

Winding-Up (Sections 425 – 560)

Contributories

Liability as contributories of present and past members (Section 426)

Question 1

By an order of the Court M/s ABC Limited was wound up with effect from 15.3.2002. Mr. Gupta, who ceased to be a member of the Company from 1.6.2001 received a notice from the liquidator to deposit a sum of ₹ 15,000 as his contribution towards the liability on the shares previously held by him. Mr. Gupta seeks your opinion about his liability. (November, 2002)

Answer

Liability of Contributory

'Contributory' is a term used in the case of winding up of a company. A Contributory can be past or present member and is liable to contribute to the assets of the company in the event of winding up.

In the instant case, Mr. Gupta ceased to be a member of the Company when it went into liquidation from 15.3.2002. Thus, Mr. Gupta will be treated as a past member. He will not be required to contribute to the assets of the company if the following conditions are fulfilled:

- (1) If Mr. Gupta had ceased to be a member of the company for a period of one year or upwards before the commencement of the winding up. In this case, since one year has not elapsed, Mr. Gupta will be liable to contribute to the assets of the company.
- (2) If the debt or liability of the company was contracted or incurred after he ceased to be a member.
- (3) If the present members are able to satisfy the contributions required to be made by them under the Act.

In any case, the liability of the past or present member cannot exceed the unpaid amount on the shares and if the shares are fully paid up, no contribution is required to be made by the members past or present.

Question 2

M/s XYZ Limited was wound up with effect from 15.3.2000 by an order of the court. Mr. A, who ceases to be a member of the company from 1.6.1999, has received a notice from the liquidator that he should deposit a sum of ₹ 5,000 as his contribution towards the liability on the shares previously held by him. In this context explain whether Mr. A can be called a contributory and whether he can be made liable and whether there is any limitation on his liability. (May, 2000)

Answer

Contributory is a term used in the case of winding up of a company. A contributory can be a past or present member and is liable to contribute to the assets of the company in the event of winding up. In the present case Mr. A ceased to be a member of the company when it went into liquidation from 15.3.2000. Thus Mr. A will be treated as a past member. He will not be required to contribute to the assets of the company if the following conditions are fulfilled:

- (a) If Mr. A had ceased to be a member of the company for a period of one year or upwards before the commencement of the winding up. In this case since one year has not elapsed, Mr. A will be liable to contribute to the assets of the company.
- (b) If the debt or liability of the company was contracted or incurred after he ceased to be a member.
- (c) If the present members are able to satisfy the contributions required to be made by them under the Act.

In any case, the liability of the past or present member cannot exceed the unpaid amount on the shares and if the shares are full paid up no contribution is required to be made by the members past or present [Section 426 of Companies Act, 1956].

Question 3

X Ltd. had gone into liquidation and a liquidator was appointed to administer the assets and liabilities of the Company. The liquidator of the Company finds that the assets of the Company are not sufficient to meet out the liabilities. He therefore, calls on the contributories including the past members as per List B to contribute towards the assets. The past members object to the liquidator's act on the ground that since they are no more members of the Company, they are not liable to contribute. Referring to the provisions of the Companies Act, 1956 decide:

- (i) *Whether the contention of the past member is tenable and can they be exempted from the liability to contribute?*
- (ii) *What would be your answer in case the members in question are the present members?* **(November 2009)**

Answer

In accordance with the provisions of the Companies Act, 1956, as contained in Section. 426, in the event of a Company being wound up every present and past member shall be liable to contribute to the assets of the Company to an amount sufficient -

- (a) for payment of (i) its debts and liabilities, and (ii) costs, charges and expenses of the winding up, and
- (b) for the adjustment of the rights of the contributories among themselves.

The liability of the present member i.e. as per List A shall be limited

- (i) in case of a Company limited by shares, to the amount remaining unpaid on the shares; and

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- (ii) in case of a Company limited by guarantee, to the amount undertaken to be contributed by him to the assets of the Company in the event of its being wound up.

However, in the winding up of a Company limited guarantee, which has a share capital, every member of the Company shall be liable, to contribute not only the amount undertaken to be contributed by him in the event of winding up but also to contribute to the extent of any sum unpaid on any shares held by him as if the company were a company limited by shares.

Liability of Past Members: (List B)

A past member shall not be liable to contribute:

- (i) if he has ceased to be a member for 1 year or more before the commencement of the winding up;
- (ii) in respect of any debt or liability of the Company contracted after he ceased to be a member;
- (iii) if it appears to the Court that the present members will be able to satisfy the contributions required to be made by them.

The past members can be called upon only after the Court has called upon the contributories in List A to pay and their contributions are found insufficient. In the case of a Company limited by shares a past member shall not be liable to contribute more than the amount unpaid on the shares in respect of which he is liable as such member:

Thus examining the above provisions, answer to the given questions shall be:

1. The past members' contention shall be tenable only:
 - (i) When they have ceased to be a member for 1 year or more before the commencement of the winding up of the Company.
 - (ii) If the liability of the Company was contracted after he ceased to be a member.
 - (iii) If it appears to the court that the present members will be able to satisfy the contributions required to be made by them.
2. In the second case, the present members shall be liable to the extent of the amount remaining unpaid on the shares in case of a Company limited by shares. In case of a Company limited by guarantee, to the amount undertaken to be contributed by him to the assets of the Company.

Question 4

Define "contributory" in a winding up. Explain the liabilities of contributories as present and past member.
(May 2011)

Answer**Contributory:**

According to Section 428 of the Companies Act, 1956 in a winding up, the term “contributory” means a past or present member liable to contribute to the assets of the company in the event of its being wound up and includes holders of shares which are fully paid up. If a member is once placed in the list of contributories, he is liable to the extent of original shares that remain unpaid, unless he proves that he should not have been placed in the list.

When a company goes into liquidation, every member, whether past or present, has to contribute to the assets of the company. However, a past member will not be required to contribute in the following circumstances:

- (a) if he had ceased to be a member for a period of one year or upwards before the commencement of winding up.
- (b) if the debt or liability of the company was contracted or incurred after he ceased to be a member.
- (c) if the present members are able to satisfy the contributions required to be made by them under the Act.

Winding-Up by Tribunal**(Cases in which companies may be wound up by the Tribunal)****Circumstances in which company may be wound up by Tribunal (Section 433)****Question 5**

XYZ Co. Limited has its subsidiary company PRM Ltd, which is formed to carry out some of the objectives of XYZ Co. Limited. XYZ Ltd suspends one of its several businesses, by passing a resolution at the company's extraordinary general meeting, with effect from 1st January 2006. The business so suspended continues to be suspended until March 2006. On 1st April 2006, a group of shareholders of XYZ Ltd file a petition in the court for winding of the company on the ground of suspension of business by the company.

Referring to the provisions of the Companies Act, 1956, decide:

- (1) *Whether the shareholders' contention shall be tenable?*
- (2) *What would be your answer in case XYZ Ltd suspends all its business?*
- (3) *Can shareholders of PRM Ltd. File a petition in the court for winding up of their company (PRM Ltd) on the ground that the holding company viz., XYZ Ltd has suspended its entire business, though PRM Ltd. has not suspended business?*

Answer

The problem relates to suspension of business by a company. Section 433 provides that if a company does not commence its business within a year from its incorporation or suspends its business for a whole year, it may be wound up by the court. The contention of the

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shareholders of XYX Ltd that the company is liable to be wound up in the ground so suspensions so business, is not tenable for the following reasons:

- (a) A company may be wound up by court if a company suspends its business for a whole year. Here the business was suspended only on 1. 1.97 . Hence on 1st April, 1997 the business has not been suspended for the whole year to attract Section 433(c)
- (b) Where a company having much business discontinues on of them, it cannot be said to have suspended business within the meaning of Section 433(c).
- (c) Where a company ceases to do any business but is a holding company of subsidiaries engaged in the pursuit of the business, which it was previously doing, it cannot be said that the company has suspended its business (Ref; Eastern Telegraph Company Ltd).

Question 6

RM Limited went for a public issue of Equity Shares (₹ 10 Crores) of ₹ 10 each. The shares were subscribed to an extent of 95% of the total issue. The shares of the company were accepted for listing by Bombay Stock Exchange but subsequently the permission was cancelled on certain grounds. On an appeal to the Central Government by the company, the decision of the Stock Exchange was held to be valid. As a result, the application money had become refundable to the allottees. The company, had no prospects of doing any business and there was a complete deadlock among the Directors. Looking at the circumstances, certain creditors filed a petition in the court for winding up of the company on the ground that the company had become commercially insolvent. The shareholders of the company object to the petition of the creditors. Decide giving reasons :

- (a) *Whether the objections of the shareholders will sustain and the court can dismiss the petition of creditors for winding up of the company?*
- (b) *State the provisions of the Companies Act, 1956 in this regard.*

Answer

- (a) Commercial Insolvency of RM Ltd.:

In this case three facts are given i.e.:

1. RM Limited went for a public issue and subsequently it was required to refund the amount received on application.
2. As a result, the company has no prospects of doing any business.
3. There was a complete dead lock among the directors.

These three circumstances may be construed as indicators of commercial insolvency of the company.

Section 433 (e) read together with Section 434 provides that a Court may order for winding up of a company if it is unable to pay its debts or deemed to be unable to pay its debts and it is proved to the satisfaction of the Court after taking into account all the

liabilities including the contingent and prospective liabilities of the company. Moreover, Section 439 gives powers to the creditors for filing an application for its petition for winding up. There are no chances for the sustainment of shareholder's objection. *Deccan Farms & Distilleries Ltd. vs. Velabai Laxmidas Bhaji* (1979). The Court has got wide discretionary powers regarding winding up. It may or may not dismiss the petition of creditors for winding up. Even if a winding up petition is a proper remedy against a company which is unable to pay its debts, the Court may in its discretion refuse to put an end to the life of the company [*Jugalkishore Banarsidas v. South India Saw Mills P. Ltd.* (1975)].

- (b) The Provisions of the Companies Act, 1956, which will apply in this case, are:
- (a) A company may be wound up by the Court, if the company is unable to pay its debts. [Section 433(e)].
 - (b) A company shall be deemed to be unable to pay its debts, if it is proved to the satisfaction of the Court that the company is unable to pay its debts, and in determining whether a company is unable to pay its debts, the Court shall take into account the contingent and prospective liabilities of the company. [Section 434 (c)].
 - (c) An application to the Court for the winding up of a company shall be by petition presented, subject to the provisions of this section, by any creditor or creditors, including any contingent or prospective creditor or creditors. [Section 439 (b)].

Question 7

Mr. X is an unsecured creditor and has to recover a sum of ₹ 7 lakhs from Global Footwear Company Limited. The said company has become financially insolvent and hence unable to pay its debts. With the object of recovery of the said amount Mr. X is willing to proceed for compulsory winding up of the company. Advise the steps and procedure in this relation under the provisions of the Companies Act, 1956 **(CA, Final, New Course, May, 2010)**

Answer

Procedure in case of Compulsory Winding-Up: Mr. X has to take the following steps to put the company into compulsory winding up:

1. A petitions for winding up of the company is to be filed in the high court, where the registered office of the company is located under section 439(l)(b) read with section 433(e) and (f) of the Companies Act, 1956. A copy of the petition should be served on the company.
2. The petition should be filled along with an affidavit showing sufficient ground for the appointment of a provisional liquidator till an order is passed by the High Court appointing an official liquidator (Rule 106 of the Companies (Court) Rules 1959).
3. After obtaining the winding up order from the high court the same should be advertised within 14 days in a newspaper in English language and in the regional language of the

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state where the company is registered (Rule 113 of the Companies (Court) Rules, 1959).

4. A certified copy of the winding up order passed by the court should be filed with the concerned Registrar of companies along with the prescribed fees within 30 days from the date of the winding up order (Section 445(i)).
5. The winding up proceedings will be carried out by the official liquidator till dissolution of the company.

Question 8

The Registrar of Companies, Mumbai filed a petition in the Bombay High Court for compulsory winding up of 'Constant Overtrading Ltd' on the ground that a perusal of the Balance Sheet of the company as at 31-03-2009 revealed that its liabilities far exceeded the assets and consequently the company is unable to pay its debts. Examine with reference to the provisions of the Company Act, 1956, the various factors the High Court will take into account before the company is ordered to be wound up compulsorily and whether there is any justification in the present case for the Court to order winding up of the company. **(May 2011)**

Answer

Compulsory Winding Up:

In the case law *Registrar of Companies Punjab vs. Ajanta Lucky Scheme and Investment Co. Private Ltd.*, the Registrar of Companies filed a petition for the winding up of the respondent company under Section 433 (e) read with Section 439(5) of the Companies Act, 1956 on the ground that the Company was unable to pay its debts and that its liabilities exceeded its assets. In the said case it was held by the Court that for determining the Company's ability or otherwise to pay its debts, it was to be considered whether the company was able to meet its liability as and when they accrued due. Section 434 of the Act, prescribes the circumstances in which a company was to be treated as unable to pay its debts. Admittedly none of these circumstances was present in the said case and no complaint had even been received by the company from its creditors as regards non-fulfilments of any of their claims against the company. In a case where no debt had been due, a demand, therefore, could not be made. The mere fact that certain liabilities might accrue due in future, which could exceed the existing assets of the company, would not necessarily lead to the conclusion that the company would be unable to meet its liabilities when they accrued due. The mere fact that the Company's liabilities being in excess of its assets could not *ipso facto* be a ground for putting the company into liquidation. The test would be that the company should be commercially solvent i.e., the company ought to be in a position to meet its liabilities as and when they arose.

Thus in the present case, the Bombay High Court may not order the winding up of the Company viz. Constant Overtrading Ltd. Merely because its liabilities far exceeded the assets of the Company. The Court will take into account whether the company has failed to meet any of the demands made by the creditors etc.

Petition for winding up**Provisions as to applications for winding up (Section 530)****Question 9**

High Value Builder Ltd. is financially insolvent and is unable to pay its debts. Mr. X an unsecured creditor has to recover a sum of ₹ 5 lakhs from the company. Advise Mr. X about the steps and the procedure to be followed to put the company into compulsory winding up, as an alternative for the recovery of his dues. **(May 2009)**

Answer

Mr. X has to take the following steps to put High Value Builders Ltd. into compulsory winding up:

- (i) A petition for winding up of the company is to be filed in the High Court where the registered office of the company is located under Section 439(1) (b) read with Section 433(e) and (f) of the Companies Act, 1956. A copy of the petition should also be served on the company.
- (ii) The petition should be filed along with an affidavit showing sufficient ground for the appointment of a provisional liquidator till an order is passed by the High Court appointing an official liquidator..
- (iii) After obtaining the winding up order from the High Court the same should be advertised within 14 days in a newspaper in English language and in the regional language of the state where the company is registered.
- (iv) A Certified copy of the winding up order passed by the court should be filed with the concerned Registrar of Companies along with the prescribed fees within 30 days from the date of the winding up order.
- (v) If the shares of the company are listed in a stock exchange, copy of the petition along with the order may be filed with the stock exchange concerned.
- (vi) The winding up proceedings will be carried out by the official liquidator till dissolution of the company.

Winding Up by Tribunal**Official Liquidators (Section 448 – 463)****Question 10**

A listed Public Company was ordered to be wound up by the order of the Bombay High Court. While ordering the winding up, the Court ordered the Official Liquidator to submit a preliminary report to the Court as per the provisions contained in the Companies Act. State briefly the details to be given in the preliminary report of the Official Liquidator. **(November, 2001)**

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Answer

As soon as the winding up order is received by the official Liquidator, a preliminary report is required to be submitted to the court. This report should be submitted as soon as the Liquidator receives the Statement of Affairs from the persons who were directors of the company at the time of winding up. There is a time limit of six months within which the official Liquidator is required to submit his preliminary report to the court.

The preliminary report should contain the following details:

- (i) The amount of capital issued, subscribed and paid up.
- (ii) The estimated amount of assets and liabilities giving separately (a) cash and negotiable securities; (b) debts due from contributories; (c) debts due to the company and securities, if any, available in respect thereof; (d) moveable and immovable properties belonging to the company; (e) unpaid calls.
- (iii) If the company has failed, the causes of the failure.
- (iv) The opinion of the Liquidator as to whether any further enquiry is desirable as to any matter relating to promotion, formation or failure of the company or the conduct of the business thereof.

The Official Liquidator has also the power to make a further report if in his opinion the company was formed with a view to commit a fraud or a fraud has been committed in respect of any matter which in his opinion is desirable to bring to the notice of the court.

Voluntary Winding-Up

Declaration of Solvency

Declaration of solvency in case of proposal to wind up voluntarily (Section 488)

Question 11

The Directors of M/s HIJ Company Ltd. desire to proceed for voluntary winding up of the company and hence they are required to File 'Declaration of Solvency'. Your advice is sought about the procedure to be followed for the said purpose.

(November, 2002)

Answer

Declaration of Solvency

Chapter III of part VII of the Companies Act, 1956 deals with "Voluntary winding up" of companies and in this relation section 488 of the said Act provides for filing of "declaration of solvency" on the part of the directors of the company when there is proposal for voluntary winding up of the company.

The analysis of Section 488 of the Companies Act, 1956 discloses that a declaration of solvency contains the following features -

1. It is declaration duly supported by an affidavit, verified by a competent authority.

2. The declaration is made by the directors or where there are more than two directors, by the majority of the directors.
3. A meeting of Board of Directors is required for the purpose.
4. There is recital on the part of the Directors that they have made full inquiry into the affairs of the company and
5. That they have formed opinion that the company has no debts or that if it will be able to pay its debt in full within a period not exceeding three years from the date of commencement of winding up as may be specified in the said declaration.

In order that the above declaration is valid, it should be made within five weeks immediately preceding the date of passing the resolution for winding up of the company and must be delivered to the Registrar before that date. Further, the said declaration should be accompanied by a copy of the auditors report on the profit and loss account of the company for the period commencing from the date of the last audited accounts upto a date practicable immediately before the date of the declaration and a balance sheet on the last mentioned date and also a statement of company's assets and liabilities as on the date of the declaration made out in accordance with the requirements laid down by clause (2) of section 488 of the Companies Act, 1956.

A false declaration of a solvency makes the directors, liable under clause (3) and (4) of section 488 of the Companies Act, 1956.

Provisions applicable to a members' voluntary winding up (Section 489 – 498)

Question 12

What are the steps to be taken for up in a case, where the company is solvent, but the business for which it was formed has been completed. **(November, 2000)**

Answer

In this case the company is proposed to be wound up as the business for which it was formed has been completed. As the company is solvent, the voluntary winding up can be member's voluntary winding up and for this purpose the following steps are to be taken:

- (1) All the directors or atleast majority of directors have to make declaration at the meeting of Board of Directors that they have made full enquiry into the affairs of the company and they are of the opinion that the company has no debts at all or it will be able to pay all its debts within three years from the date of commencement of winding up proceedings [section 488(1) Companies Act, 1956]. Such declaration should be made within five weeks preceding the date of general meeting where winding up petition is proposed to be passed.
- (2) The declaration should be filed with Registrar of Companies before the date of general meeting. The declaration should be accompanied by report of auditors of the company giving profit and loss account for the period commencing from date upto which last

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accounts were prepared and ending with latest practicable date before the making of declaration. A balance sheet on that date should also be prepared. [Section 488(2)].

- (3) Next, the company has to pass at its general meeting a resolution called 'resolution for voluntary winding up'. Ordinary resolution will do in this case, if the articles provide that the company is to be dissolved on completion of the business (section 484). Otherwise, special resolution is required.
- (4) At this meeting or any meeting subsequent thereto, one or more liquidators are to be appointed and their remuneration should be fixed. (Section 490).
- (5) After the resolution is passed, company must give notice of such resolution by advertisement within 14 days in Official Gazette and also in some newspaper circulating in the District where the registered office is situated. (Section 485).
- (6) Under section 494, the company has to give notice of appointment of the liquidator to the Registrar of Companies.
- (7) The voluntary winding up commences at the time when the resolution for voluntary winding up is passed. (Section 486).

Official Liquidators

Audit of liquidators' accounts (Section 462)

Question 13

The High Court at Mumbai appointed the Official Liquidator as the Liquidator of Imprudent Engineering Company Ltd. Some of the creditors have brought to the notice of the Liquidator that though the company is in liquidation for the past several years, nothing worthwhile has been done to speed up the winding up and no documents have been filed to indicate the progress of Liquidation. Examine in this connection the nature and periodicity of returns required to be filed by the Liquidator in terms of the provisions contained in the Companies Act. (May, 2001)

Answer

According to Section 462(1) of the Companies Act, 1956 read with Rule 298 of the companies (Court) Rules the Official Liquidator is required to fill the accounts of M/s Imprudent Engineering Company Ltd., with the Court twice a year, one made upto 31st March and the second upto 30th September, within 3 months of closing the accounts. The accounts should be drawn up in Form No. 144 of the Rules. Further according to Rule 302, the accounts should be audited by a Chartered Accountant appointed by the Court or if the Court so directs by the Examiner of the Local Fund Accounts of the State concerned. A copy of the accounts so filed by the Official Liquidator with the court is open to inspection by any creditor, contributory or any person interested.

Where the winding up is not concluded within one year after commencement, the official liquidator is required within 2 months after the expiry of the year and thereafter until the

winding up is concluded, once every year to file his statement in the prescribed form No. 148 (Rule 311) in Court. A copy thereof shall also be filed with the Registrar (Rule 511).

Provisions applicable to every voluntary winding up

Arrangement when binding on company and creditors (Section 517)

Question 14

Reckless Constructions Ltd. has gone into liquidation, because of the inability of the company to pay its debts. During the course of winding up a proposal was put forward by the previous management to revive the working of the company through a scheme of arrangement between the company and its creditors. As per the scheme, all the creditors have to forego fifty per cent of their dues. The company approaches you for advice. Discuss the steps that have to be taken by the company in this regard.
(May, 2001)

Answer

As per the provisions contained in Section 517 of the Companies Act, 1956 M/s Reckless construction Ltd. can enter into a scheme of arrangement with the creditors, even though the company is in liquidation. According to the said section, the scheme of arrangement will be binding on the company and its creditors provided it has been approved by a special resolution of the company and agreed to by three fourths in number and value of the creditors. Any creditor or contributory may, however, within three weeks from the completion of the arrangement appeal to the court and the court may amend, vary, confirm or set aside the arrangement. The company should take the following steps in this regard:

- (i) to get the draft scheme of arrangement approved by the Board of Directors.
- (ii) to apply to the Court for directions to convene the meetings of the members/ creditors.
- (iii) to hold the general meeting and pass the required special resolution.
- (iv) to move the High Court for approval of the scheme.
- (v) on receipt of the court's order, to file the certified copy of the order with the Registrar of Companies.

Question 15

Worthless Ltd. has gone into liquidation because of the inability of the company to pay its debts. During the course of winding up, a proposal was put forward by the previous management to receive the working of the company through a scheme of arrangement between the company and its creditors. As per the scheme, all the creditors have to forego fifty percent of their dues. Some of the creditors have voiced their opposition to the said scheme. The company approaches you for advice. State the steps that have to be taken by the company in this regard.
(November 2007)

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Answer

As per Section 517

- (1) any arrangement entered into between a company about to be, or in the course of being wound up and its creditors shall, subject to the right to appeal under this section, be binding on the company and on the creditors if it is sanctioned by a special resolution of the company and acceded to by three-fourths in number and value of the creditors.
- (2) any creditor or contributory may, within three weeks from the completion of the arrangement, appeal to the court (now Tribunal) against it and the (now tribunal) may thereupon, as it thinks just, amend, vary, confirm or set aside the arrangement.

Thus, the company may enter into a scheme of arrangement with the creditors by the procedure given below:

The draft scheme of arrangement shall be considered and approved by the board of director.

The company shall apply to the court for directions to convene the meetings of the members and creditors

A general meeting of the company shall be held and the special resolution approving the scheme of arrangement shall be passed.

A meeting of creditors shall be held whereat the scheme shall be agreed to by $\frac{3}{4}$ in number and value of the creditors. The company shall approach the court (Tribunal) for approval of the scheme.

On receipt of the courts (Tribunal) order, the company shall file a certified copy of the courts (Tribunal) order with the registrar.

Provisions applicable to every mode of winding up

Proof and ranking of claims

Question 16

The value of the security of a secured creditor of a company is ₹ 1,00,000. The total amount of the workmen's dues is ₹ 1,00,000. The amount of the debts due from the company to its secured creditors is ₹ 3,00,000. The aggregate of the amount of workmen's dues and of the amounts of debts due to secured creditors is ₹ 4,00,000.

With reference to the provisions of the Companies Act, 1956, what is the workmen's portion of the security?

If the liquidator incurs ₹ 10,000 for the preservation of the security before it is realised by the secured creditor, what is the portion of ₹ 10,000 that should be borne by the secured creditors?

Answer

- (i) The workmen portion of the security is therefore 1/4th of the value of the security, i.e.

25,000, [Sub-section (3) added to Section 529 by the Companies (Amendment) Act, 1985].

- (ii) If the liquidators incur ₹ 10,000 for the preservation It is equal to the following equation:

$$\text{Whole of expenses} - \text{Whole of expenses} \times \frac{\text{Workmen's portion}}{\text{Value of the security}}$$

$$= ₹ 10,000 - \frac{10,000 \times 25,000}{1,00,000}$$

$$= ₹ 10,000 - 2,500$$

$$= ₹ 7,500. \text{ This is the amount to be borne by the secured creditors.}$$

Overriding preferential payments (Section 529A)

Question 17

OGC Ltd. was a supplier of Raw Materials to SAM Ltd., which could not make payment to OGC Ltd. owing to huge losses and financial constraints. Ultimately, SAM Ltd. went into liquidation and Official Liquidator was appointed. OGC Ltd. filed a suit for recovery of its dues. The Court awarded a decree in favour of OGC Ltd. Armed with the Court's decree, OGC Ltd. approached the Official Liquidator to pay the amount to it in preference over dues of the workmen. The workmen protested the demand of OGC Ltd. and contended that their dues rank pari passu with the Secured Creditors and will override all other claims of other creditors even where a decree has been passed.

You are required to ascertain the validity of the argument of the workmen in the light of the provisions of the Companies Act, 1956 and the decide cases on the subject. (May 2008)

Answer

The problem given in the question is covered by the provisions of Section 529A of Companies Act, 1956 read with Sections 529 and 530 of the said Act. The effect of combined reading of these sections is that the workmen of the company become secured creditors by operation of law to the extent of the workmen's dues and are entitled to proportional payment along with other secured creditors. If there is no secured creditor then the workmen of the company become unsecured preferential creditors under the said Section 529A to the extent of workmen's dues. The purpose of the said section 529A is to ensure that the workmen should not be deprived of their legitimate claims on the event of the liquidation of the company and the assets of the company would remain charged for the payment of workmen's dues and such charge will be pari passu with the charge of other secured creditors. There is no other statutory provision overriding the claim of the secured creditors except the said Section 529A.

Thus under the said Section 529A, the dues of the workmen and debt due to the secured creditors are to be treated pari passu and have to be treated as prior to all other dues.

Thus, the law is very much clear in this respect and the Hon'ble Supreme Court of India held

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in the case of UCO Bank [(1994) 81 Comp. Case 780] that the provisions of Section 529A of the Companies Act, 1956 will override all other claims of the creditors even where a decree has been passed by a court.

In view of the above stated legal position, the contention of the workmen of SAM Ltd. is valid and the Official Liquidator will have to pay their dues as provided in Section 529A of the Act.

Question 18

PQR Limited is being wound up by the Court. All the assets of the company have been charged to the company's bankers to whom the company owes ₹ 1 crore. The company owes the following amounts to others:

- | | |
|----------------------------------|-------------|
| (i) Dues to workers | ₹ 25,00,000 |
| (ii) Taxes payable to Government | ₹ 5,00,000 |
| (iii) Unsecured creditors | ₹ 10,00,000 |

You are required to compute with reference to the provisions of the Companies Act, 1956 the amount each kind of creditors is likely to get if the amount realized by the official liquidator from the secured assets and available for distribution among the creditors is only ₹ 80 lakhs.

(November 2010)

Answer

Overriding preferential payments: The amount realized from assets is to be distributed to various kinds of creditors in accordance with the provisions of sections 529, 529A and 530 of the Companies Act, 1956. According to the proviso to Section 529(1)(c) the security of every secured creditor shall be deemed to be subject to a pari passu change in favour of the workmen to the extent of the workmen's portion therein. The workmen's portion is to be worked out as per section 529(3)(c).

Workmen's dues

Workmen's portion of the security = Workmen's dues

Workmen's dues+

Amount due to secured creditors.

Section 529A provides for overriding preferential payment. According to the said section the workmen's dues and that part of the secured debt which cannot be realized because it has been appropriated towards workmen's dues shall be paid in preference to all other debts. Section 529A overrides the preferential claim under section 530 (taxes payable to Government in this case).

In this case, all the assets of the company in liquidation have been charged to the secured creditor. Unless the property by which the debt is secured realizes an amount equal at least to the total of workmen's dues and the secured debts, other creditors will not get any amount. In this case the amount realized from the security is ₹ 80 lakhs, while the amount due to the workmen and secured creditors (i.e. bankers) aggregate to ₹ 125 lakhs.

Amount available for distribution ü	25,00,000	
of workmen's dues ý	$\frac{25,00,000}{1,00,000 + 25,00,000}$	x80 lacs
p		

$$\frac{1}{5} \times 80 \text{ lac}$$

₹ 16 lacs.

Amount available to secured creditor} ₹ 80 lacs – 16 lacs

₹ 64 lakhs.

Hence no amount is available for payment of Government dues and unsecured creditors.

Question 19

In relation to winding up of a company incorporated under the Companies' Act 1956; explain clearly the meaning of the term 'overriding preferential payments'. Examine the provisions of the Companies Act and decide whether the following debts of a company under the winding up shall be 'Preferential payments' and shall be paid in priority to the claim of unsecured creditors:

- Wages amounting to ₹ 30,000/- (Rupees Thirty thousand) only of an employee for services rendered for a period of 8 months within the preceding 12 months next before the relevant date.*
- ₹ 1 lac due to an employee from Provident Fund and 50,000/- towards gratuity.*
- ₹ 20,000/- payable by the company on account of expenses incurred in respect of investigation held under Section 235 of the Companies' Act, 1956.*

(CA Final, New Course, November, 2010)

Answer

Overriding preferential payments:

Under Section 529A of the Companies Act, 1956, notwithstanding anything contained in other provisions of the Companies Act, 1956 or any other law for the time being in force in the winding-up of a company - (i) workmen's dues and (ii) debts due to secured creditors to the extent such debts rank, under clause (c) of the proviso to Sub-section (1) of Section 529, pari passu with such dues, shall be paid in priority to all other debts. These debts payable under (i) and (ii) above shall be paid in full, unless the assets are insufficient to met them, in which case they shall be paid in equal proportions.

- Wages amounting to ₹ 30,000, of an employee for services rendered for a period of 8 months within the preceding 12 months next before the relevant date.

All wages and salaries of an employee for service rendered for a period not exceeding 4 months within the preceding 12 months next before the relevant date, but not Exceeding

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₹ 20,000 in anyone case. In the given case, it is not a preferential payment. Only a part of it shall be the preferential payment.

- (b) ₹ 1 lac due to an employee from provident fund and ₹ 50,000 towards gratuity.

All sums due to any employee from any fund including a provident, pension or a Gratuity for the welfare of the employees, maintained by the company are the preferential Payment. Therefore in the given case both the sums i.e. ₹ 1 lac and ₹ 50,000 are the preferential payments.

- (c) ₹ 20,000 payable by a company on account of expenses incurred in respect of investigation held under Section 235 of the Companies Act, 1956.

Expenses payable by any company in respect of an investigation held under Section 235 and 237 are preferential payments. In the given case ₹ 20,000 payable by the company on account of expenses incurred in respect of investigation are preferential payments.

Preferential Payments (Section 530)

Question 20

M/s XYZ Limited is being wound up by the Court. The official liquidator after realisation of the assets has an amount of ₹ 56,00,000 at his disposal towards payment of creditors of the company. Details of creditors are as under:

	₹
(i) Dues to secured creditors	40,00,000
(ii) Dues to workers	30,00,000
(iii) Taxes and duties payable to Government authorities	4,00,000
(iv) Unsecured creditors	80,00,000

Since the available amount is insufficient to meet the claims of all the creditors, explain the procedure to be followed for payment of dues as provided in the Companies Act, 1956, assuming that the company has created a charge on all the assets of the company in favour of the secured creditors.

Answer

Section 530 of the Companies Act, 1956 lays down the procedure for payment of debts out of available funds with the Official Liquidator. However, Section 529A provides for overriding of the preferential payments as mentioned in Section 530. According to Section 529A, not withstanding anything contained in other provisions of this Act or any other law for the time being in force, in the winding up of a company ,

- (a) workmen's dues; and
(b) debts due to secured creditors, shall be paid in priority to all other debts.

The above debts have to be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

In this light of the legal provisions explained, the funds available with the Official Liquidator are not even sufficient to meet fully the dues payable to secured creditors and workers. Thus, tax dues to the tune of ₹ 4,00,000 payable to Government authorities will not get any payment even though they are to be considered as preferential payments as per section 530 of the Act. The secured creditors dues and workmen dues will get abated equally and they get ₹ 32 lakhs and ₹ 24 lakhs respectively. The other creditors will get nothing.

Question 21

Mars India Limited, a company incorporated under the Companies Act, 1956 is being wound up by the court. After realization of the assets of the company, the official liquidator has an amount of ₹ 70,00,000 at his disposal towards payment of creditors of the said company. The details of creditors are as follows:

- (i) Unsecured creditors 50,00,000
- (ii) Taxes and duties payable to Government 5,00,000
- (iii) Dues to workers 30,00,000
- (iv) Dues to secured creditors 40,00,000

The available amount with the liquidator, obviously, is not sufficient to meet the claims of all the creditors. Moreover, the company had already created a charge on all the assets of the company in favour of the secured creditors. Explain the procedure to be followed by the liquidator for payment of dues as provided in the Companies Act, 1956. (November 2008)

Answer

WINDING UP (PAYMENT OF CREDITORS): Section 530 of the Companies Act, 1956 lays down the procedure for payment of debts out of available funds with the official liquidator. However Section 529A of the said Act provides for overriding of the preferential payments as mentioned in Section 530. According to Section 529A of the Companies Act, 1956 notwithstanding anything contained in other provisions of this Act or any other law for the time being in force, in the winding up of a company – (1) Workmen's dues and (2) debts due to secured creditors, shall be paid in priority to all other debts. Further these debts have to be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportion.

In the light of the above mentioned provisions, the funds available with the official liquidator are not sufficient to meet fully the dues payable to all the creditors. Thus, tax dues to the tune of ₹ 5,00,000 payable to government authorities will not get any payment even though they are to be considered as preferential payments as per Section 530 of the Act. Thus the secured creditors will get ₹ 40,00,000 and the remaining amount of ₹ 30,00,000 shall be paid towards workers dues. The other creditors will get nothing.

Effect of winding up on antecedent and other transactions

Fraudulent preference (Section 531)

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Question 22

M/s. Info-tech Overtrading Ltd. was ordered to be wound up compulsory by an order dated 15th October, 2007 of the Delhi High Court. The official liquidator who has taken control for the assets and other records of the company has noticed the following:

- (i) *The Managing Director of the company has sold certain properties belonging to the company to a private company in which his son was interested causing loss to the company to the extent of ₹ 50 lakhs. The sale took place on 0th May, 2007.*
- (ii) *The company created a floating charge on 1st January, 2007 in favour of a private bank for the overdraft facility to the extent of ₹ 5 crores, by hypothecating the current assets viz., stocks and book debts.*

Examine what action the official liquidator can take in this matter. Having regard to the provisions of the Companies Act, 1956. **(November 2007)**

Answer

The official liquidator can invoke the provisions contained in Section 531 of the companies Act, 1956 to recover the sale of assets of the company. According to Section 581, any transfer of property, movable or immovable made within 6 months before the commencement of winding up will be deemed to be a fraudulent preference and hence invalid in the eyes of laws. Since in the present case, the sale of immovable property took place on 10th May, 2007 and the company went into liquidation on 15th October, 2007 i.e., within 6 months before the winding up of the company and since the sale has resulted in a loss of ₹ 50 lakhs to the company. The official liquidator will be able to succeed in proving the case under Section 531 by way of fraudulent preference as the property was sold to a private company in which the son of the ex-managing was interested.

According to Section 534 of the Companies Act, any floating charge created within 12 months of the commencement of the winding up will be treated as invalid unless it is proved that the company immediately after the creation of charge was solvent. In the present case it may be difficult for the Bank, the charge holder to prove that the company was solvent after the creation of the floating charge. The charge holder i.e., the Bank is however, entitled to recover from the company. The amount advanced along with 5% interest. Further preferential debts under Section 530 will have priority over debts secured by a floating charge. The official liquidator may thus prove that the floating charge created by the company is invalid.

Effect of winding up on antecedent and other transactions

Effect of floating charge (Section 534)

Question 23

A Company created a floating charge of its Current Assets in favour of a Bank to secure a Current Account, which was in debit of ₹ 5 lakhs and also to secure further Working Capital facilities provided by the bank. The charge created on 1st January, 2003 was duly registered with the registrar of Companies. The bank advanced ₹ 10 lakhs subsequent to the creation of

charge. The company has gone into voluntary liquidation pursuant to a resolution passed on 1st September, 2003. Examine the validity of the floating charge in case it is a creditors' voluntary winding up, but there is no fraudulent preference. Would your answer be different, if it was a member's voluntary winding up? **(May, 2004)**

Answer

Effect of floating charge in Winding-up

Section 534 of the Companies Act, 1956 deals with effect of floating charge. Where a company is being wound up, a floating charge created on the assets of the company within 12 months prior to the commencement of winding up will be valid only to the extent of money advanced at the time of creating charge or subsequent to creating charge, plus interest at 5% or such other rate notified by the Central Government in this behalf. In other words, floating charge created for pre-existing debt will be invalid. This section does not, however, affect companies which can prove that after the creating of the floating charge, they were in quiet solvent condition.

The voluntary winding up commences at the time when the resolution for voluntary winding up is passed by the company (Section 486).

Members' voluntary winding up is permissible only when the company is solvent and declaration of solvency is made (Section 488). If declaration of solvency is not made, the winding up would be termed as creditors' voluntary winding up.

In this case, the floating charge was created within 12 months preceding the commencement of winding up and hence the provisions of Section 534 are attracted. In the question, there is no fraudulent preference and hence it is not necessary to examine the applicability of Section 531. In the case of creditors' voluntary winding up, the company cannot be considered as solvent. In view of the position explained above the floating charge is valid only to the extent of advances made subsequent to the creation of charge i.e. ₹ 10 lakhs plus interest at 5%.

In the case of members' voluntary winding up, the position is different. As the company is solvent, the floating charge is valid for the entire debt of ₹ 15 lakhs including the pre-existing debt of ₹ 5 lakh (at the time of creation of charge).

Offences antecedent to or in course of winding up

Power of Tribunal to assess damages against delinquent directors etc (Section 543)

Question 24

The official liquidator of ABC Limited (in liquidation) instituted misfeasance proceedings under section 543 of the Companies Act, 1956 against 'A', a director of the company in liquidation. During the pendency of misfeasance proceedings 'A' died.

What is meant by Misfeasance? Is it possible for the official liquidator to impede the legal representatives of 'A' and continue the proceeding against them? **(November 2006)**

Answer

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Misfeasance

The term 'misfeasance' has not been defined in the Companies Act, 1956. It can be considered as an act or omission in the nature of breach of trust in relation to the company which causes losses or injuring to the company. Although loss to the company has not been expressly stated in Section 543 nevertheless such 'loss' has to be implied in case of misapplication or retainer. Only such an act of misfeasance as results in the loss to the company will fall within the ambit of section 543.

As regards the second question (ii) in case of death of the directors, the Supreme Court held that the proceedings commenced against the delinquent director of a company liquidation under section 543 can be continued after his death against his legal representatives and the amount declared to be due in such misfeasance proceeding can be realized from the estate of the deceased on the hands of his legal representatives. The Court further held that the legal representatives would not, however, be liable for any sum beyond the value of the estate of the deceased in their hands (*Official Liquidator, Supreme Bank Ltd. V.P.A. Tendolkar (1973) 43 Comp. (Case 382) (Official Liquidator vs. Parthasarthy Sinha (1983) 53. Comp. Case (SC) (3c)*). Hence the misfeasance proceeding can be continued against the legal representatives of A.

Question 25

M/s Raman Ltd. was wound up by the Court. The official liquidator invited claims from its creditors which stood as under:

<i>Income tax dues</i>	<i>₹ 11 lakhs</i>
<i>Sales tax dues</i>	<i>₹ 5 lakhs</i>
<i>Dues of workers</i>	<i>₹ 25 lakhs</i>
<i>Unsecured loans payable to directors</i>	<i>₹ 25 lakhs</i>
<i>Trade creditors who supplied raw material</i>	<i>₹ 15 lakhs</i>
<i>Secured creditor being the bankers of the company</i>	<i>₹ 75 lakhs</i>
	<i>₹ 156 lakhs</i>

Official Liquidator could realize only ₹ 80 lakhs by sale of assets and realizations made from the company's debtors, which is not sufficient to pay to all the creditors. Please decide the order of priority for payment to creditors explaining the relevant provisions of the Companies Act, 1956.

Answer

Under section 529A of the Companies Act, 1956, (i) workmen's dues, and (ii) debts due to secured creditor shall be paid in priority of all debts, and shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions. Income tax dues and sales tax dues are preferential creditors under section 530 of the Act, and subject to the provisions of section 529A, the same may be paid in priority to the claims of unsecured creditors.

In the present case, the available funds are only to the extent of ₹ 80 lakhs which will be distributed amongst the secured creditor and workmen in proportion to their dues, as follows:

Workmen

(1/4th of ₹ 80 lakhs) : ₹ 20 lakhs

Secured creditor

(3/4th of ₹ 80 lakhs) : ₹ 60 lakhs

As such, the dues of preferential creditors (namely, Income tax and sales tax dues) and unsecured creditors (unsecured loan and trade debtors) cannot be paid any amount.

Provisions as to dissolution (Section 560)

Question 26

Ganesh Textiles Private Limited has discontinued its Business since 2006. Negligible assets are available with the company, but also some liabilities. The company has been regular in filing Annual Returns and Balance Sheets. The Director of the Company proposes to apply to the Registrar of Companies for striking the name of the company on the ground that it is a defunct company.

Advise, as to what steps can be taken to get the name of the company struck off under the provisions of the Companies Act, 1956. **(CA Final, New Course, May 2010)**

Answer

Striking off defunct company: In the given case Ganesh Textiles Private Ltd. is required to follow the established procedure to enable the Registrar to remove the name of the company under Section 560 of the Companies Act, 1956. For this purpose, an application accompanied with the following documents be submitted to the Registrar of Companies –

1. An affidavit of at least two directors including that of the Managing Director or whole time Director to the effect that the company has no assets or liabilities as on date and the company has not been carrying on any business during the last one year or more.
2. Latest audited balance sheet and profit and loss account of the company.

An indemnity bond from the aforesaid directors to the effect that the liabilities of the company if any will be met by them even after the name of the company is struck off.

In view of the above, Ganesh Textiles Private Limited must first take steps to realize all the assets and pay all the liabilities and make it nil. Thereafter the company may apply to the Registrar of Companies along with “nil” balance sheet, affidavit and indemnity bond. After making necessary inquiry, the Registrar will publish notice in the official Gazette that the name of the company has been struck off. Under Section 560(5) of the said Act, the company shall stand dissolved from the date of publication of notice in the Official Gazette.

Question 27

Super Chemicals Private Limited has discontinued its business since 1992. Its entire capital

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has been lost. It has some liabilities, but negligible assets. The company has been regular in filing annual Returns and Balance Sheets. The Directors propose to apply to the Registrar of Companies for striking the name of the company under Section 560 of the Companies Act, 1956 on the ground that it is a defunct company.

State the circumstances under which the name of the company can be struck off under Section 560 of the Act and the steps to be taken by the Directors of the Company to get the name of the company struck off.
(November, 2003)

Answer

Striking off defunct company

Where the Registrar of companies has reasonable cause to believe that a company is not carrying on business or in operation, he shall send to the company by post a letter inquiring whether the company is carrying on business or in operation (Section 560(1)). If no reply is received from the company within one month, Registrar will send another letter to the company by registered post [Section 560(2)].

If the Registrar either receives an answer from the company to the effect that it is not carrying on business or in operation or does not receive any reply from the company after second letter, the Registrar will publish a notice in official Gazette that the name of the company will be struck off and company dissolved, unless cause is shown to the contrary within 3 months from the date of notice. [Section 560(2) and (3)].

If no reply is received or no cause is shown within 3 months, Registrar will publish notice in Official Gazette that the company's name has been struck off. Company shall stand dissolved from the date of publication of Official Gazette [Section 560(5)].

This power can be exercised by Registrar even in the case of company being wound up, if he has reasons to believe that no liquidator is acting or the company is completely wound up or any returns required to be made to Registrar have not been made for 6 months [Section 560(4)].

Hence a defunct company can be struck off from the Register of Companies by the Registrar by following the procedure laid down in Section 560.

However, the company in this case, which is admittedly not carrying on any business since 1992 must follow the procedure laid down by Department's Circular No. 9/7/83-CL III dated 17.2.1987 to enable the Registrar of Companies to remove the name of the company under Section 560.

The company should make an application to the Registrar accompanied by the following documents:

- (1) An affidavit of at least 2 directors including that of the managing director or whole time director to the effect that the company has no assets or liabilities as on date and the company has not been carrying on any business during the last one year or more.

- (2) Latest audited balance sheet and profit and loss account of the company.
- (3) An indemnity bond from the aforesaid directors to the effect that the liabilities of the company, if any will be met by them even after the name of the company is struck off from the Register under Section 560.

The Department of Company Affairs simplified the procedure for removal of defunct companies vide Circular letter No. 17/78/2001-CLV dated 25.3.2003. This simplified procedure was in operation till 30.09.2005. But the essential condition that the assets and liabilities of the company should be zero must be fulfilled [Dept's Clarification No. 17/78/2001 - CLV dated 17.4.2003].

Hence the company must first take steps to realise all the assets and pay all the liabilities and make it 'Nil'. Thereafter, the company may apply to Registrar of Companies along with 'Nil' balance sheet, affidavit and indemnity bond.