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An Exploratory Study on Compulsory Liquidation of a Company and Its Liability

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INTRODUCTION

If incorporation is the process of establishing the company, winding up is the act of terminating the existence of that so-called artificial person corporation. A company cannot die a natural death. It has an endless life span, but if circumstances arise that make it essential to end its corporate existence, then the appropriate legal mechanisms must be put into action to effectuate this. This mechanism is the winding up procedure. It is a method used to manage a company's assets to the advantage of its creditors and members. Managing a company's assets and liabilities is the responsibility of a **"liquidator"**, who is appointed to do so. The liquidator is chosen by the Tribunal under **Section 275 of the Companies Act, 2013**[1] in the case of a compulsory winding up, or by the company itself under **Section 310 of the Act**[2] in the case of a voluntary winding up. Liquidation is another name for winding up. Upon liquidation, the name of the firm is struck from the list of entities by the Registrar of Companies and announced in the official gazette. The objective of this research is to study the causes of liquidation of a company.

According to **Prof. Gower**, "Winding up of a company is a process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator, called liquidator, is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes the surplus among the members in accordance with their rights."[3]

RESEARCH PROBLEM

Individuals have difficulty associating company liquidation with any benefits. Ultimately, the purpose of compulsory winding-up procedures is to put an end to the business permanently. Nonetheless, there are certain benefits for the director of a firm who already has little prospect of revival. The advantages include the ability to dissolve unmanageable debts and, as a result, there is an end to rising creditor pressure. There is also a lower risk of improper or fraudulent trade if the liquidation procedure is initiated via creditors' voluntary liquidation (CVL). Thus, it becomes important to investigate the reasons as to why courts/tribunals order the compulsory liquidation of any business, as well as to study the company's liabilities during such liquidation.

OBJECTIVES AND SCOPE OF RESEARCH

The objectives of this study are:

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[1] Section 275 in The Companies Act, 2013, (2013)
[2] Section 310 in The Companies Act, 2013, (2013)
[3] L C B Gower, *Gower's principles of Modern Company Law* (Stevens & Sons) (1979)

- To study the procedure of compulsory liquidation of companies in India.
- To investigate into the reasons behind the liquidation of a company.
- To determine the extent of liability of companies during the liquidation.
- To examine the powers and functions of courts and tribunals during compulsory liquidation.

The research's scope will primarily be extended to India and the provisions under Indian laws applicable on companies, i.e., Companies Act, 2013, Insolvency and Bankruptcy Code, 2016, etc. Presence of four adjudicating authorities in process of winding up, namely High Court, Company Law Board, Board for Industrial and Financial Reconstruction and Debt Recovery Tribunal, has also been discussed.

RESEARCH QUESTION

- Whether the insolvency of a company is the primary cause of its liquidation?
- What are the liabilities of a company during its compulsory liquidation?

HYPOTHESES

- H_0: Insolvency is not the only main reason for the compulsory liquidation of a company.
- H_1: Insolvency is the only main reason for the compulsory liquidation of a company.

LITERATURE REVIEW

The Insolvency and Bankruptcy Code, 2016 (IBC) marks a significant milestone in our country's dynamic past. The code is a revolutionary reform introduced to update the current provisions of the Companies Act, 2013, as it completely deleted the provisions of the voluntary winding up in the Companies Act, 2013. The IBC, 2016 combines and modifies the rules governing company insolvency, partnership firms, and limited liability partnerships into a single piece of legislation. It strives to offer a time-bound settlement and empowers creditors to begin the insolvency resolution procedure if there is a default **(Goswami and Rai, 2018[4])**. The authors of this research compare the provisions for winding up a company in the Companies Act, 2013 to the rules for winding up in the IBC, 2016. The study is doctrinal in nature, and the researchers drew on existing literature as well as numerous judicial decisions issued by tribunals and courts. The authors have established a clear differentiation and comparison of the winding up rules under existing Company laws and the new code, i.e., the IBC, 2016.

The main reasons for a company's liquidation are insolvency, obsolescence of the company's products, continuous losses, or any other compelling reasons. According to the Companies Act of 1956, a company can be liquidated in three ways: compulsory liquidation, voluntary liquidation, and winding up under the supervision of the court. **Deepthi and Tomer, 2019[5]** is an empirical study conducted in which samples were collected through the use of probability sampling and random sampling methods. A total of 1512 respondents have been sampled. The value of the chi square is found using the spas tool, and the research output is that there is no significant association between the process of liquidation of the company done by the liquidator and gender, but there is a significant association between the compulsory liquidations

[4] Akrati Goswami & Sarika Rai, *Winding up of a Company under the Insolvency and Bankruptcy Code, 2016: A Comparative Analysis*, HEINONLINE (2018), https://heinonline.org/HOL/LandingPage?handle=hein.journals/supami5&div=6&id=&page=.

[5] M. Deepthi & Sangeetha Tomer, *A Detailed Research on Liquidation of a Company*, HOME - INTERNATIONAL JOURNAL OF RECENT TECHNOLOGY AND ENGINEERING (IJRTE) (2019), https://www.ijrte.org/wp-content/uploads/papers/v8i4/D5387118419.pdf.

initiated by the creditors as per court order, and it is concluded that most of the companies go through the liquidation process in order to save the company from loss and also the money which is raisable.
The liquidation process was previously carried out in accordance with the provisions of the Companies Acts of 1956 and 2013. The main disadvantage of this provision is that the lengthy time period for liquidation and proper justification was not provided to the company's creditors. As a result, to alleviate the lengthy process of liquidation and to provide justice to creditors, the Insolvency and Bankruptcy Code of 2016 was introduced to address the aforementioned issues. The primary goal of **R., Darshan and Madhankumar, 2021**[6] is to highlight the differences between the procedural aspects of company liquidation under the Companies Act and the Insolvency and Bankruptcy Act of 2016. This case study compares companies liquidated under the Companies Act to those liquidated under the IBC. It examines several case studies of companies that are still in the process of liquidation under the Companies Act and compare them to cases that have already been liquidated under the Insolvency and Bankruptcy Code 2016.
Singhal and Goel, 2021[7] studies the company winding-up regimes in three different countries: the United Kingdom of Great Britain, the United States of America, and India. The primary object is to investigate the effectiveness of the legal processes and compare them. This paper also establishes a link between different practises and the new laws that are being implemented, focusing on the Companies Act, 2013 and the Insolvency and Bankruptcy Code, 2016, specifically in the Indian context. The study also attempts to analyse the various problems encountered by companies during the insolvency and winding up process. The study also looks at the historical evolution of insolvency laws, as well as the factors that drive such a process. This examination of provisions leads to an examination of various underlying principles, which provide useful insights. Furthermore, the paper attempts to reach a conclusion by identifying and analysing the differences and similarities in the various regimes.

RESEARCH ANALYSIS

Sections 270-365 of the Companies Act of 2013 deal with a company's winding up procedure. The Supreme Court upheld the constitutionality of the **NCLT and NCLAT** in 2015. As a result, the establishment of the NCLT and NCLAT may result in more effective implementation of the winding up provisions. This has undoubtedly reduced the number of cases filed in multiple forums. These institutions function as specialised quasi-judicial bodies, shortening the winding-up process and avoiding multiple levels of litigation before high courts, the **Company Law Board**, and the **Board for Industrial and Financial Reconstruction**. Under the Companies Act of 2013, there are two modes of winding up that can be initiated: **compulsory winding up and voluntary winding up**.[8] The voluntary winding up is further divided into two stages: members voluntary winding up and creditors voluntary winding up.

[6] Saminathan R et al., *A Study On Liquidation Of Companies Under Companies Act Compared With Liquidation Of Companies Under Insolvency And Bankruptcy Code*, RESEARCHGATE (2021), https://www.researchgate.net/publication/349807377_A_Study_On_Liquidation_Of_Companies_Under_Companies_Act_Compared_With_Liquidation_Of_Companies_Under_Insolvency_And_Bankruptcy_Code.
[7] Mayank Singhal & Kanika Goel, *Comparative Analysis of winding up of a Company: Perspectives in UK, USA & India*, HUMANITIES COMMONS (2021), https://hcommons.org/deposits/item/hc:38519/.
[8] *Compulsory liquidation*, ECONOMY, https://www.economy-ni.gov.uk/articles/compulsory-liquidation.

Compulsory Winding-Up

Compulsory winding up occurs only when a company is unable to pay its debts or has violated the law, or when a special resolution is passed stating that the company should be wound up by the court, among numerous other circumstances.

Winding up by Tribunal: A petition for winding up order can be filed with the National Company Law Tribunal. It ought to be depended on just when different methods for remedies are absolutely no avail. The statute provides remedies for issues concerning the management and operation of the company. Under the Companies Act of 2013, the NCLT has primary jurisdiction to wind up companies. There must be compelling reasons to grant a company's winding-up order.

Grounds on which a Company may be wound up by the Tribunal: When a company fails to pay its debts, a special resolution is passed stating that the company should be wound up only through court proceedings. If the company has violated a country's sovereignty or integrity, or has affected the public interest, the company may face compulsory liquidation.[9] If the company has failed to file its financial statements or annual returns with the Registrar for the preceding five consecutive financial years and the tribunal believes that it is just and equitable to wind up the company.

Inability to pay debts: Under Section 271 (2) of the Companies Act, 2013, a company is deemed unable to pay its debts if a creditor to whom the company owes more than Rs. 1 lakh has served a notice at the registered office of the company requiring the company to pay the due amount and the company has failed to pay the sum within 21 days or I f any other process issued by a court decree or order in the creditor's favour is returned unsatisfied in whole or in part, the company is forced to wind up. Under Section 272 of The Companies Act, 2013, a petition for winding up may be presented by any of the following persons: the company; or any creditor or creditors or any contributory; or all or any of the above three specified parties; or The Registrar[10]; or Central Government in this behalf if the public interest is affected or by the Central Government or a State Government in the case of a company acting against India's sovereignty and integrity. According to Section 272 of the Companies Act of 2013, a creditor includes a secured creditor, holder of debentures, and trustee for holder of debentures.

Powers and Functions of the Tribunal

According to Section 274 of the Companies Act, 2013, if the tribunal is satisfied by the filing of a petition for winding up by someone other than the company, it shall direct the company by order to file objections along with a statement of affairs within 30 days, which may be extended by another 30 days in special circumstances.

According to Section 275 of the Companies Act of 2013, when a winding up order is issued, the Tribunal will appoint an official liquidator or a liquidator from a panel. The Central Government maintains a panel of notified professionals with at least ten years of experience in corporate matters.

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[9] Chris Anderson, *What is Compulsory Liquidation? - Company Debt*, COMPANY DEBT (2023), https://www.companydebt.com/liquidation/compulsory-liquidation/.

[10] *A Guide to Compulsory Liquidation*, McTear Williams & Wood Limited, https://www.mw-w.com/a-guide-to-compulsory-liquidations

According to Section 281 of the Companies Act, 2013, the Liquidator must submit a report to the Tribunal within 60 days that includes information on the following: the nature and details of the company's assets, along with their location and value; the amount of capital issued, subscribed, and paid up; the current liabilities of the company, along with their names and other details; the debts due to the company, along with their names and addresses; details of contracts; the holding and subsidiary companies' details; and legal case information.

After considering the Liquidator's report, the Tribunal will set a deadline for the completion of the proceedings and the dissolution of the company. The Tribunal may also order the sale of the Company as a going concern or of its assets. The assets of the company will be utilised to discharge its liability after the Tribunal issues a winding-up order.

Voluntary Winding-Up

The company and its creditors settle their affairs without going to court in a voluntary winding up. For the purpose of winding up, the company and its members in general meeting appoint one or more liquidators. Section 304 deals with the circumstances in which a company may be wound up voluntarily. The first circumstance is that if a company in a general meeting passes a resolution stating that the company should be wound up voluntarily as a result of the expiry of the period for its duration if any fixed by its article of association provided that the company should be dissolved.

The second scenario is that the company is wound up voluntarily if it passes a special resolution. The voluntary winding up can only be initiated by the company's creditors or shareholders if they want to wind up the company, or by the company if they have entered any clause in the articles of association.[11]

Winding Up of Companies after the Insolvency and Bankruptcy Code, 2016

The Insolvency and Bankruptcy Code, 2016, consolidates and modifies the laws governing the insolvency of corporations, partnership firms, and limited liability partnerships into a single piece of legislation. It aims to provide a time-bound resolution and empowers creditors to initiate the insolvency resolution process if there is a default. Following a notification issued by the Ministry of Corporate Affairs on November 15th, 2016, section 255 of the Insolvency & Bankruptcy Code, 2016 amended the following sections of the Companies Act, 2013.

A new insertion was made in the definition of winding up, which now states that winding up means winding up under this Act or liquidation under the Insolvency & Bankruptcy Code, 2016, as applicable. Following the implementation of this Code, Section 270 of the Companies Act, 2013, relating to the Modes of Winding Up, was repealed. Winding up by Tribunal has taken its place. Section 271, companies Act, 2013 which deals with Circumstances in which company may be wound up by Tribunal has been substituted namely 9- A company may be wound up by the Tribunal, on petition under Section 272, if the company has resolved by special resolution that company be wound up by the Tribunal; if the company has acted against sovereignty, integrity, security of India friendly relations with foreign states, public order, decency, morality; if Tribunal is of opinion that company should be wound up on just and equitable grounds.

The sub-section has been replaced in Section 275 of the Companies Act, 2013 by Section 275(2), which deals with Company Liquidators and their appointment, according to which the Tribunal shall appoint the

[11] *Creditors' Voluntary Liquidation (CVL)*, Begbies Traynor Group, https://www.begbies-traynorgroup.com/creditors-voluntary-liquidation-cvl

provisional or Company Liquidator from among the insolvency professionals registered under the Insolvency & Bankruptcy Code, 2016.

Section 304 of the Companies Act, 2013, which deals with the circumstances under which a company may be voluntarily wound up, has been omitted by the Insolvency & Bankruptcy Code, 2016, along with other sections relating to voluntary winding up under the Act.

Section 59 of Chapter V of Part II of the Insolvency and Bankruptcy Code deals with voluntary liquidation. Furthermore, the distinction between voluntary winding up by members and voluntary winding up by creditors has been removed. According to Section 59 of the Code, a corporate person who has not committed any default may initiate the voluntary liquidation process. Default refers to debts that have not been repaid and have become due and payable. Compliance with certain requirements is required-

1. Declaration by directors that winding up is not to defraud any person
2. Liquidator can be insolvency professional who fulfils criteria under the regulations
3. Registers to be maintained in prescribed manner under the IBC
4. Liquidators to receive claims of stakeholders only in specified forms
5. Within twelve months from commencement of voluntary winding up, the affairs of corporate person to be wound up
6. Reports by Liquidator to be submitted to corporate person, Registrar of Companies and Insolvency and Bankruptcy Board of India
7. The time period to comply the requirements has also been reduced to expedite the process

Procedure for Winding-Up under New Regulations

The new procedure for winding up was established to shorten the time frame in the 1990s, when there were many cases that had been running for years and years. The Insolvency and Bankruptcy Code, 2016, was enacted to ensure time-bound insolvency settlement, which would aid in the resolution of India's bad debt problem.

STEP 1: One has to submit a declaration to Registrar of Companies, stating that company will pay its dues and liquidation is not to defraud any person

STEP 2: Within 4 weeks of such declaration, special resolution has to be passed for approval of proposal of voluntary liquidation and appointment of liquidator

STEP 3: Within 5 days of such approval, public announcement in newspaper and website of company has to be made for inviting claims of stakeholders

STEP 4: Within 7 days of such approval, intimation should be given to ROC and Board

STEP 5: Submission of preliminary report containing capital structure, estimates of assets and liabilities, proposed plan of action within 45 days to a corporate person

STEP 6: Verification of claims within 30 days and preparation of list of stakeholders within 45 days from the last date of receipt of claims

STEP 7: For receipt of money due to corporate person, bank account needs to be open in name of corporate person having words „in voluntary liquidation‟ after its name.

STEP 8: Sale of assets and recovery of due money, uncalled capital is realised

STEP 9: The proceeds from realization to be distributed within 6 months from receipt of amount to the stakeholders

STEP 10: The final report by the liquidator has to be submitted to corporate person, ROC, the Board and application to NCLT.

STEP 11: The order of NCLT regarding dissolution to be submitted within 14 days of receipt of order.
Following the adoption of this new code, any company that wishes to liquidate must now follow the Insolvency and Bankruptcy Code, 2016. In comparison to the Companies Act of 1956, the Code is far more comprehensive and vaster. The presence of four adjudicating authorities, the High Court, the Company Law Board, the Board for Industrial and Financial Reconstruction, and the Debt Recovery Tribunal, is expected to aid in overcoming delays and complexities in the process. It would also reduce the burden on the courts because all litigation would be filed under the Code.

CONCLUSION AND SUGGESTIONS

Before becoming incorporated, a company must overcome a number of challenges; only then can it begin to operate. However, after existing as an artificial person for a long time or period due to a wrongdoing, the company may enter into a winding-up procedure, either through the voluntary winding up or by the compulsory winding up. When the process of dissolution begins, there are a number of steps the company must follow as given under the Companies Act, 2013 and the Insolvency and Bankruptcy Code, 2016. Therefore, we cannot claim that insolvency is the only factor contributing to a company's liquidation as this is not always the case.

Suggestions-

- The Companies Act 2013 is not as detailed as the Companies Act 1956, where many sections have been combined into one and various provisions were removed. The provisions relating to punishments have been changed most significantly, but the number of cases is still increasing. In this way, the government must exercise greater caution in enforcing penalties rather than passing numerous laws.
- In the Indian situation, voluntary winding up is preferred because it is a quick procedure. The proceedings are under the control of both the members and the creditors. Only when necessary, such as when a company's practises do not take into account the interests of the general public, may the tribunal be asked to intervene.
- In comparison to the Companies Act of 1956, the IBC is much more extensive and broader. Due to the presence of four adjudicating authorities, including the High Court, the Company Law Board, the Board for Industrial and Financial Reconstruction, and the Debt Recovery Tribunal, it is anticipated that the Code will assist in overcoming the delays and complexities involved in the procedure.

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