Winding up of Companies under Companies Act, 2013 & Insolvency & Bankruptcy Code, 2016

Till the advent of Insolvency & Bankruptcy Code, 2016, (IBC, 2016), winding up of companies was completely under the purview of the erstwhile Companies Act, 1956 and later Companies Act, 2013. However, with the enactment of IBC, 2016, a company can be wound up either under the Companies Act, 2013 or under IBC, 2016 depending on the facts and circumstances of each case. Sections 230-231 and 270-365 of the Companies Act, 2013 and Sections 33 to 54 and Section 59 of IBC, 2016 deal with the issue of winding up of the companies.

Earlier, it is the Companies Act which alone dealt with the issues from incorporation to dissolution of the companies. The Companies Act, 1956 provided for three modes of winding up of companies, namely :

1. Winding up by the Court or Compulsory winding up
2. Voluntary winding up..
3. Winding up subject to the supervision of the Court.

The issue of "inability to pay debts" was covered under the mode of winding up by the court and generally the creditors would always press this button for recovery of their debts in a summary procedure and as a fast track solution. In this mode, if after receipt of the 21 days statutory notice, if the company failed and neglected to pay its debts, the company was deemed to be insolvent and the winding up proceedings would commence. Of course, existence of a dispute with regard to the said payments of debts was one of the main grounds for the Company court to refuse the order of winding up.

K.S. Hareesh Kumar
Chief Manager (Law)
Union Bank of India
Kolkata

The Bombay High Court has laid down the following principles in Softsule(P) Ltd. Re, (1977) 47 Com.Cases 438 (Bom):

"Firstly, it is well settled that a winding up petition is not legitimate means of seeking to enforce payment of a debt which is bona fide disputed by the company. If the debt is not disputed on some substantial ground, the Court/Tribunal may decide it

on the petition and make the order.

Secondly, if the debt is bona fide disputed, there cannot be "neglect to pay" within the meaning of Section 433(1)(a) of the Companies Act, 1956. If there is no neglect, the deeming provision does not come into play and the winding up on the ground that the company is unable to pay its debts is not substantiated.

Thirdly, a debt about the liability to pay which at the time of the service of the insolvency notice, there is a bona fide dispute, is not 'due' within the meaning of Section 434(1)(a) and non-payment of the amount of such a bona fide disputed debt cannot be termed as "neglect to pay" the same so as to incur the liability under Section 433(e) read with Section 434(1)(a) of the Companies Act, 1956.

Fourthly, one of the considerations in order to determine whether the company is able to pay its debts or not is whether the company is able to meet its liabilities as and when they accrue due. Whether it is commercially solvent means that the company should be in a position to meet its liabilities as and when they arise."

The Madras High Court in Tube Investments of India Ltd. v. Rim and Accessories (P) Ltd. (1990) 3 CLJ 322, has evolved the following principles relating to bona fide disputes:

(i) If there is a dispute as regards the payment of the sum towards principal however small that sum may be, a petition for winding up is not maintainable and the necessary forum for determination of such a dispute existing between parties is a Civil Court;

(ii) The existence of a dispute with regard to payment of interest cannot at all be construed as existence of a bona fide dispute relegating the parties to a Civil Court and in such an eventuality, the Company Court itself is competent to decide such a dispute in the winding up proceedings; and

(iii) If there is no bona fide dispute 'with regard to the sum payable towards the principal, it is open to the creditor to resort to both the remedies of filing a civil suit as well as filing a petition for winding up of the company.

The Rules as regards the disposal of winding up petition based on disputed claims are stated by the Supreme Court in Madhusudan Gordhandas & Co. v. Madhu Woollen Industries Pvt. Ltd. [1972]2SCR201 . The Court has held that if the debt is bona fide disputed and the defence is a substantial one, the Court will not wind up the company. The principles on which the Court acts are:

(i) that the defence of the company is in good faith and one of substance;

(ii) the defence is likely to succeed in point of law; and

(iii) the company adduces, prima facie proof of the facts on which the defence depends.

Further, in the case of IBA Health (I) Pvt. Ltd. vs. Info-Drive Systems Sdn. Bhd. (23.09.2010 - SC) : MANU/SC/0772/2010, the Supreme Court held as under :

"21.The Appellant company raised a contention that it is commercially solvent and, in such a situation, the question may arise that the factum of commercial solvency, as such, would be sufficient to reject the petition for winding up, unless substantial grounds for its rejection are made out. A determination of examination of the company's insolvency may be a useful aid in deciding whether the refusal to pay is a result of the bona fide dispute as to liability or whether it reflects an inability to pay, in such a situation, solvency is relevant not as a separate ground.

If there is no dispute as to the company's liability, the

solvency of the company might not constitute a stand alone ground for setting aside a notice under Section 434(1)(a), meaning thereby, if a debt is undisputedly owing, then it has to be paid. If the company refuses to pay on no genuine and substantial grounds, it should not be able to avoid the statutory demand. The law should be allowed to proceed and if demand is not met and an application for liquidation is filed under Section 439 in reliance of the presumption under Section 434(1)(a) that the company is unable to pay its debts, the law should take its own course and the company of course will have an opportunity on the liquidation application to rebut that presumption.

22. An examination of the company's solvency may be a useful aid in determining whether the refusal to pay debt is a result of a bona fide dispute as to the liability or whether it reflects an inability to pay. Of course, if there is no dispute as to the company's liability, it is difficult to hold that the company should be able to pay the debt merely by proving that it is able to pay the debts. If the debt is an undisputedly owing, then it should be paid. If the company refuses to pay, without good reason, it should not be able to avoid the statutory demand by proving, at the statutory demand stage, that it is solvent. In other words, commercial solvency can be seen as relevant as to whether there was a dispute as to the debt, not as a ground in itself, that means it cannot be characterized as a stand alone ground.

The Court further held that "Where the company has a bona fide dispute, the petitioner cannot be regarded as a creditor of the company for the purposes of winding up. "Bona fide dispute" implies the existence of a substantial ground for the dispute raised. Where the Company Court is satisfied that a debt upon which a petition is founded is a hotly contested debt and also doubtful, the Company Court should not entertain such a petition. The Company Court is expected to go into the causes of refusal by the company to pay before coming to that conclusion. The Company Court is expected to ascertain that the company's refusal is supported by a reasonable cause or a bona fide dispute in which the dispute can only be adjudicated by a trial in a civil court. In the instant case, the Company Court was very casual in its approach and did not make any endeavour to ascertain as to whether the company sought to be wound up for non-payment of debt has a defence which is substantial in nature and if not adjudicated in a proper forum, would cause serious prejudice to the company".

The court cautioned against Malicious Proceedings for Winding up and held as under :

"25. We may notice, so far as this case is concerned, there has been an attempt by the respondent company to force the payment of a debt which the respondent company knows to be in substantial dispute. A party to the dispute should not be allowed to use the threat of winding up petition as a means of enforcing the company to pay a bona fide disputed debt.

A Company Court cannot be reduced as a debt collecting agency or as a means of bringing improper pressure on the company to pay a bona fide disputed debt. Of late, we have seen several instances, where the jurisdiction of the Company Court is being abused by filing winding up petitions to pressurize the companies to pay the debts which are substantially disputed and the Courts are very casual in issuing notices and ordering publication in the newspapers which may attract adverse publicity. Remember, an action may lie in appropriate Court in respect of the injury to reputation caused by maliciously and unreasonably commencing liquidation proceedings against a company and later dismissed when a proper defence is made out on substantial grounds. A creditor's winding up petition implies insolvency and is likely to damage the company's creditworthiness or its financial standing with its creditors or customers and even among the public.

26. A creditor's winding up petition, in certain situations, implies insolvency or financial position with other creditors, banking institutions, customers and so on. Publication in the Newspaper of the filing of winding up petition may damage the creditworthiness or financial standing of the company and which may also have other economic and social ramifications. Competitors will be all the more happy and the sale of its products may go down in the market and it may also trigger a series of cross-defaults, and may further push the company into a state of acute insolvency much more than what it was when the petition was filed. The Company Court, at times, has not only to look into the interest of the creditors, but also the interests of public at large.

27. We have referred to the above aspects at some

length to impress upon the Company Courts to be more vigilant so that its medium would not be misused. A Company Court, therefore, should act with circumspection, care and caution and examine as to whether an attempt is made to pressurize the company to pay a debt which is substantially disputed. A Company Court, therefore, should be guarded from such vexatious abuse of the process and cannot function as a Debt Collecting Agency and should not permit a party to unreasonably set the law in motion, especially when the aggrieved party has a remedy elsewhere."

Therefore, it could be seen that the provision of winding up was being used for arm twisting of the Companies for recovering their debts by the creditors. However, under the IBC, in respect of application filed under Section 7, dispute is not relevant, but "default" is.

The revised Companies Act, 2013 had the same provisions as of the Companies Act, 1956 with regard to the winding up of companies till the enactment of Insolvency & Bankruptcy Code, 2016. But, the aspect of insolvency resolution, as is envisaged under IBC, 2016, was not covered by the Companies Act, though the same was comprehensively covered under Sick Industrial Companies (Special Provisions) Act, 1985 and to some extent under the Chapter of Compromise and Arrangement.

The main objective under IBC, 2016 is resolution of the Company's insolvency rather than recovery of creditors' dues though the same is well part and parcel of the resolution plan. Section 271 of the Companies Act, 2013 has been amended by Section 245 of the of the IBC,2016 and new grounds for winding up of the company have been introduced while completely taking away the provisions of winding up for inability to pay debts by shifting it to the IBC, 2016, but giving it a new impetus. Presently, Section 271 of the Companies Act, 2013 provides for the following circumstances under which a company could be wound up :

1) If the Company has, by special resolution, resolved that the company be wound up by the Tribunal.

2) If the Company has acted against the interest of the sovereignty and integrity of India, the security of the State, friendly relations with foreign states, public order, decency or morality.

3) If on an application made by the Registrar or any other person authorized by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the Company have been conducted in a fraudulent manner or the Company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith ad that it is proper that the company be wound up.

4) If the Company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or

5) If the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

Under the Companies Act, 2013, in a case of a situation arising under Section 271(b), Central and State Governments have also been empowered to file the Petition for winding up of the Company. The elaborate discussion contained in Sections 304-323 under Part II, i.e., "Voluntary winding up" has been omitted, apparently, since the Section 271 and Section 10 of the IBC themselves enabled the Companies to apply for winding up and/or resolution.

IBC proposes a paradigm shift and seeks to encourage resolution as a means of first resort for recovery and winding up of the company as a last resort unlike the previous regime when companies were to be wounded up for their inability to pay debts. Further, the resolution has to be in a time bound manner and as such it can be said that the IBC to be a fast track mechanism to either resolve or to liquidation.

Classification Of Creditors of the Corporate Debtors :

The Companies Act, 2013 (or earlier versions of the Companies Acts) did not make any distinction between the creditors save and except as Secured and Unsecured Creditors. Whereas, IBC, 2016 has made a further distinction and provided for two more kinds of creditors, namely Financial and Operational Creditors. A Financial Creditor has been defined under Section 5(7) of the Code to mean any person to whom a financial debt is owed whereas Section 5(20) of the Code defined Operational Creditor as a person to whom

operational debt is owed. The word "Financial Debt" has been defined under Section 5(8) of the Code indicating that where money is disbursed/borrowed for interest and whereas Operational Debt is defined under Section 5(21) where it is a claim in respect of supply of goods or services.

Service of Notice :

Under the Companies Act, 2013, a creditor (Whether Financial or Operational) was required to issue a three weeks notice before filing the winding up petition. But, under Section 7 of the IBC,2016, no notice is required to be issued to the Corporate Debtor whereas in case of an operational creditor, as per Section 8 of the Code, a demand notice is required to be served upon the corporate debtor.

In the Companies Act, 2013, the issue of "dispute" was relevant for the company court/NCLT to pass the order of winding up as discussed above whereas under IBC,2016, the same is not relevant for passing the orders in respect of the application filed by a Financial Creditor under Section 7 of the Code for initiation of corporate insolvency resolution process. But, in case of an Operational Creditor, as per Section 8(2)(a) of the Code, the Corporate Debtor is required to bring to the notice of the Operational Creditor of existence of a dispute, if any, within a period of 10 days of the receipt of the demand notice.

Decision of the Tribunal

If after admission of the Petition filed either by Financial or Operational Creditor, as per Section 33 of the IBC, 2016, if the Adjudicating Authority does not receive a resolution plan as approved by the Committee of Creditors or if the Adjudicating Authority rejects the resolution plan as per Section 31, the Adjudicating Authority shall pass an order requiring the corporate debtor to be liquidated. A company can be liquidated even during the course of Insolvency Resolution Process if the Committee of Creditors decides to liquidate the Company. Further, a Company may be ordered to be liquidated by the Adjudicating Authority if the Resolution Plan approved by him is violated by the Corporate Debtor.

Jurisdiction of the Courts for winding up of the Companies

Under the Companies Act, 1956, it was the High Courts which had been vested with the jurisdiction to deal with winding up matters. The repealed Sick Industrial Companies (Special Provisions) Act, 1985 had provided that the Board for Industrial Construction and Rehabilitation (BIFR) could recommend winding up of a Company though it was not binding on the Company Court.

Presently, jurisdiction to pass orders for winding up under Section 271 of the Companies Act, 2013 and winding up under the provisions of IBC, 2016 has been vested in the 11 National Company Law Tribunals situated across the country which are constituted under Section 408 of the Companies Act, 2013.

Further, despite every aspect of Company's insolvency and its resolution has been dealt with under IBC, 2016, it is observed that the Chapter XV of the Companies Act, 2013 (Sections 230-231) which deals with, inter alia, the Compromises and Arrangements has been retained even after IBC, 2016 has come into force. The IBC, 2016 comprehensively deals with all the issues of company's insolvency and resolution thereof including by way of Compromise and arrangement. The resolution and procedure therefor envisaged by way of Compromise and Arrangement between a company and its creditors is also similar to the one envisaged in the IBC, 2016.

Section 231 of the Companies Act provides that if the Compromise or Arrangement sanctioned under Section 230 of the Act cannot be implemented satisfactorily with or without modifications, and the company is unable to pay its debts as per the Scheme, the Tribunal may make an order for winding up the Company which is also similar to Section 33 of the IBC, 2016. Hence, these provisions appear to be superfluous and there is a case for deletion of Sections 230 and 231 of the Companies Act, 2013 in view of the comprehensive IBC, 2016 thereon being already in force.

Therefore, it can be said that the Companies Act, 2013 and IBC, 2016 are complementary to each other and provide a comprehensive scheme for winding up of companies. MA

kshk.hareesh@gmail.com