Karnataka High Court Kanchanaganga Chemical ... vs Mysore Chipboards Ltd. on 16 March, 1995 Equivalent citations: 1998 91 CompCas 646 Kar, ILR 1995 KAR 977, 1995 (2) KarLJ 85 Author: R Vasanthakumar Bench: R Vasanthakumar JUDGMENT R.V. Vasanthakumar, J. 1. This petition arises out of an action initiated for winding up of the respondent-company (hereinafter called "the company") under section 433(e) of the Companies Act, 1956 (hereinafter referred to as "the Act"). 2. The question that arises for consideration in this company petition is about the exercise of the powers of the company court in respect of a petition filed under section 433(e) of the Companies Act, 1956 (Central Act 1 of 1956), even before issuing notice regarding admission. 3. The petitioner claims to be a creditor of the respondent-company and has caused a notice dated December 3, 1994, to be served on the company. Even though there is no mention in the notice that the same has been issued under section 434(1)(a) of the Act there is a mention that the same be treated as a statutory notice under section 434 of the Act. There is a demand for payment of debt. After the expiry of the statutory period this company petition has been presented for winding up of the company on the averments that the company is unable to pay its debts. The relevant averments are found at para 11 of the petition. It reads : "The petitioner submits that the company is in dire financial distress. The total liabilities of the company far exceed its assets. The company has sustained losses of over Rs. 200 lakhs as on date. The company is not in a position to pay its debts and is commercially insolvent. Under these circumstances, it is just and proper to wind up the company. In support of the petition, the following documents are produced : Documents Annexures (1) Copy of the letter of confirmation, dated December 3, 1988, issued by the company acknowledging indebtedness in a sum of Rs. 76,141.02 A (2) Copy of the letter dated, November 30, 1994, issued by the company confirming the outstanding balance amount as on July 31, 1988, at Rs. 77,141.02 B (3) Copy of the notice dated, December 3, 1994, issued to the company by the petitioner demanding payment of outstanding purported to be issued under section 434 of the Companies Act. C (4) Copy of the reply dated December 5, 1994, issued by the company to legal notice, dated December 3, 1994, acknowledging and confirming the outstandings. D

4. Winding-up may be by two processes, one by voluntary winding-up and another by compulsory winding-up by the court. The essential difference between compulsory winding-up by the court and that of voluntary winding-up is that the former does not involve action taken by any organ of the company itself whereas voluntary winding-up does.
5. Under section 433 of the Act, the company may be wound up by the court on one or more of the grounds mentioned in clauses (a) to (f). Of these grounds by far the most important is ground (e), that the company is unable to pay its debts. Creditors are among those who may petition and this they are likely to do once it becomes widely known that the company is in financial difficulties like a petition for the bankruptcy of an individual. A petition for winding-up is the creditors' ultimate remedy

and the company is assumed to be insolvent and it is the creditors in whose interests the winding up is undertaken.

6. The ground on which the petitioner has sought winding up is that the company is unable to pay its debts both in the sense that it is actually unable to pay debts presently due and demanded and in the sense that it has reached a stage where, in the language of Sir William Jaes v. European Life Assurance Society [1869] LR 9 EQ 122 at page 128, it is plainly and commercially insolvent that is to say that its assets are such and its existing liabilities are such as to make it reasonably certain as to make the court feel satisfied that the existing and probable assets would be insufficient to meet the existing liabilities, language which seems to be the origin of the phrase "commercially insolvent". Further, it is to be noted that creditors for bringing the case within the clauses of section 434 of the Act depend on the notices sent and their liability having not yet been discharged. A proper demand made in accordance with the provisions of section 434(a) only gives the benefit of presumption that arises under it. Section 434 envisages the right of action to the creditor to initiate action for winding-up on the ground of the company's inability to pay its debts. Though a petitioning creditor whose debt is not paid has a right ex debito justitiae to a winding-up order, clause (a) of sub-section (1) gives a statutory right to a creditor to have the company wound-up.
7. To raise the presumption of inability to pay, it is not enough merely to show that the company has omitted to pay the debt despite service of statutory notice, it must be further be shown that the company omitted to pay without reasonable excuse and the condition of insolvency in the commercial sense exists.
8. Machinery for winding-up will not be allowed to be utilised merely as a means for realising debts due from a company. It is also well settled that a winding-up petition is not a legitimate means of seeking to enforce payment of debt. An order will not be made if a sufficient case is not stated in the petition even if such a case is proved in evidence. The petition must disclose the assets of the company and whether they are insufficient to meet the liabilities including contingent and prospective liabilities, and further it must disclose the position of fixed assets as well as valuation of plant and machinery of the company. The question is not whether at given time the company can pay all its debts whether presently due or only in future and still to continue to function but the question is whether it is able to meet current demands. It would of course be insolvent if it cannot do that even if it has assets not presently available but more than ample to pay its debts and is in that sense rich and whether its existing and probable assets would suffice to meet future demands, that if all demands were forthwith made upon it, it would be able to meet the demands only by mortgaging or selling its capital assets. Perhaps closing down does not mean that it is insolvent. If a man can by disposing of all his assets pay all his liabilities no one would think of calling him insolvent even if the result might be that as a result thereof he has to close down his business

undertakings or even sell his dwelling house. The position of a company is no different. Further what is to be noted is that mere production of the balance-sheet of the company would not by itself be decisive, even though ordinarily the court does not go behind the company's balance-sheet to ascertain its financial position, but this does not mean that the mere fact that a particular item appears in the balance-sheet under the head "Liabilities" conclusively establishes that that item is a liability of the company.

9. Although for balance-sheet purposes share capital is shown among liabilities, it is no more a liability of the company than losses which in the balance-sheet are shown among assets are an asset of the company. The subscribed but uncalled up capital of the said company was said to be about the first asset which one looks to in testing the solvency or insolvency of a company and if that be so it obviously follows that paid-up capital cannot be regarded as liability.
10. One thing to be borne in mind is that this is not a proceeding for recovery of money as such, but this is a proceeding for winding up of the company. The company court has to exercise its equitable jurisdiction. Materials have to be placed on record by the petitioner to prima facie substantiate the grounds raised in the petition. If details as to insolvency are wanting and no supporting documents are produced, then that petition without supporting documents cannot prove prima facie insolvency and the same could not be construed as satisfying the legal requirements and bona fides and the company court should not permit the petitioner to have a roving inspection into the company's documents for ulterior purposes. The question for consideration therefore is whether in the light of the working of the company as disclosed by the pleadings, supporting documents on record any case has been made out for ordering winding up. Further, it is to be noted that the mere fact that the company's assets are less than its liabilities is by itself no ground for sending the company for winding up. When the court is called upon to wind-up a company under clause (e) of section 433 what is to be considered is not whether the company if it converted all its assets into cash would be able to discharge its debts but whether in a commercial sense the company is insolvent, that is, whether it is unable to meet its current demands although the assets when released may exceed its liabilities. The petitioner has to place prima facie evidence that the company is commercially insolvent, that its existing assets, probable assets are insufficient to meet the existing liabilities, that the company is heavily indebted to various creditors, its assets being in mortgage or in pledge and that there is no possible chance of profit being made or its business being carried out.
11. In considering the commercial insolvency of a company under section 433, while it is not possible to regard the entire unpaid capital as available to its creditors at its face value, it is equally wrong to leave it out of consideration altogether regardless of the position and solvency of shareholders, on the one hand allowance must be made for the fact that some of the

shareholders may not be able to meet the call when made and those who have the means may not be willing to pay too readily.

12. The petitioner's counsel contends that when a company is not in a position and by virtue of deemed provision as envisaged under section 434(1) of the Act a presumption of inability to pay arises. What is to be noted is that in order to raise the presumption of inability to pay, it is not enough merely to show that the company has omitted to pay the debt despite service of the statutory notice, but further it should be shown that the company has omitted to pay without reasonable excuse.
13. It is to be stated that a winding up petition cannot be a substitute for filing a suit or any other remedy which may be available to it in accordance with law. Refusal to pay should be without any reasonable excuse and only in a case where the amount is a debt which can only be a definite sum without there being a dispute can it be said that the company is unable to pay its debt within the meaning of section 433(e) read with section 434(1)(a) of the Act.
14. It is relevant to note the observations of the Supreme Court in National Conduits (P.) Ltd. v. S. S. Arora . The relevant observations are : "Nothing in these rules shall be deemed to limit or otherwise affect the inherent powers of the court to give such directions or pass such orders as may be necessary for the ends of justice or to prevent abuse of the process of the court."
15. The law is settled that the company court can exercise its discretionary powers even before issuing a show-cause notice regarding admission. The court's attention is invited to the ratio decided in Airwings (P.) Ltd. v. Viktoria Air Cargo GmbH [1994] ILR 1994 Kar 2560; [1995] 84 Comp Cas 688, 703. The relevant observations are found at para 12 : "The aforesaid decision, therefore, squarely lays down three types of procedures which the company court can follow when a winding up petition is moved under section 433 of the Act :

(i) Before even admitting the petition, a show-cause notice can be issued to the company;
(ii) The court may admit the petition, fix the date for hearing and issue notice to the company before giving directions about advertisement; and
(iii) The petition may be admitted, the date of hearing may be fixed and also the petition may be directed to be advertised and all these exercises can be undertaken without issuing notice to the company. It becomes at once clear, therefore, that though nowhere in the Rules or the Act it is provided that notice to show cause to the company can be issued prior to admission and advertisement, the Supreme Court by judicial interpretation of the relevant schemes of the Act and the Rules, has taken the aforesaid view which has held the field throughout till date. But the moot question is under what circumstances, the last course can be adopted by the company court, namely, after hearing the petitioning creditor, the company court can order admission and advertisement without hearing the respondent-

company. In our view, such a course can be adopted safely in a case where after hearing the petitioner and assessing the material produced by the petitioning creditor before the company court, the company court finds that the respondent-company is a defunct company, it has closed its shutters, it has discharged its labour force and its commercial-cum-manufacturing activities have come to a grinding halt since a long time and it is not a temporary suspension thereof. In such a case on the principle that there will be no occasion to slay the slain, the petition can be admitted and advertised without issuing notice to the company. The reason is obvious. By such admission and advertisement of the petition, the respondent-company is not going to suffer a greater damage in the commercial world or its business is not going to suffer any more than what has already been suffered prior to the filing of such company petition. However, even in such a case, it cannot be disputed that before setting the law in motion, the court would require the petitioning creditor to show at least prima facie that there is a case for compulsory winding-up of a company on the ground that it is unable to pay its debts and is commercially insolvent. For that purpose, the petitioning creditor has to show that there is a debt due by the company to the petitioning creditor, it is of an ascertained or substantially ascertained sum of money, it is within limitation and it has not been paid by the company to the petitioning-creditor. He can also show whether the presumption under section 434(1)(a) or (1)(b) arises in the case. But even if such a presumption that the company is unable to pay its debts does not arise, such presumption can also be raised under section 434(1)(c) of the Act on the facts available on record about the financial doldrums in which the company is situated as it is a case of a defunct company. Therefore, as per this exercise after hearing the petitioning creditor alone the court if satisfied on these aspects can admit the petition and straightway direct advertisement of the company petition even without issuing notice to the respondent-company. But this procedure, as seen earlier, would be confined only to the peculiar facts and circumstances of the case as indicated above. If such a course is adopted, neither such a defunct company would suffer any more nor the petitioning-creditor will be put to extra burden as the gamut of advertisement has to be undertaken by him in all cases where he wants final relief from the court about compulsory winding-up of the company. This procedure will get expedited in such circumstances." Similarly, the Supreme Court in Hind Overseas Pvt. Ltd. v. R. P. Jhunjhunwalla , has observed. The relevant report is at para 34, which reads; “In an application of this type allegations in the petition are of primary importance. A prima facie case has to be made out before the court can take any action in the matter. Even admission of a petition which will lead to advertisement of the winding-up proceedings is likely to cause immense injury to the company if ultimately the application has to be dismissed. The interest of the applicant alone is not of predominant consideration. The interest of the shareholders of the company as a whole apart from those of other interests have to be kept in mind at the time

of consideration as to whether the application should be admitted on the allegations mentioned in the petition."

16. In Pradeshiya Industrial and Investment Corporation of Uttar Pradesh v. North India Petro Chemical Ltd. [1994] 79 Comp Cas 835 (SC), the Supreme Court has in detail laid down the requirements to be established even prima facie before getting a petition under section 433(e) admitted and advertised in paragraphs 26 to 33 of the judgment (pages 842-844 of Comp Cas). If from the materials on record it could not be made out that the company is commercially insolvent, then that petition could be dismissed even before issuing notice regarding admission. It is also salutary to note that judicial process should not be an instrument of oppression or needless harassment. There lies responsibility and duty on the courts to find whether the concerned company has become commercially insolvent for purposes of winding up. At the initial stage the court would be circumspect and judicious in exercising discretion and should take all relevant facts and circumstances into consideration before even issuing process regarding admission lest it would be an instrument in the hands of creditors as vendetta to harass the debtor company needlessly. Vindication of majesty of justice and enforcement of law are prime objects of justice and it should not be abused since the company petition for winding-up is an interest litigation.
17. In the instant case, the petitioner has failed to place necessary materials to warrant any exercise of powers under section 433(e) of the Act. Hence, the petition is dismissed.