COMAPANY LAW STUDY MATERIAL (LAW 507)

UNIT V

(WINDING - UP)

BY

Mr. ABHISHEK KUMAR

Assistant professor

College of law and legal studies

Teerthankar Mahaveer University

1. WINDING UP

Company winding up, or liquidation refers to the formal process through which a company concludes its operations, ultimately leading to its dissolution. This process entails the systematic closure of the company's affairs, including the sale of assets, settlement of debts from the proceeds, and distribution of any remaining surplus to the shareholders according to their stake in the company. The initiation of winding up occurs either by a court order or through a voluntary resolution passed by the company. Once the winding-up proceedings are complete, the company is officially dissolved and ceases to exist, marking the end of its corporate existence through this legal procedure.

The term "winding up", as outlined in Section 2(94A) of the Companies Act, 2013, refers to the formal process of closing a company through the mechanisms provided by the Companies Act or by undergoing liquidation under the Insolvency and Bankruptcy Code, 2016. This process involves ceasing regular business activities, liquidating assets, and settling debts ultimately leading to the company's dissolution. Despite this, during the winding-up phase and until dissolution, the company maintains its legal entity status, allowing it to partake in legal actions within a Tribunal. The objective of winding up is to ensure an orderly closure and distribution of the company's assets.

2. DISSOLUTION

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

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

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

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

- ***Difference between Winding up and Dissolution***

Basis	**Winding Up**	**Dissolution**
meaning	Winding up is one of the method by which dissolution of a company is brought about.	Dissolution is the end result of winding up.
Existence of Company	Legal entity of the company continues at the commencement of the winding up.	Dissolution brings about an end to the legal entity of the company.
Continuation of business	A company may be allowed to continue its business so far necessary for the beneficial winding up of the company.	Company ceases to exist on its dissolution.

- ***Reasons for Winding Up A Company***

There are many reasons why businesses may choose to wind up their operations, including insufficient funds or cash flow problems, changes in market conditions or technological advancements, legal or regulatory issues, shareholder disputes or lack of succession planning, and fraud or mismanagement. There are several reasons for winding up a company, and why a company may decide to wind up its operations. In this article, we'll delve into each of these reasons in more detail, providing valuable insights into the challenges that businesses may face and helping entrepreneurs make more informed decisions about their operations. By understanding the potential pitfalls and challenges of winding up a company, business owners can take steps to avoid these issues and build a more sustainable and successful business.

Winding up a company refers to the process of dissolving a business entity and distributing its assets to creditors and shareholders. It can be a voluntary decision by the company's directors or shareholders or a forced decision by the court or creditors.

The reasons for winding up of a company are as following:-

1. **Insufficient Funds or Cash Flow Problems**

One of the most common reasons for winding up a company is insufficient funds or cash flow problems. If a company is unable to generate enough revenue to cover its operating expenses or make loan payments, it may be forced to shut down its operations. This can be due to a variety of factors, including economic downturns, poor financial management, or industry-specific challenges.

2. **Changes in Market Conditions or Technological Advancements**

Market conditions and technological advancements can also impact a company's operations and financial performance. If a company is unable to adapt to changing market conditions or fails to keep up with technological advancements, it may find itself struggling to remain competitive. In some cases, a company may decide to wind up its operations rather than continuing to invest resources in a failing business model.

3. **Legal or Regulatory Issues**

Legal or regulatory issues can also lead to the winding up of a company. For example, if a company is found to be in violation of laws or regulations, it may be subject to fines or legal action. In some cases, the company may be unable to comply with legal or regulatory requirements, forcing it to shut down its operations.

4. **Shareholder Disputes or Lack of Succession Planning**

Shareholder disputes and lack of succession planning can also lead to the winding up of a company. If there is a disagreement between shareholders over the direction of the company or the distribution of profits, it can result in a deadlock that cannot be resolved. Additionally, if there is no clear plan for succession, the death or departure of key personnel can leave the company without a clear path forward.

5. **Fraud or Mismanagement**

Fraud or mismanagement can also lead to the winding up of a company. If a company is found to have engaged in fraudulent activities or if there is evidence of mismanagement, it may be subject

to legal action or investigation. In some cases, the company may be forced to shut down its operations to avoid further liability.

3. CONSEQUENCES OF COMPANY WINDING UP

Winding up a company brings about significant changes affecting various stakeholders. Here's a breakdown of the key consequences:

- *For the Company*

The company continues to exist as a legal entity until officially dissolved, retaining all rights associated with such an entity. However, its management shifts to the appointed liquidator(s) who oversee operations until dissolution.

- *For Shareholder*s

Shareholders face a new form of statutory liability as contributors. Any share transfers or changes in shareholders' status post the initiation of winding up, if not sanctioned by the liquidator, are considered null and void.

- *For Creditors*

- **Legal Actions:** Creditors are barred from initiating or continuing any legal proceedings against the company without court permission.
- **Execution of Decrees:** If creditors have previously obtained decrees against the company, they are prevented from enforcing them.
- **Debt Claims:** Creditors must formally submit and validate their claims with the liquidator to be considered for repayment.

- *For Management*

Upon a liquidator's appointment, the powers held by the company's directors, chief executive, and other officers are suspended, except for specific actions like notifying stakeholders of the winding-up resolution, appointing a liquidator, and similar procedural tasks.

- *Regarding Company Assets*

Any disposition of the company's assets post the commencement of winding up is invalid without either the liquidator's consent or court approval.

These consequences collectively ensure that the winding-up process is orderly, with the liquidator playing a central role in managing the company's affairs, settling debts, and, ultimately, distributing any remaining assets to the rightful claimants.

4. Liquidator

A liquidator is a person or entity that liquidates something. A liquidator is specially appointed to act on behalf of a company in various capacities. They are legally empowered to wind up a company's affairs when it is closing typically when the company is going bankrupt. When things get to this point, the liquidator may represent companies in lawsuits or sell off their assets for cash or equivalents. The resulting funds are used to pay off the company's debts. Liquidators may also defend companies in lawsuits. A liquidator is a person assigned to take charge of and wind up a company's affairs before it closes—usually due to bankruptcy. The liquidator is generally responsible for taking control of a company's assets and selling them on the open market for cash or equivalents. Liquidators may also bring forth lawsuits or defend the company against legal claims. They are the first to be paid in the hierarchy of claims during liquidation. Smaller or voluntary liquidations like inventory sales often do not require the services of a liquidator.

A liquidator is a person with the legal authority to act on behalf of a company before it closes. They are generally assigned by the court, unsecured creditors, or the company's shareholders. They often step in when a company declares bankruptcy. Their primary function is to generate cash for a variety of reasons, including debt repayment.

A liquidator has several key responsibilities. The first is to take control of the organization's assets, which are pooled together and sold off individually. Cash from the sale proceeds is then used to pay off the outstanding debt held by unsecured creditors. Another key function of

liquidators is to bring and defend lawsuits. Other actions include collecting outstanding receivables, paying off bills and debts, and finishing other corporate termination procedures.

- ***Powers and Duties of Liquidators***

Section 35 of the Insolvency and Bankruptcy Code, 2016, enumerates the Powers and Duties of the Liquidator which includes the following:-

- to verify claims of all the creditors and consolidate them;
- to take into his custody or control all the assets, property, effects and actionable claims of the corporate debtor;
- to evaluate the assets and property of the corporate debtor in the manner and prepare a report;
- to take such measures to protect and preserve the assets and properties of the corporate debtor;
- to carry on the business of the corporate debtor for its beneficial liquidation;
- to sell the immovable and movable property and actionable claims of the corporate debtor in liquidation by public auction or private contract, with power to transfer such property to any person or body corporate, or to sell the same in parcels, though transfer are subjected to section 52 and further the liquidator shall not sell the immovable and movable property or actionable claims to any person who is **not eligible** to be a resolution applicant.
- to draw, accept, make and endorse any negotiable instruments on behalf of the corporate debtor, with the same effect as if such instruments were drawn, accepted, made or endorsed by or on behalf of the corporate debtor in the ordinary course of its business;
- to take out, in his official name, letter of administration to any deceased contributory and to do in his official name any other act necessary for obtaining payment of any money due and payable from a contributory or his estate which cannot be ordinarily done in the name of the corporate debtor, and in all such cases, the money due and payable shall, for

the purpose of enabling the liquidator to take out the letter of administration or recover the money, be deemed to be due to the liquidator himself;

- to obtain any professional assistance, in the discharge of his duties, obligations and responsibilities;
- to invite and settle claims of creditors and claimants and distribute proceeds in accordance with the provisions of this Code;
- to institute or defend any suit, prosecution or other legal proceedings, civil or criminal, in the name of on behalf of the corporate debtor;
- to investigate the financial affairs of the corporate debtor to determine undervalued or preferential transactions;
- to take all such actions, steps, or to sign, execute and verify any paper, deed, receipt document, application, petition, affidavit, bond or instrument and for such purpose to use the common seal, if any, as may be necessary for liquidation, distribution of assets and in discharge of his duties and obligations and functions as liquidator;
- to apply to the Adjudicating Authority for such orders or directions as may be necessary and to report the progress of the liquidation process in a manner as may be specified by the Board; and
- to perform such other functions as may be specified by the Board.

Other than the ones quoted above the Liquidator has the following Rights and Duties too:-

1. To Admit and Reject claims of Creditors,
2. Power to access any information system for the purpose of verification of Claims and identification of assets forming part of Liquidation Estate of the Corporate Debtor from sources such as, Information Utility, Credit Information Systems, Central and State Government Agency, database maintained by the Board etc. as specified in Section 37 of the Code.
3. To evaluate preferential transactions, if any done by the Corporate Debtor.
4. Avoid undervalued transactions

5. Distribute the Liquidation proceeds as per Section 53 of the Code.
6. Make application for the Dissolution of the Corporate Debtor once all its assets are duly liquidated.

5. ROLE OF THE COURTS IN WINDING UP OF A COMPANY

A. Winding Up Subject to the Supervision of the Court

Winding up a company subject to the supervision of the court is a unique hybrid process that combines elements of both voluntary winding up and compulsory winding up. This method provides a framework where the company's dissolution is primarily carried out as a voluntary process, but under the watchful eye and guidance of the judiciary. This approach is designed to bring an additional layer of scrutiny and protection, ensuring that the interests of all stakeholders, including creditors, shareholders, and employees, are duly considered and protected.

Winding up subject to the supervision of the court offers a balanced approach, combining the autonomy of a voluntary winding-up with the protective oversight of compulsory liquidation. It is particularly suited for situations where the complexity of the winding-up process requires judicial intervention to ensure fairness, transparency, and the equitable treatment of all parties involved.

- *Applicability*

The applicability of winding up under the supervision of the court is often determined by specific circumstances where the company, its creditors, or other stakeholders believe that a voluntary winding up would benefit from judicial oversight. This could be due to complex legal disputes, concerns about the fairness of asset distribution, or the need for authoritative resolution of contentious issues that may arise during the winding-up process.

- Process and Benefits

Initiation

- The process typically begins with a petition to the court, either by the company itself, its creditors, or other interested parties, requesting that a voluntary winding up proceed under court supervision.
- The court will consider the petition and, if it finds merit in the request, will issue an order for the winding up to continue under its supervision.

Court's Role

- The court's involvement adds a layer of oversight to the winding-up process, with the power to appoint a liquidator or confirm the appointment of one chosen by the company or its creditors.
- It provides a forum for resolving disputes that may arise among the company's stakeholders during the winding-up process.

➢ *Stakeholder's Involvement*

- Creditors, shareholders, and others are given the liberty to apply to the court with concerns or disputes related to the winding up.
- The court's supervision ensures a transparent and fair process, where the rights and interests of all parties can be considered and protected.

➢ Advantages

- **Protection of Interests**: The court's oversight ensures that the interests of minority shareholders, creditors, and other stakeholders are protected.
- **Dispute Resolution**: The judiciary can resolve disputes efficiently, preventing deadlock situations that could stall the winding-up process.
- **Flexibility and Control**: While under court supervision, the process retains some flexibility of voluntary winding up, allowing for potentially quicker resolutions compared to compulsory winding up.

B. Compulsory winding up – by court

A court order initiates this mode. It usually occurs when the company cannot pay its debts, breaches legal requirements, or when it is just and equitable to wind up. The court appoints an official liquidator to manage the process, which includes selling assets, paying creditors, and distributing any surplus among the shareholders.

he compulsory winding up of a private limited company is a legal process overseen by the tribunal. This action is typically initiated for several reasons, including:

- **Unpaid Debts:** The company fails to settle its debts, prompting creditors to seek legal redress through winding up.
- **Special Resolution:** The company's members pass a special resolution acknowledging the need to dissolve the company due to insurmountable challenges or other reasons.
- **Unlawful Acts:** The company or its management engages in illegal activities, compromising its integrity and legal standing.
- **Fraud and Misconduct:** Involvement in fraudulent practices or serious misconduct tarnishes the company's reputation and operational legality.
- **Non-compliance with ROC Filings:** Failure to file annual returns or financial statements with the Registrar of Companies (ROC) for five consecutive years signals operational dysfunction and possible abandonment.
- **Tribunal's Discretion:** The tribunal, upon reviewing the company's situation, may determine that winding up is in the best interest of the public, creditors, and other stakeholders.

Procedure for Compulsory Winding Up

The following steps outline the legal process for such a winding up:

- **Filing a Petition:** The process begins with filing a petition to the tribunal, accompanied by a detailed statement of the company's affairs, requesting the winding up.

- **Tribunal's Review:** The tribunal reviews the petition. If the petition is filed by someone other than the company, the tribunal may require the company to submit its objections and statement of affairs within 30 days.
- **Appointment of a Liquidator:** The tribunal appoints a liquidator to oversee and manage the winding-up process, ensuring the company's assets are fairly distributed to its creditors and shareholders.
- **Preparation and Approval of Reports:** The liquidator prepares a preliminary report, which, upon approval, is finalized and submitted to the tribunal to sanction the winding-up order.
- **Submission to the Registrar of Companies (ROC):** The liquidator must submit a copy of the winding-up order to the ROC within 30 days. Failure to do so results in penalties.
- **Final Approval by ROC:** Upon satisfactory review, the ROC officially dissolves the company by removing its name from the register.
- **Publication in the Official Gazette:** The ROC publishes a notice in India to announce the company's dissolution formally.

6. PROCEDURE FOR WINDING UP A COMPANY IN INDIA

Winding up a company is a structured process involving several key steps to ensure an orderly closure of the company's operations, settlement of liabilities, and distribution of assets. Here is a detailed procedure for different modes of Winding up of a Company in India:

- *Resolution or Petition*

- **Voluntary Winding Up**: Initiated by passing a resolution in the general meeting of the company. In the case of a Members' Voluntary Winding Up, a declaration of solvency must also be made by the directors.
- **Compulsory Winding Up**: Initiated by filing a petition in the court, usually by a creditor, the company itself, or the Registrar of Companies.

- *Appointment of Liquidator*

- A liquidator is appointed to manage the winding-up process.
    - **Voluntary Winding Up**: The members or creditors appoint the liquidator.
    - **Compulsory Winding Up**: The court appoints the official liquidator.

➢ *Notice of Resolution or Petition*

- The winding-up resolution or court order must be published in the Official Gazette and a local newspaper to inform the public and stakeholders.

➢ *Collection and Realization of Assets*

- The liquidator takes control of the company's assets, books, and records.
- The liquidator collects and sells the company's assets to generate funds.

➢ *Settlement of Liabilities*

- The proceeds from the sale of assets are used to pay off the company's debts and liabilities.
- The liquidator prioritizes the payment of secured creditors, followed by unsecured creditors, employees, and other claimants.

➢ *Distribution of Remaining Assets*

- After settling all liabilities, any remaining assets are distributed among the members or shareholders according to their shareholding or claims.

➢ *Final Meeting and Dissolution*

- **Voluntary Winding Up**: A final meeting of the members or creditors is held to present the liquidator's report on the winding-up process.
- **Compulsory Winding Up**: The liquidator submits a final report to the court.
- After the final meeting or report, the company is formally dissolved, and its name is struck off the register of companies.

➢ *Filing of Final Documents*

- The liquidator files the final accounts and returns with the Registrar of Companies, including a statement of accounts, the liquidator's report, and a return of the final meeting.

➢ *Official Dissolution*

- Upon satisfaction that the winding up has been properly conducted and all procedures have been followed, the Registrar of Companies issues a certificate of dissolution.
- The company is officially dissolved, ceasing to exist as a legal entity.

7. LIABILITY OF PAST MEMBERS DURING WINDING UP OF A COMPANY

Section 2(26) defines "contributory" as a person liable to contribute towards the assets of the company in the event of its being wound up. The explanation annexed to this clause clarifies that a person holding fully paid-up shares in a company shall be considered as a contributory but shall have no liabilities of a contributory under the Act whilst retaining rights of such a contributory.

Section 4(1) (d) provides that memorandum of a company shall state-

(i) in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and

(ii) in the case of a company limited by guarantee, the amount up to which each member undertakes to contribute to the assets of the company –

(A) in the event of its being wound-up while he is a member for payment of the debts and liabilities of the company or if he was a member within one year before the commencement of the winding up for such debts and liabilities as may have been contracted before he ceases to be a member.

(B) To the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves.

Thus the liability of past members is provided expressly in case of members of the company limited by guarantee. Condition precedent to such liability is that the winding up commenced within one year from the date he ceases to be member and that such debts and liabilities are contracted before he ceases to be a member.

Section 295 provides that after a winding up order is made, the Tribunal may at any time pass an order requiring any contributory for the time being on the list of contributories to pay any money due to the company, from him or from the estate of the person whom he represents. Any money required to be paid by such representatives shall be out of the estate only.

In the case of an unlimited company, the Tribunal may allow the contributory to set off any money due to him or to the estate which he represents, from the company, on any independent dealing or contract with the company. But any money due to him as a member of the company in respect of any dividend or profit cannot be set off.

8. RECONSTRUCTION AND AMALGAMATION

Companies to accelerate the growth prospects of their business enterprise or undertaking often undergo the process of the reconstruction as well as amalgamation which affects the share capital of the company eventually leading to the diversification of the business activities. To initiate the process of reconstruction and amalgamation companies pursue several arrangements and compromises with different stakeholders of the company in order to make the process as clutter free as possible. They can make arrangements and compromises with the members of the company as stated under s.230 of the companies Act,2013.

- *RECONSTRUCTION*

The term reconstruction has not been defined anywhere in the act of 2013. However, the institution of judiciary has interpreted the term through various ruling hence in ***Hooper v. western countries co***.[1] in this case reconstruction was defined as incorporation of a new

company which intends to take over the assets of the old company with the intention that new company shall carry out the same business run and manged by same person in the similar manner.

Reconstruction connotes reconstituting the financial structure of the company with or without resorting to the dissolution of the business. Reconstruction is done to achieve following objective: –

- Simplification of capital structure.
- Decreasing the fixed charge
- Adjusting the arrears in forms of dividend
- Increasing the working capital of the company
- Elimination of past losses.

Usually reconstruction becomes a necessary recourse in the situation when financial position of a company degrades. Reconstruction can be both internal as well as external.

Internal reconstruction implies alteration of share capital without effecting the transfer of the business whereas external reconstruction occurs when existing company is dissolved and new company is formed which take-over the business of existing company.

- *AMALGAMATION*

Though the term has not been defined anywhere in the act but in the context of s232 it means merger of one company with another in order to facilitate the reconstruction of the company which is amalgamating.

In the case of ***somayujula v. Hope Prudhome & co. ltd.***[2] observed amalgamation takes place when two or more companies are joined to form a third entity or one is absorbed in another. In Re. South African Supply Co.[3] the court interpreted amalgamation to connote "blending of two or more undertakings into one undertaking, shareholders of each blending company becoming substantially the shareholders in the company which holds the blended undertaking".

In ***Marshall sons & co. v. Income Tax Officer***[4] the supreme court in this case held that every amalgamation scheme has to provide a date from which it takes effect. Although tribunal under

scheme can provide direction as well as dates from which it takes effect but when tribunal only provides sanction to scheme & not the date from which amalgamation takes effect in such case date of effect will become date specified in scheme and not from the date the scheme was approved by the tribunal.

- *OBJECTIVE OF AMALGAMATION & RECONSTRUCTION*

Provisions for facilitating amalgamation & reconstruction has been given under s232 of the Act of 2013. Usually a company take recourse to such tools during following scenarios: –

- To restructure the capital as per the Act
- To diversify the activities which business can undertake
- Reorganisation of the share capital

9. INTERNATIONAL NORMS FOR CONTROL OF MULTINATIONAL COMPANIES

A multinational corporation is a centrally coordinated company that is established in more than one nation-state. A typical multinational corporation comprises a parent company in one state with subsidiaries in one or more other states. There is no uniform terminology, however. The United Nations continues to use the term "transnational corporation," although many academic authors have dropped that term because of its association with the now discredited New International Economic Order. The International Labour Organization (ILO) and the Organisation for Economic Co-operation and Development (OECD) employ the term "multinational enterprise." The main difficulty with multinational corporations is the accountability or governance gap caused by the absence of corporate regulation in international law. In traditional international law, multinational corporations have rights but no obligations. In practice, therefore, multinational corporations are subject only to the domestic laws of the different states in which they operate. Since states compete with each other to attract investment from multinational corporations, the regulatory framework applicable to such corporations has a tendency to weaken rather than strengthen.

MULTINATIONAL CORPORATIONS (MNCs) and Global Administrative Law (GAL) are both products of a single overarching phenomenon of globalization that has fundamentally changed the very nature of social, political, economic and administrative interactions between societies, communities and countries. While MNCs represent the fusion of economic boundaries between states, GAL though still fluid as a concept essentially envisages transcending classical state administrative law boundaries and putting in place some sort of a meta-state administrative structure of global governance. In essence GAL can be understood as comprising the legal rules, principles, and institutional norms applicable to processes of 'administration' undertaken in ways that implicate more than purely intra-state structures of legal and political authority.

Last few decades have seen the emergence and intense proliferation of multinational corporations as economic entities and global actors whose operations and activities have transcended not just geographical but also legal and jurisdictional boundaries of nation states. MNCs today have become virtual behemoths employing large workforces worldwide and accounting for a considerable proportion of the world GDP. With the increasing diversification of state functions, states' inability to perform all functions on their own and the consequent necessity to delegate to external agencies has seen a number of MNCs expanding their outreach to cover even those sectors which have been traditionally managed by the state. For these reasons they have come to wield considerable economic and social power and their activities are capable of impacting the lives of a large number of people directly and indirectly. This is further accentuated by their outreach in unexplored and unsaturated areas in search of markets, client bases, workforce, favorable work environment etc. that has led many multinationals that were conventionally present in developed countries of the world to far flung corners of the globe including developing and least developed countries. This interaction while bringing revenue, employment and other fringe benefits to the host countries and societies has also brought tensions created by exploitative practices, environmental degradation, corruption, hegemonistic control and the like.

MNCs have indeed brought about changes in people's lives in multiple ways as acknowledged by a number of international organizations, WTO included. They have brought about technological advancements, introduced new cultures and engendered economic prosperity among other things.

On the flip side however, their activities have also resulted in deleterious effects causing harm to local communities and environment. This harm has come in various forms which ultimately impinge on human rights. This has led to calls for establishing some kind of framework to regulate these entities. However, the fact that MNCs operate across multiple national jurisdictions, have complex organizational structures involving multiple hierarchies of corporate governance as well as other issues to be elaborated subsequently in this write up often renders the task of regulating them extremely difficult. Furthermore, conventionally private entities including transnational corporations essentially being non-state actors are not considered to be holding human rights obligations despite a burgeoning academic debate around this issue and growing recognition that they are participants in the international law with capacity to bear some rights and duties. This creates additional difficulties in directly imputing human right violations on them.

In this backdrop GAL can serve as an important regulatory instrument and can provide legal interventions necessary to hold MNCs accountable. The underlying logic is that GAL draws its very basis from being able to provide solutions to issues of global governance that arise due to the interoperability of entities in multiple jurisdictions.