to pay the debts. Therefore a winding up petition was filed by the petitioner company. In the claim for the recovery of debts the petitioner company also claimed for liability of payment for the interest thereon. During the pendency of the petition the respondent company paid the debt but refused to pay for the interest liability. The court in this case held that the petition for winding up cannot include the claim for recovery of interest due or the claim for recovery of debts. The only matter before the court is to determine that whether the company is able to pay its debt or in other words whether the company has become commercially insolvent?

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<sup>20</sup> IBID

<sup>21</sup> S. 280 of Companies Act, 2013.

<sup>22</sup> S. 282 of CA, 2013

<sup>23</sup> S. 277 of CA, 2013

<sup>24</sup> S. 301 of CA, 2013.

<sup>25</sup> S. 302 of CA, 2013.

<sup>26</sup> S. 303 of CA, 2013.

<sup>27</sup>[2001] 3 Comp LJ 413 (Karn)

The High Court of Madras and Delhi earlier had given a view that the inability to pay the interest due is also the inability to pay debts and therefore company is liable to be dissolved. This was based on the reason of S. 433(e) of Interest Act, 1972 which provides that non payment of interest would constitute an inability to pay debts. Therefore the petition for WU was maintainable. This was decided in *Stephen Chemicals Ltd. v. Innosearch Ltd.*<sup>28</sup> wherein the Stephen Chemicals was aggrieved by the order of Division Bench to pay the debts of interest at twelve percent rate and relied on *Amalgamated Commercial Traders Ltd. v. A.C.K Krishnaswami*<sup>29</sup> in which the bona fide dispute of payment of interest along the petition of WU was held to be not maintainable. The court finally in this case followed Supreme Court that the liability of interest is maintainable so as to put pressure on the defaulter company.

It must also be considered that when the court approves for the payment of interest whether the person in whose favour the judgement is given should apply to civil court for recovery. The answer directly is no. It is because the forum and jurisdiction is only of the NCLT or competent authority to try the case and where the judges are already overburdened with the daily court matters there must not be multiplicity of suits on a single matter. Therefore, one does not have any right to move to civil court for recovery of damages, compensation or interests in company matters.

Another question which is relevant to discuss here is that whether the secured creditors have pari passu charge with the workmen if the company. According to Industrial Disputes Act there must be a workmen's portion in each company. The liquidator after recovering amount by selling the assets of the company must keep 25% of the amount for pay to workmen. These are known as overriding preferential payments. This question was at length discussed in *Jitendra Nath Singh V. Official Liquidator*<sup>30</sup> where the petitioner the workmen claimed to amount recovered from the sale of unsecured assets by the liquidator to be distributed to the workmen first. The court held that section 529 should be construed in a beneficial manner and therefore it provides for a deeming fiction in law that the security of the secured creditors would make a pari passu charge in favour of workmen to the extent of their portion only. The situation arises only when the secured creditors realises his debts and opting for the outside WU process instead of relinquishing his security or proving his debts (Inside WU process) ultimately resulting into the pari passu charge in favour of the workmen. The court had referred the judgement of *Andhra Bank v. Official Liquidator*<sup>31</sup>. New Tobacco Ltd was the subsidiary of Duncan Agro Industries Ltd. the properties of the Duncan Agro were transferred to New Tobacco Company. Andhra Bank was the secured financial creditor of subsidiary company and therefore filed for recovery of dues and winding up. The petition was granted by the court and a liquidator was appointed. The liquidator was directed by the

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<sup>28</sup> (1986) 60 Comp Cas 702

<sup>29</sup> (1965) 35 Comp Cas 456 SC.

<sup>30</sup> Arising out of SLP (C) No. 4104 of 2011.

<sup>31</sup> (2005) 5 SCC 75; See also Allahabad Bank v. Canara Bank and Another (2000) 4 SCC 406; UCO Bank v. Official Liquidator (1994) 5 SCC 1.

court to sell the assets of the company and pay the wages of the workmen. The direction was criticised by many court holding error and incorrect in law as there were no proper reasons assigned.

The claims of secured creditors surely hold priority and above the unsecured creditors but workmen and secured creditors hold the pari passu charge over the debts. Basic principle enunciates that workmen hold the priority for the payments of debts but so does the secured creditors as they are protected under section 529A and therefore both are on equal footing for the payments.

**LANDMARK CASES: VYSYA BANK V. OFFICIAL LIQUIDATOR, SHREENIWAS COTTON MILLS LTD.<sup>32</sup>**

The company Shreeniwas Cotton Mills Ltd. was ordered to be wound up and a liquidator was appointed. The company was in debt to Vysya Bank which has discounted some bills in the favour of the company. The Bank had filed a suit to recover the money. The bank had to take the leave of the court to file the suit as the company was ordered to be wound up. The single judge referred to the decision of supreme court in *Bansidhar Shankarlal v. Mohd. Ibrahim*<sup>33</sup> where the question was whether to take leave from the court for institution of fresh proceedings is a condition precedent. According to S. 446<sup>34</sup> the suit can be only after taking leave of the court when the winding up order by the court has been passed. Therefore all the pending suits and proceedings will be stayed and no fresh suits can be instituted by or against the company except by leave of the court. The legislative intent of this section is to safeguard the company and protect its rights and claims. False and frivolous suits against the company can be taken out by the court before its institution. Therefore, in *Bansidhar*<sup>35</sup> case the Supreme Court held that it is not a condition precedent and leave can be granted ex- post facto. Thus, the court held in this case that leave can be granted under section 446.

**NATIONAL TEXTILE WORKERS V. RAMAKRISHNA<sup>36</sup>**

This case related to matter of employees, that whether they have locus standi in the winding up of company. In this case there were three workers union which had applied that they should be impleaded as respondents or interveners as their interest was being adversely effected because the winding up order of the company was passed and the court had restrained the company from borrowing any money from banks, financial institutions or from any other. The resources of the company were blocked and it was the employees who had to suffer at last for their wages. This application was rejected by the court and this decision was upheld by the division bench on appeal. The unions filed for special leave which was then

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<sup>32</sup> (1992) 94 Bom LR 303

<sup>33</sup> (1971) SCR 2 746. See also, *State of Bihar v. Saiyed Anisur Rehman* (1977) 47 Comp Cas 372.

<sup>34</sup> Companies Act, 1956

<sup>35</sup> (1970) 9 TMI 62

<sup>36</sup> 1983 SCR (1) 9 See also, *Fertilizer Corporation Kamgar Union and Oters v. Union of India and others* (1981) 2 SCR 52, *Balchandra Dharmajee Makaji and others v. Alcock Ashdown and Co. Ltd and Others* 42, Comp Cases 190.

granted to them. The five judge bench by majority held that the employees had a locus standi in the petition. As the principle of natural justice, audi alteram partem suggests that the other party should be heard and no decision should be given without hearing the other party. Although the employees may not have a say when the winding up order has been finalized but they must be given a opportunity of being heard before that. The workmen are the people whose livelihood will be put at risk as their services will end and they will have to search for work again in this situation. There is no provision in the law which bars the workers from having any say in these proceedings. Therefore, both the lower courts were in error for not allowing the stand of workmen in the winding up petition where their interests were seriously and adversely affected.

**CONCLUSION:** As the death of the company is drawn from the analogy of that the death of the man, we can clearly see that how a company liquidator compared to the power of attorney of man, takes custody of the assets and properties of the company and man respectively and disposes of them with proper procedure of the court. Anything done in contrary to the directions will be void and invalid. Once the winding up process begins the company can no longer carry on its business and it is considered to a termination notice for the employees. The company after the completion of liquidation stands dissolved and cannot keep its property. If the property still remains it goes to the government.