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Winding of a company-An analysis

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INTRODUCTION

Winding up is a proceeding by means of which the dissolution of a company is brought about and in the course of which its assets are collected and realized and applied in payment in its debts, and when these are satisfied , returning to its members the sums which they have contributed to the company. In the words of Professor Gower: "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 the rights.[2] The proceeding is not confined to cases where a company is insolvent, but may be adopted as a means of enabling the corporations or their members to re-incorporate while extended objects or further powers or more efficient means of management. Winding of a company differs from the insolvency of an individual inasmuch as a company cannot be made insolvent under the insolvency laws. Moreover, perfectly solvent company may be wound up. The company is not dissolved immediately at the commencement of winding up. Its corporate status and powers continue.[3] Winding up proceeds dissolution.

MODES OF WINDING UP:

Section 425, as amended by the Companies (second amendment) Act, 2002 provides the following modes of winding up of a company, viz:-

1. Winding up by the court.
2. Voluntary winding up.
   The voluntary winding up may be subdivided into two:-

(a) Member's voluntary winding up.
(b) Creditor's voluntary winding up.
   In the case of former all the control remains in the hands of members whereas in the case of latter the control is in the hands of creditors as the company goes insolvent.

WINDING UP BY TRIBUNAL

According to section 433, a company may be wound up by the tribunal under the following circumstances:-

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[2] The principle of modern company law 647(3rd edn. 1969)
[3] BACHAWAT J in Pierce Leslie & co. v Wapshare,(1969) 2 SCA 378. The order of winding up does not change the character of the company as an industrial concern for the purposes of the State Financial Corporation Act,1951

(a) If the company has, by special resolution, resolved that the company be wound up by the Tribunal.
(b) If default is made in delivering the statutory report to the Registrar or in holding the statutory meeting.
(c) If the company does not commence its business within a year from its incorporation, or suspends its business for a whole year.
(d) If the number of members is reduced, in the case of a public company, below seven, and in the case of a private company, below two.
(e) If the company is unable to pay its debts.
(f) If the Tribunal is of the opinion that it is just and equitable that the company should be wound up.
(g) If the company has made a default in filing with the Registrar its balance-sheet and profit and loss account or annual return for any five consecutive financial years.
(h) 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.
(i) If the tribunal is of that the company should be wound up under the circumstances specified in section 424-G.

Provided that the Tribunal shall make an order for winding up of a company under clause (h) on application made by the Central Government or a state government.

A company may be wound up at an order of the Tribunal. This is also called compulsory winding up. The cases in which a company may be wound up are given ion section 433.

JUST AND EQUITABLE

The Tribunal may make a winding up order if it is of the opinion that it is just and equitable.[4] This gives the Tribunal a very wide discretionary power to order winding up whenever it appears to be desirable. The tribunal may give due weight to the interest of the company, its emloyees, creditors and shareholders and general public interest should also be considered.[5] The position of the Tribunal in determining whether it is ' just and equitable' to wind up the company requires a fair consideration of all circumstances connected with the formation and the carrying on the business of the company and the common misfortune which has fallen on some share holders in the company. For a long period *ejusdem generis* dominated interpretations of the just and equitable provision. But the rule has been entirely abandoned and the words are to be treated as conferring a discretionary power which is of the widest character and the courts are left to work out for themselves the principles on which such orders should be granted.[6] There must be a really strong ground for liquidating a company. Moreover, the court may refuse to make an order of winding up, if it is of the opinion that some other remedy is available to the

[4] S.433(f).it is also the remedy of the last resort. Godahar Dixit vf Utkal flour mills P Ltd. (1989) 66 comp case 188 Ori.
[5]Cine industries & Recording Co Ltd,(1921) 59 IC 524
[6] B. H. McPherson, winding up on the just and equitable ground, Followed in Jivabhai M. patel v Extrucion Process P Ltd, (1966) 2 Comp LJ 74

petitioner and he is acting unreasonably in seeking to have the company wound up, instead of pursuing that other remedy.[7]

It is not desirable nor possible to categorize facts that render it just and equitable to wind up accompany. The tendency to create categories or headings is wrong; the general words of the sub section should remain general and not be reduced to the sum of particular instances. But the circumstances in which the courts have in the past dissolved companies on this ground can be resolved into the general categories. And they are as follows:

(a) Deadlock

Firstly, when there is a deadlock in the management of a company, it is just and equitable to order winding up. The well-known illustration is **Yenidle Tobacco Co Ltd,Re**:[8]

W and R, who traded separately as cigarette manufacturers, agreed to amalgamate their business and formed a private limited company of which they were the shareholders and the only directors. They had equal voting rights and, therefore, the articles provided that any dispute would be resolved by arbitration, but one of them dissented from the award. Both then became so hostile that neither of them would speak to the other except through the secretary. Thus there was a complete deadlock and consequently the company was ordered to be wound up although its business was flourishing.

But the 'just and equitable' clause should not be involved in cases where the only difficulty is the difference of the view between the majority directorate and those representing the minority. The Madras High Court observed on the facts of a case that 'where nine or ten directors belonging to different communities unanimously and solidly take one view as against the minority of three holding another view and the company has been earning profits and has accumulated a goodwill, the mere incompatibility of good relations between the rival factions in the directorate is not sufficient for ordering winding up.[9] Similarly, the Calcutta High Court has held that 'winding up cannot be ordered on the grounds of friction and disputes between the Directors; the scramble for power is at the bottom of all'.[10] The courts, however, do not insist on a paralyzing deadlock.

(b) LOSS OF SUBSTRATUM

Secondly, it is just and equitable to wind up a company when its main object has failed to materialize or it has lost its substratum. A good illustration is **German Date Coffee,Re**[11]

A company was formed for the purpose of manufacturing coffee from dates under a patent which was to be granted by the Government of Germany and also for working other patents of similar kind. The German patent was never granted and the company embarked upon other patents. But, on the petition of a shareholder, it was held that "the substratum of the company had failed, and it was impossible to carry out the objects for which it was formed; and, therefore, it was just and equitable that the company should be wound up".

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[7] ibid
[8] (1916) 2 ch 426
[9] Veeramachineni Seethiah v Venkatasubbiah, AIR 1949 Mad 675
[10] A.N.RAY j in Hind Overseas Ltd, Re,(1968) 2 Comp Lj 95,
[11] (1882) 20 Ch D 169

Similarly, where a company's business had come to standstill owing to a banker having seized and sold all its assets in the execution of a decree, and where the company's main business of supplying electricity in a particular area was taken over by the state and the company had put the compensation money in fixed deposits and did no business for seventeen long years, although it had a long list of objects, winding up was ordered in either case.[12]

However, a temporary difficulty which does not knock out the company's bottom should not be permitted to become a ground for liquidation. For example, in **Steam Navigation Co, Re:**[13]

A steamship company was incorporated with the principle object of acquiring a firm's business of plying steamers. This business was acquired, but very soon afterwards grave differences arose between the company and the firm. As a result the company had to return seven out of nine steamers acquired from the firm. Subsequently losses were also incurred, yet an application for winding up on the ground of failure of substratum was rejected, as the orginal objects had not become impossible to attain. The company had bought other steamers and there was nothing to prevent further purchases.

Thus it is a question of fact in each case whether the substratum of the company is gone or not. In **Seth Mohan lal v Grain Chambers Ltd**,[14] SHAH J of the Supreme Court observed:

"The substratum of the company can be said to have disappeared only when the object for which it was incorporated has substantially failed, or when it is impossible to carry on the business of the company except at a loss, or the existing and possible assets are insufficient to meet the existing liabilities.

In that case owing to a long drawn out litigation the business of a company had come to a standstill and a part of its business was banned by the legislation, SHAH J held that "we cannot on that ground direct that the company be wound up. The company could always restart business with assets it possessed."

(c) LOSSES

Thirdly, it is considered just and equitable to wind up a company when it cannot carry on business except at losses. It will be needless, indeed, for a company to carry on business when there is no hope of achieving the object of trading at a profit.[15] The Bombay High Court observed in **Shah Steamship Navigation Co,Re**[16] that "the court will not be justified in making a winding up order merely on the ground that the company has made losses; and is likely to make further losses."

(d) OPPRESSION OF MINORITY

Fourthly, it us just and equitable to wind up a company where the principal shareholders have adopted an aggressive or oppressive or, squeezing policy towards the minority. The

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[12] Lawang Tahang v Goenka Commercial Bank Ltd,(1960) 64 CWN 828
[13] (1901) 10 Bom LR 107
[14] (1968) Comp LJ 275,
[15] A winding up on this ground was ordered in Bachraj Factories v Hirjee Mills,AIR 1955 Bom 355
[16] (1901) 10 bom LR 107

decision of madras High Court in **R. sabapathi Rao V Sabapathi Press Ltd**[17] is an illustration in point. The court observed:

Where the directors of a company were able to exercise a dominating influence on the management of the company and the managing directors was able to outvote the minority of the shareholders and retain the profits of the business between members of the family and there were several complaints that the shareholders did not receive a copy of the balance-sheet, nor was the auditor's report read at the general meeting, dividends were not regularly paid and the rate was diminishing, that constituted sufficient ground for winding up.

(e) FRADULENT PURPOSE

It is just and equitable to wind up a company if it has been conceived and brought forth in fraud or for illegal purposes. Thus in **Universal Mutual Aid and Poor Houser Association v Thopa Naidu**[18] the Madras High Court observed:

Where the main object of a company is the conduct of a lottery, the mere fact that some of its objects were philanthropic will not prevent the company from being ordered to be wound up as being one formed for an illegal purpose.

But "the mere fact of there having been a fraud in promotion , or fraudulent misrepresentation in the prospectus, will not be sufficient to found a winding up order, for the majority of shareholders may waive the fraud"[19]

(f) INCORPORATED OR QUASI-PARTNERSHIP

It has been observed that "there is little in common between the giant corporation and the family or one-man company. To apply the same legal requirements to such different organisations is productive of inconvenience and injustice.[20] In order to avoid such inconvenience and injustice the act treats them differently in several respects. But even in matters in which the Act treats them alike, the courts have to distinguish them. One such matter is the interpretation of the just and equitable clause in reference to the winding up of a small private company. The principle that seems to emerge from a long line of cases culminating in the House of Lords' decision in **Ebrahimi v Westbourne Galleries Ltd**, [21] is that where a private company is in essence or substance a partnership, it may be ordered to be wound up under the just and equitable clause as interpreted in accordance with the partnership principles.

According to Lord WILBERFORCE[22] a private company can be treated as an incorporated partnership if it possesses one or probably more of the following elements:

(i) An association formed or continued on the basis of a personal relationship, involving mutual confidence---this element will often be found where a pre-existing partnership has been converted into a limited company;

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[17] AIR 1925 Mad 489
[18] AIR 1933 Mad 16
[19] Oriental Navigation Company v bhanaram Agarwala, AIR 1922 Cal 365
[20] R.S Nock,The Ford Foundation Workshop On Company Law, july 1969,
[21] (1972) 2 WLR 1289
[22] Ebrahimi v Westbourne Galleries Ltd,(1972) 2 WLR 1289

(ii) An agreement, or understanding, that all, or some (for there must be sleeping members) of the shareholders shall participate in the conduct of the business; and

(iii) Restriction on the transfer of the member's interest in the company—so that if confidence is lost, or one member is removed from management, he cannot take out his stake and go elsewhere.

Winding up can also be ordered when public interest demands it. A type of conduct which comes in conflict with public interest is indicated in a Court of Appeal decision in England.[23] The company in question had no proper records; it presented to be an impartial adviser in matters of investment when, in fact, it was only a share-vending company; the American companies in which the clients were advised to invest their money were such whose share could not be easily traded and the company was also violating its investment agreement. The court was of the view that public interest demanded winding up of a company which was wasting the capital resources of the country.

(g) DEFAULT IN FILING BALANCE-SHEET

According to section 433(g)[24], if the company has made a default in filing with the Registrar its balance-sheet and profit and loss account or annual return for any 5 consecutive financial years, the company may be wound up by the Tribunal.

(h) Acts of company against sovereignty and integrity of India

A company may be wound up if it has acted against the interests of sovereignty and integrity of India, the security of the state, friendly relations with foreign states, public order,decency or morality.

(i) Winding up under circumstances of S.424-G

A company may be wound up by the order of the Tribunal if it is of the opinion that the company should be wound up under the circumstances specified in Section 424-G as a sick industrial company.

The remedy of winding up is a remedy of last resort. It may not be allowed where an equally effective alternative remedy is available.

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[23] Walter L Jacob & Co Ltd,Re (1989) BCLC 345 CA

[24] Companies (Second Amendment) Act 2002 has substituted new section 433 in which three new grounds (g), (h), and (i) have been added on which a company may be wound up.