

## WINDING UP UNDER COMPANIES ACT, 2013

### 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. In the words of Pennington<sup>1</sup>“**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**”.

#### 1.1. **ROLE OF LIQUIDATOR**

A liquidator is a person with the legal authority to act on behalf of a company to sell the company's assets before the company closes in order to generate cash for a variety of reasons including debt repayment.

Liquidators are generally assigned by the court, by unsecured creditors, or by the company's shareholders. They are often employed when a company goes bankrupt. Once the liquidator is assigned, they will then take over control of the person or organization's assets. These are then pooled together and sold off one by one. Cash received from the proceeds of the sale is then used to pay off the outstanding debt held by unsecured creditors.

**One of the chief functions 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.**

### 2. MODES OF WINDING UP [SECTION 270]

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.

#### 2.1. **VOLUNTARY AND INVOLUNTARY WINDING UP**

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<sup>1</sup>Pennington’s Company Law, 5th Edition, Page 839

According to Indian Law Companies Act, 2013, winding up of a company can be done by two methods which are voluntary and involuntary. The voluntary winding up contains petitions to the company tribunal by members or creditors<sup>2</sup> whereas the involuntary contains winding up by the court.

### **3. CIRCUMSTANCES IN WHICH COMPANY MAY BE WOUND UP BY TRIBUNAL [SECTION 271]**

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 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, 2016.

In *Swiss Ribbons Pvt. Ltd. and Anr. Vs. Union of India and Ors*<sup>3</sup> the Apex Court Pressed on the Constitutional Viability of our newly formulated

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<sup>2</sup>Section 272 of companies act, 2013

<sup>3</sup>2019 SCC Online SC 73

Insolvency Law all over again. The Supreme Court, while rejecting the Arguments which challenged the validity of the Code, gave a well-deserved upper hand to the Legislative intent of the Law. The Court upheld the Preamble of the Code stating that the law does not intend to encourage Liquidation of the Assets of the Corporate Debtor in any manner and treats it as a solution of last resort only in the case where the CD does not receive any feasible resolution plan or if the plan gets dismissed by either the COC or the NCLT itself. The Court also advised that the Code or its pillars should not be used as a Recovery mechanism whatsoever.

### 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, 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.**<sup>4</sup>

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.**<sup>5</sup>

**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 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 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**<sup>6</sup>

<sup>4</sup>[1992] 73 Comp. Cas. 136 (Mad.).

<sup>5</sup>[1918] 1 IR 62/521 LG 93

<sup>6</sup>[1981] 51 Comp. Cas. 601 (Ker.).

3.2. **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 [SECTION 271(b)]**

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.

To understand the above proviso, the clarification or difference between the two different aspects i.e. 'how a corporate entity is working against the interests of sovereignty and integrity of India or of the security of the State' and 'How a corporate entity can affect public order, decency and morality' is needed.'

The only way a corporate entity can challenge this clause is that it is engaged in media related activities or in advertisement and publicity, producing obscene literature or graphics but 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, this approach is also debatable.

So, as to remove such conflicts and debatable approaches, 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.

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.

In *Devas Multimedia Private Limited v. Antrix Corporation Limited & Another*<sup>7</sup> the Supreme Court of India ruled that Devas Multimedia (an Indian multimedia services provider), to be wound up as it was fraudulently incorporated for unlawful purposes.

This dispute stems from Antrix's decision to cancel an agreement with Devas. It was agreed that Devas would use the S-band spectrum transponders on two ISRO satellites developed for a cost of Rs 766 crore to provide multimedia services to Indian mobile platforms under this deal. Concerned that the 2005 agreement with Devas, founded by ex-ISRO officials and a company called World Space, was part of a quid pro quo between Antrix's leadership and the company, the agreement was unceremoniously annulled by Antrix in 2011 during the 2G telecom turmoil.

After the annulment, Devas pursued arbitration proceedings, which ultimately led to rulings that turned against India. In January of 2021, Antrix petitioned the National Company Law Tribunal (NCLT) with allegations that Devas was founded for "Fraudulent purposes," and the NCLT subsequently issued an order to liquidate Devas. In an appeal against NCLT's order, the National Company Law Appellate Tribunal (NCLAT) confirmed NCLT's decision to liquidate Devas. After that, the case was headed to the supreme court of the country.

- 3.4. **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. [Section 271(d)]**

Under section 164 if 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.

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.

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.

### 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.

In *Gadadhar Dixit v. Utkal Flour Mills (P.) Ltd.*<sup>8</sup> it was held that 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.

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<sup>8</sup>[1989] 66 Comp. Cas. 188 (Ori.)

In *Prem Seth v. National Industrial Corpn. Ltd.*<sup>9</sup> it was expressed that the winding up must be just and equitable not only to the persons applying but also to the company and to all its shareholders.

In *German Date Coffee Co.*<sup>10</sup>, the case relates to the situation where the company's objectives provided to sell coffee with Spanish Patent but the company was selling the coffee with German Patent because they could not get Spanish Patent. The company had lost its fundamental substratum and therefore was just and equitable to be wound up.

The examples of 'just and equitable' ground on the basis of which the Tribunal may order the winding up are given below:

### 3.5.1. Disappearance of substratum

A company's substratum is the purpose or group of purposes which it was formed to achieve (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<sup>2</sup>, or if it fails to acquire the business which it was formed to purchase<sup>3</sup>, 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.

In *Pundra Investments & Leasing Co. (P.) Ltd. v. Petron Mechanical Industries (P.) Ltd.*<sup>11</sup> 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 of loss of substratum of the business can be admitted.

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<sup>9</sup>[2002] 35 SCL 636 (Delhi)

<sup>10</sup>(1882) Ch. D 169

<sup>11</sup>[2000] 23 SCL 220 (Bom.)

In *Kaithal and General Mills Co. Ltd.*<sup>12</sup>, 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. KasimariesCeramique (P.) Ltd*<sup>13</sup>, 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.

### 3.5.2. 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.

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.

In *Friends Tea Co. Ltd*<sup>14</sup> 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.

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<sup>12</sup>[1951] 31 Comp. Cas. 4617

<sup>13</sup>[2004] 50 SCL 116

<sup>14</sup>[2012] 112 SCL 45 (Cal.).



#### **4. PROCESS OF WINDING UP**

The process of winding up a company under the Companies Act 2013 involves the following steps:

1. Appointment of a Liquidator: A liquidator is appointed to manage the winding-up process and liquidate the assets of the company. The liquidator can be appointed by the shareholders, creditors, or the court, depending on the mode of winding up.
2. Preparation of Statement of Affairs: The company needs to prepare a statement of affairs, which includes details of its assets and liabilities. The statement of affairs needs to be submitted to the liquidator within 21 days of the appointment.
3. Realization of Assets: The liquidator is responsible for realizing the assets of the company and distributing the proceeds among the creditors by the priorities set out in the Companies Act 2013.
4. Payment of Liabilities: The liquidator needs to pay off the company's liabilities by the priorities set out in the Companies Act 2013.
5. Dissolution of the Company: Once all the assets have been realized, and all the liabilities have been paid off, the liquidator needs to submit a final report to the court. If the court is satisfied with the report, it will pass an order for the dissolution of the company.

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#### **STATUTES REFERRED :**

THE COMPANIES ACT, 2013

#### **BOOKS REFERRED :**

COMPANY LAW - ROBERT R. PENNINGTON

#### **OTHER REFERENCES :**

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