Chapter 33 Winding Up

"Winding up is a means by which the dissolution of a company is brought about and its assets realized and applied in payment of its debts, and after satisfaction of the debts, the balance, if any, remaining is paid back to the members in proportion to the contribution made by them to the capital of the company."

"The liquidation or winding up of a company is the process whereby its life is ended and its property is administered for the benefit of its creditors and members. An Administrator, called a liquidator, is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights."

Thus, winding up ultimately leads to the dissolution of the company. In between winding up and dissolution the legal entity of the company remains and it can be sued in a court of law/Tribunal.

Dissolution

A company is said to be dissolved when it ceases to exist as a corporate entity. On dissolution, the company's name shall be struck off by the Registrar from the Register of companies and he shall also get this fact published in the Official Gazette. The dissolution thus puts an end to the existence of the company.

Dissolution of a company may be brought about in any of the following ways:

Through transfer of a company's undertaking to another under a scheme of reconstruction or amalgamation. In such a case the transferor company will be dissolved by an order of the Tribunal without being wound up.

Through the winding up of the company, wherein assets of the company are realized and applied towards the payment of its liabilities. The surplus, if any is distributed to the members of the company, in accordance with their rights.

Difference between Winding up and Dissolution

Basis	**Winding Up**	**Dissolution**
Meaning	Winding up is one of the method by which dissolution of a company is brought about.	Dissolution is the end result of winding up.

Existence of Company	Legal entity of the company continues at the commencement of the winding up.	Dissolution brings about an end to the legal entity of the company.
Continuation of Business	A company may be allowed to continue its business so far necessary for the beneficial winding up of the company.	Company ceases to exist on its dissolution.

Modes of Winding up

A company may be wound up in any of the following two ways:

1. Winding up by the Tribunal. (Section 270,271 272)
2. Insolvency and Bankruptcy Code 2016 (previously Voluntary Winding up section 304-323)

1. Compulsory Winding up

Winding up a company by an order of the Tribunal is known as compulsory winding up.

Ground of Compulsory Winding up

As per section 271, Tribunal may order for the winding up of a company on a petition submitted to it under section 272 on any of the following grounds:

1. **Passing of special resolution for the winding up.** When a company has by passing a special resolution resolved to be wound up by the Tribunal, winding up order may be made by the Tribunal. The resolution may be passed for any cause whatever. Tribunal may not order for the winding up if it finds it to be opposed to public interest or the interest of the company as a whole.

2. **Inability to pay debts.** As per section 271(2), a company shall be deemed to be unable to pay its debts under the following circumstances:

a) *Notice for payment*. If a creditor to whom the company owes a sum exceeding one lakh rupees has served on the company a demand for payment and the company has for three weeks thereafter neglected to pay the sum or otherwise satisfy the creditor, it shall be deemed that the company has become unable to pay its debt. It is essential that the debt is payable presently. Negligence in paying a debt on demand is omitting to pay without reasonable cause. Mere omission by itself will not amount to negligence. Further, where a debt is *bonafide* disputed, there is no negligence to pay. Failure to pay public deposits on their due dates amount to inability to pay debts. A dividend

when declared becomes a debt due by the company and the shareholder can also apply for company's liquidation if the company is unable to pay his dividend.

b) *Decree*. If a decree or order issued by a Tribunal/court in favour of a creditor of the company on execution remains unsatisfied on its execution.

c) *Commercial Insolvency*. It is proved to the satisfaction of the Tribunal that the company cannot pay its debts. This implies commercial insolvency (when company's assets are insufficient to meet its existing liabilities) of the company as is disclosed by its balance sheet. The mere fact that the company is incurring losses does not mean that it is unable to pay its debts, for its assets may be more than its liabilities. Liabilities for this purpose will include all contingent and prospective liabilities and even if the debt relied upon in the petition is disputed *bona fide*, the company may be wound up if the applicant can prove the insolvency of the company. However, non-payment of a *bona fide* disputed claim is no proof of insolvency.

3. Just and equitable. The Tribunal may order for the winding up of a company if it thinks that there are just and equitable grounds for doing so. The Tribunal has very large discretionary power in this case. This power has been given to the Tribunal to safeguard the interests of the minority and the weaker group of members. Tribunal, before passing such an order, will take into account the interest of the shareholders, creditors, employees and also the general public. Tribunal may also refuse to grant an order for the compulsory winding up of the company if it is of the opinion that some other remedy is available to the petitioner to redress his grievances and that the demand for the winding up of the company is unreasonable. A few of the examples of 'just and equitable' grounds on the basis of which the Tribunal may order for the winding up of the company are given:

(i) **Oppression of minority.** In cases where those who control the company abuse their power to such an extent that it seriously prejudices the interests of minority shareholders, the Tribunal may order for the winding up of the company.

(ii) **Deadlock in management.** Where there is a complete deadlock in the management of the company, the company may be ordered to be wound up.

(iii) **Loss of substratum.** Where the objects for which a company was constituted have either failed or become substantially impossible to be carried out, *i.e*., '*substratum* of the company' is lost.

(iv) **Losses.** When the business of a company cannot be carried on except at a loss, the company may be wound up by an order of the Tribunal on just and equitable grounds. But mere apprehension on the part of some shareholders that the company will not be able to earn profits cannot be just and equitable ground for the winding up order.

(v) **Fraudulent object.** If the business or the objects of the company are fraudulent or illegal, or have become illegal with the changes in the law, the Tribunal may order the company to be wound up on just and equitable grounds. However, the mere fact of having been a fraud in the promotion or fraudulent misrepresentation in the prospectus will not be sufficient ground for a winding up order, for the majority of shareholders may waive the fraud.

4. If the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years.

5. If the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality.

6. If on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up.

Who may file petition

An application for the winding up of a company has to be made by way of petition to the Court. A petition may be presented under Section 272 by any of the following persons:
(a) the company; or
(b) any creditor or creditors;
(c) any contributory or contributories;
(d) all or any of the parties specified above in clauses (a), (b), (c) together
(e) the Registrar;
(f) any person authorized by the Central Government in that behalf;
(g) by the Central Government or State Government in case of company acting against the interest of the sovereignty and integrity of India

Section 272 provides that the petition for compulsory winding up of a company may be filed in the tribunal by any of the following persons:

1. Company. A company can make a petition to the Tribunal for its winding up by an order of the Tribunal, when the members of the company have resolved by passing a special resolution to wind up the affairs of the company. Managing director or the directors cannot file such a petition on their own account unless they do it on behalf of the company and with the proper authority of the members in the general meeting. (Section 272(5))

2. **Creditors.** A creditor may make a petition to the Tribunal for the winding up of the company, when he is able to prove that the company is unable to pay off his debts exceeding Rs. 1, 00,000 within three weeks of the notice of demand or where a decree or any other process issued by the Tribunal in favour of a creditor of a company is returned unsatisfied in whole or in part. Law does not recognize any difference between the secured and unsecured creditors for this purpose. 'A secured creditor is as much entitled as of right to file a petition as an unsecured creditor.' But in case of secured creditor's petition, winding up order shall not be made where the security is adequate and no other creditor supports the petition.

A contingent or prospective creditor can also file a winding up petition if he obtains the prior consent of the Tribunal. The Tribunal shall grant the permission only when:
(*i*) It is satisfied that there is a *prima facie* case for the winding up of the company; and
(*ii*) The creditor provides such security for costs as the Tribunal thinks reasonable.
The Tribunal may, before passing a winding up order, on a creditor's petition, ascertain the wishes of other creditors. If the majority of the creditors in value oppose, and the Tribunal having regard to the company's assets and liabilities considers the opposition reasonable, it may refuse to pass a winding up order.

3. **Contributories.** A contributory3 shall be entitled to present a petition for the winding up of a company, notwithstanding that he may be the holder of fully paid-up shares, or that the company may have no assets at all or may have no surplus assets left for distribution among the shareholders after the satisfaction of its liabilities, and shares in respect of which he is a contributory or some of them were either originally allotted to him or have been held by him, and registered in his name, for at least six months during the eighteen months immediately before the commencement of the winding up or have devolved on him through the death of a former holder. (Section 272(3))

4. **Registrar.** Registrar may with the previous sanction of the Central Government make petition to the Tribunal for the winding up the company only in the following cases:

a) when it appears that the company has become unable to pay debts from the accounts of the company or from the report of the inspectors appointed by the Central Government under section 210; or

b) If the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years.

c) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality.

d) if on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent

and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up.

2. The Insolvency and Bankruptcy Code 2016

The Insolvency and Bankruptcy Code passed by the Parliament is a welcome overhaul of the existing framework dealing with insolvency of corporates, individuals, partnerships and other entities. It paves the way for much needed reforms while focusing on creditor driven insolvency resolution.

BACKGROUND

At present, there are multiple overlapping laws and adjudicating forums dealing with financial failure and insolvency of companies and individuals in India. The current legal and institutional framework does not aid lenders in effective and timely recovery or restructuring of defaulted assets and causes undue strain on the Indian credit system. Recognizing that reforms in the bankruptcy and insolvency regime are critical for improving the business environment and alleviating distressed credit markets, the Government introduced the Insolvency and Bankruptcy Code Bill in November 2015, drafted by a specially constituted 'Bankruptcy Law Reforms Committee' (**BLRC**) under the Ministry of Finance. Trilegal worked with the BLRC to assist with the drafting of the bill.

After a public consultation process and recommendations from a joint committee of Parliament, both houses of Parliament have now passed the Insolvency and Bankruptcy Code, 2016 (**Code**). While the legislation of the Code is a historical development for economic reforms in India, its effect will be seen in due course when the institutional infrastructure and implementing rules as envisaged under the Code are formed.

THE CODE

The Code offers a uniform, comprehensive insolvency legislation encompassing all companies, partnerships and individuals (other than financial firms). The Government is proposing a separate framework for bankruptcy resolution in failing banks and financial sector entities.

One of the fundamental features of the Code is that it allows creditors to assess the viability of a debtor as a business decision, and agree upon a plan for its revival or a speedy liquidation. The Code creates a new institutional framework, consisting of a regulator, insolvency professionals, information utilities and adjudicatory mechanisms, that will facilitate a formal and time bound insolvency resolution process and liquidation.

Insolvency Resolution Process, during which financial creditors assess whether the debtor's business is viable to continue and the options for its rescue and revival; and

Liquidation, if the insolvency resolution process fails or financial creditors decide to wind down and distribute the assets of the debtor.

(a) *The Insolvency Resolution Process (IRP)*

The IRP provides a collective mechanism to lenders to deal with the overall distressed position of a corporate debtor. This is a significant departure from the existing legal framework under which the primary onus to initiate a reorganization process lies with the debtor, and lenders may pursue distinct actions for recovery, security enforcement and debt restructuring.

The Code envisages the following steps in the IRP:

(i) *Commencement of the IRP*

A financial creditor (for a defaulted financial debt) or an operational creditor (for an unpaid operational debt) can initiate an IRP against a corporate debtor at the National Company Law Tribunal (**NCLT**).

The defaulting corporate debtor, its shareholders or employees, may also initiate voluntary insolvency proceedings.

(ii) *Moratorium*

The NCLT orders a moratorium on the debtor's operations for the period of the IRP. This operates as a 'calm period' during which no judicial proceedings for recovery, enforcement of security interest, sale or transfer of assets, or termination of essential contracts can take place against the debtor.

(iii) *Appointment of Resolution Professional*

The NCLT appoints an insolvency professional or 'Resolution Professional' to administer the IRP. The Resolution Professional's primary function is to take over the management of the corporate borrower and operate its business as a going concern under the broad directions of a committee of creditors. This is similar to the approach under the UK insolvency laws, but distinct from the "*debtor in possession*" approach under Chapter 11 of the US bankruptcy code. Under the US bankruptcy code, the debtor's management retains control while the bankruptcy professional only oversees the business in order to prevent asset stripping on the part of the promoters.

Therefore, the thrust of the Code is to allow a shift of control from the defaulting debtor's management to its creditors, where the creditors drive the business of the debtor with the Resolution Professional acting as their agent.

(vi) *Creditors Committee and Revival Plan*

The Resolution Professional identifies the financial creditors and constitutes a creditors committee. Operational creditors above a certain threshold are allowed to attend meetings of the committee but do not have voting power. Each decision of the creditors committee requires a 75% majority vote. Decisions of the creditors committee are binding on the corporate debtor and all its creditors.

The creditors committee considers proposals for the revival of the debtor and must decide whether to proceed with a revival plan or liquidation within a period of 180 days (subject to a one-time extension by 90 days). Anyone can submit a revival proposal, but it must necessarily provide for payment of operational debts to the extent of the liquidation waterfall.

The Code does not elaborate on the types of revival plans that may be adopted, which may include fresh finance, sale of assets, haircuts, change of management etc.

(b) *Liquidation*

Under the Code, a corporate debtor may be put into liquidation in the following scenarios:

- ***(i)*** A 75% majority of the creditor's committee resolves to liquidate the corporate debtor at any time during the insolvency resolution process;
- ***(ii)*** The creditor's committee does not approve a resolution plan within 180 days (or within the extended 90 days);
- ***(iii)*** The NCLT rejects the resolution plan submitted to it on technical grounds; or
- ***(vii)*** The debtor contravenes the agreed resolution plan and an affected person makes an application to the NCLT to liquidate the corporate debtor.

Once the NCLT passes an order of liquidation, a moratorium is imposed on the pending legal proceedings against the corporate debtor, and the assets of the debtor (including the proceeds of liquidation) vest in the liquidation estate.

Priority of Claims

The Code significantly changes the priority waterfall for distribution of liquidation proceeds.

After the costs of insolvency resolution (including any interim finance), secured debt together with workmen dues for the preceding 24 months rank highest in priority. Central and state Government dues stand below the claims of secured creditors, workmen dues, employee dues and other unsecured financial creditors. Under the earlier regime, Government dues were immediately below the claims of secured creditors and workmen in order of priority.

Upon liquidation, a secured creditor may choose to realise his security and receive proceeds from the sale of the secured assets in first priority. If the secured creditor enforces his claims outside the liquidation, he must contribute any excess proceeds to the liquidation trust. Further, in case of any shortfall in recovery, the secured creditors will be junior to the unsecured creditors to the extent of the shortfall.

2. Insolvency Resolution Process for Individuals/Unlimited Partnerships

For individuals and unlimited partnerships, the Code applies in all cases where the minimum default amount is INR 1000 (USD 15) and above (the Government May later revise the minimum amount of default to a higher threshold). The Code envisages two distinct processes in case of insolvencies: automatic fresh start and insolvency resolution.

Under the automatic fresh start process, eligible debtors (basis gross income) can apply to the Debt Recovery Tribunal (**DRT**) for discharge from certain debts not exceeding a specified threshold, allowing them to start afresh.

The insolvency resolution process consists of preparation of a repayment plan by the debtor, for approval of creditors. If approved, the DRT passes an order binding the debtor and creditors to the repayment plan. If the plan is rejected or fails, the debtor or creditors may apply for a bankruptcy order.

3. Institutional Infrastructure

(a) *The Insolvency Regulator*

The Code provides for the constitution of a new insolvency regulator i.e., the Insolvency and Bankruptcy Board of India (**Board**). Its role includes: (i) overseeing the functioning of insolvency intermediaries i.e., insolvency professionals, insolvency professional agencies and information utilities; and (ii) regulating the insolvency process.

(b) *Insolvency Resolution Professionals*

The Code provides for insolvency professionals as intermediaries who would play a key role in the efficient working of the bankruptcy process. The Code contemplates insolvency professionals as a class of regulated but private professionals having minimum standards of professional and ethical conduct.

In the resolution process, the insolvency professional verifies the claims of the creditors, constitutes a creditors committee, runs the debtor's business during the moratorium period and helps the creditors in reaching a consensus for a revival plan. In liquidation, the insolvency professional acts as a liquidator and bankruptcy trustee.

(c) *Information Utilities*

A notable feature of the Code is the creation of information utilities to collect, collate, authenticate and disseminate financial information of debtors in centralised electronic databases. The Code requires creditors to provide financial information of debtors to multiple utilities on an ongoing basis. Such information would be available to creditors, resolution professionals, liquidators and other stakeholders in insolvency and bankruptcy proceedings. The purpose of this is to remove information asymmetry and dependency on the debtor's management for critical information that is needed to swiftly resolve insolvency.

(d) *Adjudicatory authorities*

The adjudicating authority for corporate insolvency and liquidation is the NCLT. Appeals from NCLT orders lie to the National Company Law Appellate Tribunal and thereafter to the Supreme Court of India. For individuals and other persons, the adjudicating authority is the DRT, appeals lie to the Debt Recovery Appellate Tribunal and thereafter to the Supreme Court.

In keeping with the broad philosophy that insolvency resolution must be commercially and professionally driven (rather than court driven), the role of adjudicating authorities is limited to ensuring due process rather than adjudicating on the merits of the insolvency resolution.