CONTENTS

Winding-up by Tribunals – An Insight

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☞ INTRODUCTION

Winding-up of a company is a mechanism envisaged under the Companies Act, 1956 (**"the Act"**) by which an Indian company is dissolved. The Act provides two modes for winding-up (a) voluntary winding-up, initiated by either the shareholders or creditors of a company; and (b) winding-up by an order passed by a tribunal. Once a company is wound up all its assets are utilized in settling the outstanding debts. The remaining assets, if any, are utilized in paying back the shareholders pro rata their contribution.

The focus of the present newsletter is on the circumstances where the tribunal may wind-up a company.

1. Circumstances of Tribunal's jurisdiction

Section 433 of the Act describes certain circumstances - discussed in-depth below - when the jurisdiction of the tribunal can be invoked. Different people can initiate the winding-up process: these include the company itself, its creditors, its contributories[1] or the Registrar of Companies (**"ROC"**) or any person authorized by the central or the state government. The *locus standi* of the applicant depends upon the circumstances in which the proceedings are initiated. For example, in case a company is unable to pay its debts then either the company or its creditors will be entitled to move the petition.

As a matter of procedure before such proceedings are initiated, shareholders approval has to be obtained. The approval can be either by way of an ordinary[2] or a special resolution.[3] The choice for passing ordinary or special resolution depends upon the ground(s) on which a company intends to dissolve. For instance, where a company does not commence business within a year of its incorporation or where it has suspended its operations or where it is unable to pay its debts, then an ordinary resolution will suffice. However, where the decision is beyond the ambit of Section 433 – say, where a company is running into losses or where it intends to venture into a new area of operation then a special resolution is mandatory. Upon passing the resolution a company is under an obligation to present a petition before the tribunal.

The following eight grounds describe various situations which can be the basis for dissolving a company. Some of these grounds relate to statutory non-compliances, which theoretically entitle various persons (indicated in each ground) to apply for dissolution, but practically prior to taking the extreme step of dissolving a company the law also provides alternatives which, to some, may appear contradictory. For example, a company may either seek an extension from the appropriate statutory authority for a time-bound activity or pay a penalty for the default. Thus, non-compliances can be a ground for winding-up; however, at the same time the Act provides the remedy in case of default.

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[1] Under section 428 of the Act contributory is a person who is under an obligation to contribute to the assets of a company in the event of its winding-up.

[2] Ordinary resolution is a resolution passed in a general meeting which is approved by a simple majority of shareholders present and voting.

[3] Section 189 of the Act provides that a special resolution must be passed by majority of at least three-fourth of such shareholders who are entitled to vote, at a general meeting of which notice specifying the intention to propose the resolution as a special resolution is duly given. Thus, the notice must expressly stipulate that the resolution will be a special resolution.

1.1 Default in delivering statutory report or conducting statutory meeting

A public limited company must convene,[4] once during its life, a statutory meeting. The Act provides that a company limited by shares or guarantee having a share capital must within one month of obtaining a certificate of commencement of business, convene a general meeting - statutory meeting-of the shareholders - in order to enable the shareholders to know aspects pertaining to the formation of a company. Before convening the statutory meeting a company is under an obligation to forward a report to its shareholders containing details regarding to the number of shares allotted, cash received, and details of directors.

If a public limited company defaults in convening a statutory meeting or delivering a statutory report, then the ROC or the contributories are empowered to invoke the jurisdiction of the tribunal. However, section 165 of the Act, which imposes an obligation to convene a statutory meeting provides that in case of a default every director or officer will have to pay a penalty, which may extend unto INR 5000 (US $ 125). Therefore, while failure in convening the statutory meeting is a ground for dissolution, yet the Act simultaneously provides for an alternative. As a consequence, there are no known cases where judicial intervention was sought for winding-up on this ground.

1.2 Non-operational or defunct company

The tribunal is empowered to dissolve, at the behest of a company/ its creditors/ROC/recommendation by the central or the state government-where a company has suspended its operation from one year since incorporation. A company is considered as having suspended its operations or non-operational or defunct where its operations have come to a standstill and, there is no likelihood of resuming and, as a consequence the company has become commercially dead.[5] However, in certain cases even though the operations of a company are suspended it may not necessarily be considered as defunct. For instance, where a company had suspended its operations for few years but there was nothing to suggest that there was impossibility for resuming the operations[6] or where a company has various units and they decide to withdraw business from one of their units[7] then, courts have held that such a company cannot be construed as defunct.

While adjudicating the tribunal focuses on various factors ranging from profitability, the reason why a company has failed to operate, whether it has any intention of carrying on the business and the likelihood of commencing the business as well as any mode available for revival. However, where no reasonable prospects for revival are available, the tribunal may order dissolution.[8]

1.3 Shareholders below the statutory limit

The Act prescribes that the minimum number of shareholders required is two (2) in case of a private limited company and seven (7) in case of a public limited company.[9] Where the number of shareholders is reduced below the statutory limit, then the jurisdiction of the tribunal can be invoked by the ROC. However, the Act contains a contradiction because it provides that where the shareholders are below minimum and a company continues its business for more than six months, then the remaining shareholders shall be liable for the debts of a company[10] thereby implying that the remaining shareholders can continue.

1.4 Bankruptcy or inability to pay debts

Debt is a definite sum and excludes contingent or conditional liability unless the contingency or the condition has already occurred.[11] Inability to pay debt arises when a company undergoes financial crisis. In such situations it is

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[4] Section 165 of the Act.

[5] China Shipping Development Company Limited vs. Lanyard Foods Limited (Company Petition 420 of 2006-Bombay High Court).

[6] Registrar of Companies vs. Bihar Wire and Wire Products Pvt. Limited (1975)45CC194 (Pat.).

[7] Paramjit Lal Badhwar vs. Prem Spinning and Weaving Mill Co. Ltd (1986) 60 Comp. Cases 420 (All.).

[8] New Swadeshi Mills of Ahmedabad vs. Dye-Chem Corporation (1986)59 Comp Cases 183 (Guj).

[9] Section 12 of the Act.

[10] Section 45 of the Act.

[11] P.K Varghese vs. J.T.V Metal (P) Limited (1988) 63 Comp. Cases 644 (Kant.).

neither economically nor commercially viable to run the business and the company or its creditors consider dissolution. For instance, in a case the balance-sheet of a company showed that the total realizable assets of the company were over six hundred thousand rupees versus liabilities of over one million rupees there was no mode for revival. The court held that the company had become financially unsound and was unable to carry business and was dissolved.[12] Needless to say, the facts are circumstances of each case are different and the courts pass a winding-up order based on the merits.

It is noteworthy that a winding-up petition cannot be used as an alternative for realizing the debt as such a tactic would tantamount to blackmailing or stigmatizing a company. The idea behind a petition on this ground is that a company is in genuine financial crisis and unable to settle the dues of its creditors. For example, where a creditor with an intention to extract money from a company files a petition based on an un-acknowledged debt, then the tribunal will deny dissolution.[13] The tribunal first ascertains the reasons why a company is unable to pay the outstanding debts. In the course of its inquiry, it will go into the merits of the case and evaluate whether the financial crisis is caused due to deliberate actions of the shareholders/officers or by market conditions. Merely because the tribunal is empowered does not bind the tribunal to order dissolution.

1.5 Just and equitable ground for winding-up

In certain situations a company may be dissolved on principles of justice and equity at the instance of the creditors, shareholders, ROC and the central or the state government. Whether it is just and equitable to dissolve depends upon the merits of each case and, therefore, there are no straight jacket formulae which can be applied. The tribunal focuses on whether there is any misconduct on the part of the management or a company as a result of which they should be disallowed to carry business. If it is found that there is misconduct which cannot be rectified, then the tribunal may order dissolution. Alternatively, the tribunal explores remedies available for revival. Assuming an alternative remedy is possible, the tribunal will refrain from dissolving a company. In a matter before the Delhi High Court a dispute between two joint venture partners led to a deadlock. One of the parties moved a petition before the court seeking to wind-up the company. While adjudicating the court, with the consent of the petitioner, made a proposal to the respondents to purchase the entire shareholding of the petitioner and modify the corporate name of the joint-venture so that the petitioner's name was deleted. The respondents accepted and, consequently, the tribunal did not order winding-up.[14]

1.6 Default in filing annual accounts

Under the Act, it is mandatory for every company to file the audited balance sheet and profit and loss accounts[15] with the ROC within 30 days after shareholders' approval. If a company defaults in filing its annual returns with the ROC for five consecutive years then under section 433 (g) the jurisdiction of the tribunal can be invoked by the ROC. However, such a provision will be inapplicable where a company has become defunct i.e. it does not carry out any operations.

1.7 Company acting against public policy

A company should conduct its affairs in a manner which is not prejudicial to the interest of the public or which hampers the sovereignty, integrity, and security of the state. Where a company operates in a manner which is against the interest of the state then the tribunal may dissolve a company. Activities which unacceptable by the public or which are against the interest of the community at large will be considered as against public policy - for instance, money laundering. It is important to note that a petition can be made either by the central or the state government. However, there are no known cases where the government has exercised such powers.

[12] Registrar of Companies vs. KT. Financiers Private Ltd. (1978) 48 Comp. as. 129 (All.).

[13] Deutsche Homöopathie-Union DHU-Arzneimittel GmbH and Co. KG vs. R.K Import Private Limited and German Homoeopathic Distributors Private Limited 141(2007) DLT378.

[14] Dragerwerk AG vs. Usha Drager Private Limited (2007)75SCL355 (Delhi).

[15] Section 220 of the Act.

1.8 Winding-up of a sick industrial company

The tribunal is also empowered to wind-up an industrial company at the behest of the Board of Industrial Finance and Reconstruction[16] or where it is of the view that a company has become "sick" and it is not economically viable to run it. A company is considered as "sick" where it has failed to make the net worth[17] positive within a reasonable period. A reasonable period depends on a case-to-case basis. Though there is a special enactment - The Sick Industrial Companies (Special Provisions) Act, 1985 - for sick industrial companies, yet only the tribunal is entrusted with the power to wind-up a sick company.

☞ CONCLUSION

The Act though envisages the circumstances under which a company can be dissolved, however only few of the enumerated grounds are applied practically. The companies generally avoid approaching the tribunal for dissolution since it is a long and a tedious process which takes years to complete. Before resorting to winding-up companies explore all the options available for revival or restructuring by venturing into other areas of business or amalgamating with another entity. Dissolution is applied only in cases where no other remedies are efficacious enough to protect the general interest of a company.

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[16] Board of Industrial Finance and Reconstruction is a board constituted under the Sick Industrial Companies (Special Provisions) Act, 1985 which determines whether a company can be termed as "sick" or not, and what are the remedies available for reviving a sick company.

[17] Section 2 (29A) of Sick Industrial Companies (Special Provisions) Act, 1985 defines net worth as the sum total of the paid-up capital and free reserves after deducting expenses.

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