24.1 Meaning

Winding up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator, called a 'liquidator', is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their respective rights. In the words of Pennington, winding up or liquidation is the process by which the management of a company's affairs is taken out of its directors' hands, its assets are realised by a liquidator, and its debts and liabilities are discharged out of the proceeds of realisation and any surplus of assets remaining is returned to its members or shareholders. At the end of the winding up the company will have no assets or liabilities, and it will therefore be simply a formal step for it to be dissolved, that is, for its legal personality as a corporation to be brought to an end.

Winding up of a company differs from insolvency of an individual inasmuch as a company cannot be made insolvent under the insolvency law. Besides, even a solvent company may be wound up.

24.2 Modes of winding up [Section 270(1)]

With the passing of Insolvency and Bankruptcy Code, 2016, a company can now be wound up under the Companies Act, 2013 only by the Tribunal. The concept of voluntary winding up, as provided earlier, has been removed. Section 2(94A), as amended by the Insolvency and Bankruptcy Code, defines the expression winding up to mean winding up under this Act or liquidation under the Insolvency and Bankruptcy Code, 2016, as applicable. Chapter XX of the Act contains provisions for winding up of a company.

24.2-1 Insolvency and Bankruptcy Code, 2016

The Insolvency and Bankruptcy Code, 2016 received the assent of the President of India on 28 May 2016. The code aims to consolidate and amend the laws relating to

...locations, which are contained in various enactments, into a single legislation. The main focus of this legislation is at providing resurrection and resolution in a time bound manner for maximization of value of debtor's assets. The Code has put forth an overarching framework to aid sick companies to either wind up their business or engineer a revival plan, and for investors to exit. Notably, the Code has also empowered the operational creditors (workmen, suppliers etc.) to initiate the insolvency resolution process, if default occurs.

The code contains provisions for insolvency resolution process as well liquidation of companies. It also provides for voluntary liquidation of companies. With the passing of the Code, the concept of voluntary winding up of companies under the Companies Act, 2013 has been removed. Consequently Sections 304-323 of the Act have been deleted. Likewise Chapter XIX of the Act, dealing with the Revival and Rehabilitation of Sick Companies has been omitted and Sections 253-269 of the Act have been deleted. Two of the grounds for winding up by the Tribunal - due to inability to pay debts and winding up under Chapter XIX - have been omitted.

The Insolvency and Bankruptcy Board of India has notified Insolvency and Bankruptcy Board of India (Voluntary Liquidation Process) Regulations 2017, effective 1 April 2017.

24.3 Winding up by the Tribunal

Winding-up by the Tribunal, may be ordered in cases mentioned in section 271. The Tribunal will make an order for winding up on an application by any of the persons enlisted in section 272.

Apart from sections 271 to 303 (Part I of Chapter XX) which deal specifically with winding up by the Tribunal, sections 324 to 358 (Part III of Chapter XX), being the provisions applicable to every mode of winding up, are also relevant to the subject of "winding up by the Tribunal". Sections 304 to 323, which dealt with the voluntary winding up, have been deleted, with the passing of the Insolvency and Bankruptcy Code, 2016.

**Grounds for compulsory winding up [Section 271]** - Section 271 provides for circumstances in which a company may be wound up by Tribunal. The section reads:

*A company may be wound up by the Tribunal—*

(a) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;

(b) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;

(c) if on an application made by the Registrar or any other person authorised 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...
WINDING UP BY THE TRIBUNAL

Para 24.3

been guilty of fraud, misfeasance or misconduct in connection therewith and that it is proper that the company be wound up;

(d) 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

(e) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

Two of the grounds for winding up by the Tribunal - Inability to pay debt and winding up under Chapter XIX of the Act - have been deleted with the passing of Insolvency and Bankruptcy Code.

24.3-1 Winding up by Special Resolution [Section 271(a)]

The company may, by special resolution, resolve that it can be wound up by the Tribunal. The resolution may be passed for any cause whatsoever. However, court (now Tribunal) must see that the winding up is not opposed to public interest or the interest of the company as a whole - B. Viswanathan v. Seshasayee Paper and Boards Ltd. [1992] 73 Comp. Cas. 136 (Mad.).

The court (now Tribunal) is also to take into account the possibility/potency of the company to have a financial revival, when the company is incurring loss that led the company to pass special resolution for winding up. The court (now Tribunal) cannot allow a design underlying to frustrate an arbitration proceeding where a significant amount is involved - Advance Television Network Ltd. v. ROC [2011] 108 SCL 702 (Delhi)

This clause is based on the premise that, barring other circumstances, the shareholders themselves are the best judge to decide as to whether or not the company should go out of existence. It is the shareholders who had formed themselves into the company and, therefore, it is for them to dissolve the company. The directors are not entitled to file a winding up petition without the authority of the general meeting. Of course, the directors may file such a petition, subject to the general meeting ratifying their action - Galway & Salt Hill Tramways Co., In re [1918] 1 IR 62/521 LG 93. The company has to call general body meeting and pass a special resolution including therein specifically their resolve for winding up by court (now Tribunal) and setting out grounds in the explanatory statement appended thereto as to why such winding up of the company is called for.

It may be noted that the court (now Tribunal) has a discretion in the matter and is under no obligation to order winding up merely because company has so resolved. The word 'may' in section 433 [now Section 271] denotes that the court (Tribunal) is vested with a discretion in taking a decision. The discretion, no doubt, is to be exercised in a judicial manner - New Kerala Chits & Traders (P.) Ltd. v. Official Liquidator [1981] 51 Comp. Cas. 601 (Ker.).

Further, it may be noted that the right of the company to file the winding up petition is not based merely on the ground mentioned in clause (b) (i.e. by passing special resolution). A company may present that petition, without special resolution, on other grounds mentioned in Section 271.
Para 24.3  WINDING UP

24.3-2 Company acting against the interests of sovereignty and integrity of India, the security of the State, the friendly relations with foreign states, public order, decency or morality [Section 271]

While grounds like acting against the interests of sovereignty and integrity of India or of the security of the State or even of the friendly relations with foreign States are understandable given the prevailing geo-political scene and its contours, the remaining grounds of public order, decency and morality, do not appear to belong to the same strain. How they have been combined together with the former three grounds and what precisely they stand for, need clarification. How a corporate entity can affect public order, decency and morality need explaining. Is it that a corporate entity engaged in media related activities or in advertisement and publicity, producing obscene literature or graphics is to be wound up under this clause? For these, other regulating agencies are there to control these activities like the Press Council, Censor Board and the Police. It is also possible that the Press Council does not hold an article in a magazine as against public order but a State administrator files winding up petition on this ground with the Tribunal and the Tribunal upholds the prayer in the petition. The company publishing the magazine would then be wound up. But would it be fair? Corporate matter should remain encompassed by activities that make corporate entities and abstract individualistic propositions, in fairness, should not find place in corporate legislation. Even a conflict based on fundamental rights enshrined in the Constitution of India can arise; further it has a damaging potential of stifling an individual or a group of individuals working perfectly legally when he or they earn the wrath of ruling political group and/or the ruling bureaucracy. A public debate on this clause is very much an urgent necessity before it inflicts damage to responsible freedom in the society.

The Tribunal will entertain petition under this clause only from the Central Government or a State Government and it appears from the language used in proviso to this section that Tribunal will order winding up on receipt of the petition.

24.3-3 Company’s affairs been conducted in a fraudulent or unlawful manner etc. [Section 271(c)]

The Registrar or any other person authorized by the Central Government may make application to the Tribunal for winding up. On such an application, the Tribunal may order winding up on the following grounds:

(i) The affairs of the company are being conducted in a fraudulent manner; or
(ii) The company was formed for fraudulent or unlawful purpose; or
(iii) The persons concerned in the formation of the company or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith.

It may be noted that an action under sub-clause (e) can be taken by the Tribunal only on application made to it by the Registrar or person authorized by the Central Government for reasons specified therein. It may be noted that under section 213(b) the Tribunal is empowered to order investigation into the affairs of a company on the grounds mentioned therein which are similar to the grounds mentioned under
sub-clause (e) as aforesaid. Under section 224(2)(a) the Central Government may make a petition to the Tribunal for winding up of the company.

24.3-4 Company making default in filing with the Registrar its Financial Statements or Annual returns for immediately preceding five consecutive financial years [Section 271(d)]

It may be recalled that under section 164 any person who is or has been a director of a company which has not filed financial statements or annual returns for any continuous period of three financial years shall not be eligible for appointment or reappointment as a director. On similar lines, Section 271(d) provides a ground of winding up for default in filing financial statements or annual returns. It is a welcome feature as non-accountability and indiscipline in running the affairs of the company is widespread and chronic and Government companies are no exceptions. However, to what extent the danger of being wound up will discourage rampant indiscipline by corporate management in this regard is a matter of conjecture specially the time frame of five consecutive years is too long a period to inflict considerable damage to the corporate viability. This clause contains two distinct non-compliances (i) non-filing of the financial statements and (ii) non-filing of annual return. If default is made in respect of either (for consecutive five immediately preceding financial years), this clause for winding up can be invoked. It is not necessary that default has to be for both financial statements and annual return. If financial statements filed regularly but annual return has not been filed for five consecutive years, the clause becomes applicable. If converse is the case then also it becomes applicable. The test of its applicability lies in default in either matter for consecutive five financial years. However, say default in filing annual accounts is for two years and the same for annual returns is for three years, then this clause cannot be invoked. Further the default has to be in respect of five ‘immediately preceding five consecutive’ financial years. That follows is that default in the earlier years is not a ground of winding up under this clause and also that the default must be for five consecutive years.

24.3-5 Just and Equitable [Section 271(e)]

The Tribunal may also order for the winding up of a company if it is of the opinion that it is just and equitable that the company should be wound up. This is a separate and independent ground for a winding up order, and for a case to be made out under it, it is not necessary that the circumstances should be analogous to those which justify an order on one of the six other specific grounds already dealt with. In exercising its power on this ground, the Court (now Tribunal) shall give due weightage to the interest of the company, its employees, creditors and shareholders and the interest of the general public. The relief based on the just and equitable clause is in the nature of a last resort when the other remedies are not efficacious enough to protect the general interests of the company - Gadadhar Dixit v. Utkal Flour Mills (P.) Ltd. [1989] 66 Comp. Cas. 188 (Ori.). The Gujarat High Court held a similar view in Kiritbhai R. Patel v. Lavina Construction & Finance Ltd. [1999] 20 SCL 158. The Madras High Court in S. Palaniappan v. Tirupur Cotton Spg. & Wvg. Mills Ltd. [2004] 50 SCL 293 also followed the above principle and dismissed the winding up petition. While in the foregoing six grounds for winding up definite conditions should be fulfilled, in the ‘just and equitable’ clause the entire matter is
left to the ‘wide and wise’ direction of the court (now Tribunal) - *Hind Overseas Pvt. Ltd. v. R.P. Jhunjhunwala* [1977] ASIL XIII. The winding up must be just and equitable not only to the persons applying but also to the company and to all its shareholders. Same view has been expressed in *Prem Seth v. National Industrial Corpn. Ltd.* [2002] 35 SCL 636 (Delhi). A few examples of ‘just and equitable’ ground on the basis of which the Tribunal may order the winding up are given below:

1. **Disappearance of substratum** - A company’s substratum is the purpose or group of purposes which it was formed to achieve (in other words, its main objects). If the company has abandoned all of its main objects and not merely some of them, or if it cannot achieve any of its main objects, its substratum is gone, and it will be wound up.

A company may lose the ability to achieve its main objects in a variety of ways. It will do so if it fails to obtain a patent for an invention which it was formed to exploit on the assumption that the patent would be granted\(^2\), or if it fails to acquire the business which it was formed to purchase\(^3\), or if it fails to obtain the necessary approval of a local authority for the erection of the building which it was formed to erect\(^4\).

The fact that the company is exercising some of the ancillary powers conferred by its memorandum of association will not save it, because these powers are intended merely to aid it in achieving its main objects, and not to enable it to carry on a different kind of business or to preserve some appearance of activity\(^5\). If the company’s memorandum of association provides that each of the powers conferred by the objects clause shall be a main object, the Tribunal will nevertheless determine the purposes for which the company was really formed, and will wind it up if it has abandoned them.\(^6\)

In *Dunlop India Ltd., In re* [2013] 31 taxmann.com 135 (Calcutta), respondent was a tyre manufacturing company; however, its two manufacturing facilities had not been functioning for a long period of time. Properties of value in excess of Rs. 2,300 crore had been removed from company without meeting debts of its creditors or even offering unpaid wages and salaries to its workmen and other employees. In such circumstances, instant petition was filed seeking winding up of respondent-company. It was noted that no workmen or employee of company had appeared to resist order of winding up. Further, company had been unable to show any prospects of it carrying on any business in near or distant future. Besides, conduct of management of respondent-company in fraudulently selling off assets estimated at Rs. 2,300 crore made it just and equitable for company to be wound up. Accordingly, the Court allowed petition for winding up of the company.

Where plant and machinery have been sold off and the company was not carrying on any business other than earning interest, a petition for winding up on the ground

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of loss of substratum of the business can be admitted - Pundra Investments & Leasing Co. (P.) Ltd. v. Petron Mechanical Industries (P.) Ltd. [2000] 23 SCL 220 (Bom.). When the Debt Recovery Tribunal orders the sale of the properties of the Company (under RDBFI Act, 1993), it will be presumed that the substratum of the company has gone, unless the order is set aside by competent forum - Prakash Hassaram Mahtani v. Official Liquidator of Nielcom Ltd. (supra) Ch. 23.

Where a joint venture agreement between parties to construct and run a hotel falls a ground due to unilateral action by one of the parties and also the company promoted under that agreement failed to pay bona fide debt and accumulated huge losses, the Delhi High Court ordered winding up of the company as just and equitable - International Caterers (P) Ltd. v. Manor Hotel (P) Ltd. [2007] 79 SCL 234.

However, a temporary difficulty which does not knock out the company’s bottom shall not be permitted to become a ground for liquidation - Re-Shah Steam Navigation Co. [1908] 10 Bom. L.R. 107. In re, Kaithal and General Mills Co. Ltd. [1951] 31 Comp. Cas. 4617, the Court laid down the following tests to determine as to whether the substratum of the company has disappeared :

(a) where the subject-matter of the company has gone; or
(b) the object for which it was incorporated has substantially failed; or
(c) it is impossible to carry on the business of the company except at a loss which means that there is no reasonable hope that the object of trading at a profit can be attained; or
(d) the existing or probable assets are insufficient to meet the existing liabilities.

The Madras High Court in K.S. Mothilal v. K.S. Kasimaries Ceramique (P.) Ltd. [2004] 50 SCL 116 has held that winding up proceedings are not meant for settling personal scores among family members. The court rejected the petition as the company’s liability was marginal compared to its net worth and the company can very well proceed with one or more objects stated in the memorandum even though its major business has been stopped. This does not suggest that company’s substratum is lost.

In Majestic Infracon (P.) Ltd. v. Etisalat Mauritius Ltd., [2014] 45 taxmann.com 76 (Bombay), the Bombay High Court held that inability of the company to carry on main business or undertake any other business in a commercially viable manner indicates that the company has lost its substratum and it is just and equitable to wind up the company. The telecom licences allotted to the company were cancelled by a judgment of the Supreme Court. The petition for winding up was filed on the grounds that it was just and equitable to wind up company, inter alia, on ground that substratum of company had almost completely been eroded that there was a deadlock in management of company and that there was a complete lack of uberrima fides between main shareholders of company.

In Etisalat Mauritius Ltd. v. Etisalat DB Telecom (P.) Ltd. [2015] 55 taxmann.com 271 (Bombay), the petitioner-company had validly acquired thirteen 2G licences which constituted main assets of company and invested a huge sum in company. However, those licences were subsequently cancelled by a judgment of Supreme Court
rendering company unable to carry on its principal object, viz., provision of second
generation (2G) telecommunication services in India. Petitioner and respondent No. 2
were major shareholders who held about 45 per cent each of shareholding of company. Respondent No. 2 withdrew its two nominee directors from Board of
company making board of directors dysfunctional. The petitioner, being other
major shareholder of company, filed winding up petition under just and equitable
clause which was opposed by the Respondent No. 2 who also submitted a scheme
for the revival of the company. The Bombay High Court admitted the winding up
petition on the grounds that the company had lost its substratum and that there was
complete lack of faith and probity resulting in irretrievable breakdown between
major shareholders of company. The court also noted that the liabilities of company
had far exceeded its assets and scheme propounded by respondent No. 2 was
unrealistic, speculative and unworkable.

The Karnataka High Court in Arasor Corporation v. Xalted Information Systems (P.)
Ltd. [2015] 60 taxmann.com 445 (Karnataka), refused to admit a winding up petition
by the petitioner as the petitioner’s certificate of incorporation had become void
because of failure to pay franchise taxes. It was held that the petitioner not being
in existence on date of filing winding up petition had lost its right to be sued and
heard and, therefore, winding up petition filed by it was not maintainable.

2. Illegality of Objects and Fraud - If any of a company’s objects are illegal, or
apparently, if they become illegal by a change in the law, the Tribunal will order the
company to be wound up on the ground that it is just and equitable to do so.8

Similarly, if a company is promoted in order to perpetrate a serious fraud or
deception on the persons who are invited to subscribe for its shares, the Tribunal
will wind it up. Thus, a winding up order was made when the company’s prospectus
stated that it had agreed to purchase the business of an existing firm, together with
the right to use the firm’s name, for a very substantial sum, and subscribers for the
company’s shares were intentionally misled by the name and the amount of the
purchase price into thinking that the firm was a different and reputable concern,
whose business name the vendor firm had, in fact, successfully but illegally imitated
for a number of years. Again, a winding up order was made against a company
whose promoters sold a business to them at a gross overvalue, and when the
defection was discovered, bought up at a very low price most of the shares
subscribed for by the public, so as to prevent the company from suing them for their
misfeasance, and so as to wind the company up voluntarily and distribute its assets
among themselves9

When the defence raised by the respondent is based on falsity in terms of
documents produced as regards the status of the debt claimed by the petitioner, the
court held that the respondent is liable to be wound up not only for non-payment
of debt but also for lack of commercial morality on the ‘just and equitable’ ground - Friends Tea Co. Ltd., In re [2012] 112 SCL 45 (Cal.).

However, for winding up on this ground, fraud in the prospectus or in the manner
of conducting company’s business is not sufficient. It must be shown that the