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WINDING UP OF COMPANIES ON JUST AND EQUITABLE GROUNDS.

By

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Winding up as applied to a partnership or company is the operation of stopping the business, realising the assets and discharging the liabilities of the concern, settling any questions of account or contribution between the members and dividing the surplus assets (if any) among the members. A company once incorporated under the Companies Act cannot put an end to except through the machinery of winding up.

In a nutshel the winding up or liquidation of a Company is a proceeding in which all its affairs are wound up, its rights and liabilities ascertained, and the claims of its creditors paid off out of the assets of the company including the contributions by its members to the extent to which they may be necessary. If any surplus assets are left, they are divided among the shareholders of the company in proportion to their rights under the articles. This being done, the company is dissolved on compliance with the requisite formalities prescribed by the Act.

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It is essential to know in this connection that winding up of a company is not the same thing as the bankruptcy of a company, for the general rule in regard to winding up is that of the members of a company desire that the company should be dissolved or if it becomes insolvent or is otherwise unable to pay its debts, or if for any reason it seems desirable that it should cease to exist, it is wound up. It is therefore obvious that a company may be wound up even when it is perfectly solvent, e.g., for the purpose of reconstruction. On the other hand, a company can never be declared bankrupt although it is unable to pay its debts. It can only be wound up, when some provisions of insolvency law are made applicable to companies in liquidation.

The position is thus, that in so far as inability to pay debts is concerned, a bankruptcy of an individual under the insolvency law is the same thing as a winding up of a company under the company law, but a company can also be wound up for reasons other than mere inability to pay its debts e.g. where a company or its members want its re-incorporation with extended objects or amalgamation with one or more other companies.

It should also be mentioned here that an order winding up a company does not by itself put an end to its existence. As observed by Viscount Caul " a company in liquidation, though the administration of its affairs has passed to the liquidator, retains its complete existence. If the liquidation should be annulled the company will resume its powers". (Employees Liability Assurance Corporation v. Sedgwick. 1927 A.C. 95)

According to the Companies Act, both English and India, there are three kinds of winding up, namely,

(1) Compulsory winding up by the court.

(2) Voluntary winding up without the intervention of the court, and

(3) Voluntary winding up under the supervision of the court.

Section 425 of the Act lays down these three methods of winding up and provides that the provisions of the Act with respect to winding up shall apply, unle s the contrary appears, to the winding up of a company in any of these three modes.

In every winding up, a liquidator or liquidators is or are appointed to administer the property of the company, and he or they must apply the assets of the company, first, in the payment of the creditors in their proper order and then, distributing the residue among the members according to their rights.

Circumstance in which Company may be wound up by the Court.

A Company may be wound up by the Court under Section 433, when,

(i) If the Company has, by special resolution, resolved that the company be wound up by the Court,

(2) If default is made in delivering the statutory report to the Registrar or in holding the statutory meeting, or

(3) it does not commence business within a year from its incorporation or suspends business for a year, or

(4) the number of its members falls below seven (*in case of a private company, below two*) or

(5) it is unable to pay its debts, or

(6) the court is of opinion that it is just and equitable that it should be wound up.

Under cl.(1), a company may be wound up for any cause whatever, if it passes a special resolution to that effect, An application on this ground is not very frequent for the shareholders may prefer a voluntary winding up rather than a winding up by the Court. If, however, such a resolution is passed by the shareholders, that affords thecourt jurisdiction to wind up the company.

For cl(ii), a petition for winding up a company can only be made either by the Registrar with the previous sanction of the Central Government or by a contributary on or after the expiration of 14 days after the last day on which the statutory meeting ought to have been held. The power of the court is discretionary. It may give directions for the statutory report to be filed or a meeting to be held and refuse to order the winding up of the company. It may also make the person responsible for the default in costs.

Under cl.(iii) also the power of the Court to wind up a company is discretionary and will not be exercised unless there are indications that the company has no intention of commencing its business or where the delay has been sufficiently accounted for and there is no evidence of an improbability of its commencing its business within a reasonable time. But a Company will not be wound up because it has ceased to carry on one of its several business unless that business is the main object of the company, nor can a company which has amalgamated withanother be wound up on the ground that it has ceased to carry on business as a separate company. In this case, the proper, course is to move the Registrar to strike the company's name off the register as a defunct company.

Under cl. (iv), a company is generally wound up voluntarily, and it is not very frequent that the Court orders the winding up under this clause.

As to cl. (v) we have to consider when a company should be deemd to be unable to pay its debts. Section 434 of the Act lays down specific instances when the company shall be deemed unable to pay its debts. They are:-

(i) if a creditor by assignment or otherwise to whom the company owes a sum exceeding Rs.500 then due has served on the company a demand for payment, and the company has for three weeks thereafter neglected to pay it or to secure or compound for it to the reasonable satisfaction of the creditor.

(ii) if execution or other process issued on a decree or order of any court in favour of a creditor is returned by the company unsatisfied the whole or part, and

(iii) if it is proved to the satisfaction of the court that the company cannot pay its debts, and in determining whether it is unable to pay its debts, the court shall take into account the contingent or prospective liabilities of the company.

If any of these instances be proved, the company may be wound up by the court. In the first case, it is really no necessary for the court to inquire whether the company is infact solvent or not, nor can any such inquiry be

undertaken by it. It will be sufficient for the purpose of the section if there be a failure on the part of the company to meet the creditors demand within the time prescribed by the statute.

But the machinery for winding up will not be allowed to be utilised merely as a means for realising debts due from a company. As the Supreme Court points out in Amalgamated Commercial Traders Ltd. v. Krishnaswami, 1965, 2: Comp.L.J. 128

> "it is well settled that" a winding up petition is not a legitimate means of seeking to enforce payment of the debt which is bonafide disputed by the company. A petition presented ostensibly for a winding up order but really to exercise pressure will be dismissed, and under circumstances may be stigmatised as a scandalous abuse of the process of the court. At one time petitions founded on disputed debt were directed to stand over till the debt was stablised by action: If, however, there was no reason to believe that the debt, if established, would not be paid, the petition was dismissed. The modern practice has been to dismiss such petitions. But, of course, if the debt is not disputed on some substantial ground the court may decide it on the petition and make the order---------- If the debt was bonafide disputed, as we hold it was, there cannot be "neglect to pay" within section 434(i)(a) of the Companies Act. If there is not neglect, the deeming provision does not come into play and the ground of winding up, namely, that the Company is unable to pay its debts is not substantiated."

In fact, a petition for winding up made with a view to enforcing payment of disputed debt amounts to an abuse of the process of the court and will be dismissed with costs.

The expression 'unable to pay its debts' should be taken in the commercial sense of being unable to meet current demands, though the company may have large assets. But the fact that liabilities exceed assets does not necessarily show that the company is unable to pay its debts. It may still be in a position to meet the demands of creditors as and when they are made.

The test is whether the company has reached a stage where, in the words of Sir William James, V.C. 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."

Thus in all cases the question is, not whether the company can pay all its debts whether presently due or payable in future, and continue to function, but whether it is able to meet its current demands and whether its existing and probable assets would suffice to meet future demands.

Cl.(vi) of 433 is the most general clause under which petitions for compulsory winding up are usually made. The words 'just and equitable' in the clause are not to be contrued 'ejusdeem generis' with the matters specified in clause (i) to (v) described above as it was at one time held. They are words of widest significance and do not limit the jurisdiction of the court to any case. It is a question of fact, and each case must depend on its own circumstances.

The words 'just and equitable' in cl.(vi) will have to be construed in a manner to fit in with the scope and purpose of the Act, after taking into regard to the detailed provisions of the present Act, as regard the promotion; formation and management of companies, and rights given to the shareholders, the Registrar, and the Central Government in respect of many matters touching the affairs of Companies, including the right to present an application for winding up. Taking into account all the facts and circumstances of the case, the Court will have to see whether there is anything in the management and conduct of the company which shows to the court that it should no longer be allowed to continue. But the doing of an unauthorised business and entering into ultra vires transactions will not furnish a just and equitable ground for an order of winding up.

Under the 'just and equitable' clause, the discretion of the court is wide and has been exercised on a variety of grounds. Thus, winding up orders have been passed in the following cases:-

1. When there is justifiable lack of confidence in the conduct and management of the company's affairs owing to the management being held in one family which dominates the other shareholders and monopalises the company's affairs for their own individual benefit.

2. Where the company becomes commercially insolvent.

3. Where the majority of the shareholders were using their powers unfairly or were guilty of oppressing the minority and mismanagement of the company.

4. Where there is a strong suspecion of irregular and improper proceedings in connection with the formation or the conduct of the company.

5. Where there is preponderating influence of some shareholders whose conduct requires investigation, but who by reason of the majority of votes commanded by them, prevent the necessary resolution for winding up being passed.

6. Where there is a deadlock in the management of the company on account of there being no properly constituted board of Directors.

7. Where the business contemplated by the Company at the date of its formation has become substantially impossible.

8. Where the whole or substantially the whole of the paid up capital has disappeared without any hope of recovery.

9. Where it is necessary to defeat a reconstruction scheme which is prejudicial to the interest of the shareholders.

10. Where the whole object of the company is fraudulent, and

11. Where the substraction of a company is gone - it is deemed to be gone when the subject matter of the company is gone, or the object for which the company was incorporated has substantially failed, it is impossible to carry on the business of the company except at a loss, or the assets, existing or probable are insufficient to meet the existing liabilities.

Under this 'just and equitable' clause the court will not make an order for winding up, of the petitioner has another remedy to have the matters complained of by him rectified, as, for instance, an application under section 397 or 398 or an injunction to restrain ultra vires or illegal acts or the requisition to call a general meeting and have the matters rectified and settled by the general body of shareholders.

The cases usually coming under this clause are therefore, cases of deadlock in the management, where the substraction of the company is gone and cases of fraud and of oppression of a minority by the majority.

In such cases, the court is not to take into consideration the nature of the petitioners in presenting the application for winding up of the company.

Lack of confidence, in order to sustain a winding up petition must arise from a lack of probity in the conduct of the company's affairs, e.g. where a father and two of his sons were the only, shareholders of the company and on the father's death, the latter in exercise of their discretion under the article refused to register the transfer of their fathers shares in the name of their three other brothers to whom they were bequethed by the father, it was no ground for winding up the Company. Infact, a winding up petition in such cases is misconceived, having regard to the existence of an alternative and more effective remedy by way of a petition for rectification of the register or a regular suit. Merely an ultra vires transaction on the part of the directors is of itself also no ground for a winding up order.

'Oppression of minority shareholders' will be a just and equitable ground, where those who control a company exceed or abuse their power to such an extent as to seriously prejudice the interests of minority shareholders. The court will be justified in interfering

in such a case, even though the general principle of company law is that the proper forum for settlement of "indoor affairs" of a company is a general meeting of the company. But the court will not make an order of winding up unless it is proved that wrong has been done to the company by abuse of majority voting power and it is impossible for the business of the company to be carried on for the benefit of the company as a whole owing to the way in which the voting power is held and used.

In the case of a private company, the principles to guide the court in determining whether or not a winding up order should be made are those which apply to determining whether or not a partnerships should be wound up.

Who may petition for winding up order?

An application to the court for the winding up of a company shall be by petition presented to it. Section 439 of the Act enumerates the persons who can make such petition: They are,

1. the company,

2. any creditor or creditors(including any contingent or prospective creditor or creditors)

3. a contributary or contributaries

4. all or any of these parties specified in cl.1,2, 3, together or separately,

5. the Registrar, and

6. any person authorised by the central Government in a case falling under S.243 of the Act, (relating to investigation of Company's affairs)

The Registrar shall not be entitled to present a winding up petition:-

(i) unless he is authorised to do so by the Central Government under s.243 (relating to investigation of company's affairs) or

(ii)unless the following grounds exist,e.g.

(a) failure to deliver the statutory report or to hold the statutory meeting.

(b) failure of the company to commence its business for a whole year,

(c) reduction of the number of members in the case of a public company below seven and in the case of a private company below two,

(d) inability to pay its debts,

(e) or if the court is of opinion that it is just and equitable that the company should be would up.

In the case of inability to pay its debts, it must appear to the Registrar either from the financial condition of the company as disclosed in its balance sheet or from the report of a special auditor appointed under s.233 A or an inspector appointed under sec.235 or sec. 237 for investigation of the affairs of the Company, that the Company is unable to pay its debts. In each of such cases the Registrar shall obtain the previous sanction of the Central Government to the presentation of the petition on any of the grounds aforesaid The Central Government shall not accord its sanction unless the company has first been offered an opportunity of making its representations, if any.

A petition for winding up a company on the ground of default in delivering a statutory report to the Registrar or in holding the statutory meeting shall not be presented except by the Registrar or by a contributory or before the expiry of 14 days after the last days on which the statutory meeting aught to have been held.

A petition for winding up a company presented by a contingent or prospective creditor shall not be admitted untill leave of the court is obtained for the admission of the petition and such leave shall not be granted:-

(a) unless in the opinion of the court, there is a prema facie case for winding up the company and

(b) untill such security for casts has been given as the court thinks reasonable.

A policyholder in a Life Insurance company cannot apply to wind up a company as he is neither a contributory nor a creditor of the company, nor is company's workers union entitled to make any such application: On the other hand, the Government can make use of the machinery of winding up of a company in the High Court for enforcing a debt in the nature of revenue from the company and present a petition for winding up like any other creditor. As regards the petition by the company itself, it has been held that its directors can also file the petition for winding up even without obtaining the sanction of the general body of shareholders.

Procedure in compulsory winding up

The winding up of a company by the court shall be deemed to commence at the time of the presentation of the petition for winding up. Where before the presentation of a petition; a resolution has been passed by the company for voluntary winding up, the winding up shall be deemed to have commenced at the time of the passing of the resolution:

On hearing a winding up petition; the court may

(i) dismiss it, with or without casts or

(ii) adjourn the hearing conditionally or unconditionally or

(iii) make any interim order that it thinks fit, or

(iv) make an order for winding up the company with or without casts or any other order that it thinks fit.

Consequences of winding up order

On a winding up order make by a court, the official liquidator shall, by virtue of his office, become the liquidator of the company. He will be known as the official liquidator of the particular company in respect of which he acts, and not by his individual name.

On a winding up order, the company does not cause to exist. It exists as a corporate entity, but its management and administration are changed, the same being carried

on through the liquidator. No suit or other legal proceeding shall be commenced or continued against the company without the leave of the court and subject to such terms as the court may impose.

Any suit a proceeding by or against the company which is pending in any court other than that in which the winding up of the company is proceeding may be transferred to and also disposed of by that court (s.446 (3)). But it shall not apply to any proceeding pending the appeal before the Supreme Court or a High Court. (s.446(4)).

A winding up order once made shall operate in favour of all the creditors and the contributors of the company as if it had been made on the joint petition of a creditor and of a contributory (s.447).

Dissolution of company

When the court is of the opinion that the liquidator cannot proceed with the winding up of a company for want of funds and assets or for any other reason whatsoever and it is just and reasonable in the circumstances of case that an order of the dissolution of the company should be made, the court shall make an order that the company be dissolved from the date of the order and the company shall be dissolved accordingly. A copy of the order shall, within 14 days from the date thereof, be forwarded by the liquidator to the Registrar who shall enter in his books a minute of the dissolution of the company. If the liquidator makes default in forwarding a copy, he shall be punishable with fine which may extend to fifty rupees for every day during which the default continues. (s.481). If on such dissolution, any assets of the company remain undistributed, they pass to the Government as bona Vacantia (means goods without an apparent owner in which no one claims a property but the king).

The court has also got the power to declare the dissolution of a company void in appropriate cases under s.559 of the Act, where a company has been dissolved as a result of the courts order or under s.394 of the Act (Provision for facilitating reconstruction and amalgamation of companies) or otherwise, the court may at any time within two years of the date of the dissolution; make an order on the application of the liquidator or of any other person interested in the company, and upon such terms as it thinks

fit; declaring the dissolution to have been void, and thereupon such proceedings may be taken as if the company had not been dissolved. Such applications are usually made where assets are found or recovered after the dissolution of the company and the court may exercise its jurisdiction under this section on the allegation and proof of fraud.

The person who obtains the order avoiding the dissolution must file a certified copy thereof with the Registrar within 30 days or such further time as the court may allow. In case of default, he will be punishable with fine to the extent of Rs.50 for every day during which the default continues.