Elements of Bankruptcy law and Business Rescue in India

Vaneeta Patnaik

1. Introduction

The insolvency laws of India not only look for a disposal of assets but also look actively at the possibilities of rehabilitation and revival of companies. However this remains strong in spirit and translates very reluctantly into reality. In the current framework the insolvency regime which deals with rescue as well retains a procedure in which the winding up of companies turns out to be a long drawn out procedure. This paper would look into the opening of the Insolvency proceeding – primarily corporate insolvency- in the jurisdiction of India. It would also dwell into the rescue mechanism laid out both formal and informal.

As we stand today at the threshold of multiple reforms the latest reform is the Companies Bill 2012, which was slated to replace the Companies Act of 1956, which is currently in force in all its amended glory. The latest attempt is to provide a more efficient version of the 1956 Code, which is a voluminous document with 781 sections and 15 schedules, in the face of economic reforms being undertaken. This it has sought to do by segregation of procedural laws from substantive laws and allowing the Government to prescribe the procedural laws in the form of rules.

Under the Constitution of India the Companies Act is a central legislation which is binding on all federal states of India.

2. Historical development and current statutory scheme

2.1. Brief Historical Overview

Historically the law of insolvency in India is based on the Roman principle of cession bonarum.¹ The origins of the law of insolvency goes back to the colonial era in India and is found to be enacted in two centrally administered² pieces of legislation: ‘The Presidency-Towns Insolvency Act of 1909’ and ‘The

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¹ The term means ‘surrender’ of all his goods by the debtor for the benefit of his creditor, in return for immunity from the process’ (Sathya, 2003)at page 93
²India under the British colonial rule was administered centrally. The Independent India is a federal state with central jurisdiction on certain matters, insolvency being one of them. However, some states have incorporated a differential ranking system in the scheme for overriding preferential payments and preferential payments.
Provincial Insolvency Act of 1920. These two acts deal primarily with consumer insolvency and the corporate insolvency is dealt under the Companies Act of 1956.\(^3\)

To understand the reasoning behind the disparate jurisdictional applications- India under the British Colonial Rule was divided into three main areas which were otherwise known as the Presidency Towns – these towns were Calcutta, Bombay and Madras (currently known as Kolkata, Mumbai and Chennai respectively). The rest of the country was defined as the Provinces and hence the Provincial Insolvency Act applied. The necessity of separate legislations has long since passed and a law commission in 1958 had recommended the consolidation of the law of insolvency into a single comprehensive legislation which to date has not been initiated.

The earliest rudiments of insolvency legislation can be traced to Sections 23 and 24 of the Government of India Act, 1800, which conferred insolvency jurisdiction on the Supreme Court at Fort William\(^4\) and Madras and the Recorder's Court at Bombay. These Courts were empowered to make rules and order for granting reliefs to insolvent debtors on the lines intended by the Act of the British Parliament called the Lord’s Act passed in 1759.\(^5\) Though the insolvency court was presided over by a judge of the Supreme Court it had its distinct existence and presence.

The next step in the development of law of insolvency was when the law in 1848 (11& 12 Viet.c.21) was passed. The Act presumed the distinction between traders and non-traders in certain respects on the lines of the corresponding Bankruptcy statutes, then in force in England. It continued the Courts for the relief of insolvent debtors established by the Act of 1828 in the Presidency towns and in their place the present High Courts were set up devolving the jurisdiction from the Supreme Courts to the High Courts. The Act of 1848 continued in force in the Presidency-towns until the enactment in 1909 of the present Presidency-towns Insolvency Act, 1909.\(^6\)

While there was special insolvency legislation for the Presidency-towns, there was no insolvency law in the rural areas. The main reason for this difference was the absence of any flourishing trade and commerce therein. In the rural areas for a considerable period the ordinary principle of distributing the sale proceeds pronotes among decree-holders after satisfaction in full of the amount due to the attaching decree holder seems to have prevailed.

Introduction of insolvency law in the rural areas was in 1877. Rules were incorporated in Chapter 20 of the Code of Civil Procedure, 1877, conferring jurisdiction on the district Courts to entertain insolvency petitions and grant orders of discharge, rules were re-enacted with certain modifications in Chapter 20 of the Code of Civil Procedure 1882. These provisions were limited to cases in which legal proceedings


\(^4\) The East India Company Regulating Act, 1773 was introduced to place the East India Company under the control of the British Government and provision was made for establishment of a Supreme Court of judicature at Fort William, Calcutta, through Charter or Letters Patent. The Supreme Court of Judicature at Fort William in Bengal was established by Letters Patent issued on March 26, 1774, which as a Court of Record had power and authority to dispose of all complaints against the Majesty’s subjects in respect of any crime, suit or action arisen within the territory of Bengal, Bihar and Orissa. This was later on known as the High Court of Calcutta and continues to be so even today. The High Court Judicature was brought into existence by the Letter Patent dated 14\(^{th}\) May, 1862 and was formally opened on 1\(^{st}\) July 1862.

\(^5\)http://www.iica.in/images/confdetailpaper/Country_Report_on_Corporate_Insolvency_laws.pdf (Emerging Insolvency In India: Issues & Options)

\(^6\) See above at n. at pg. 1
were instituted and judgment obtained. Creditors of a debtor were not entitled to file an insolvency petition. These defects were removed by the Provincial Insolvency Act of 1907 which was later repealed by the Provincial Insolvency Act, 1920. This is the Act which is now in force in the areas other than the Presidency towns.  

The basic substantive provisions of both the acts are similar. For example to be deemed insolvent one must be a “debtor” including judgment debtors. Similarly both acts provide that the creditors as well as debtors can petition to have a consumer debtor as insolvent if a debtor owes at least 500 Rupees and commits “an act of insolvency” – this could include to mean – transferring all or most of one’s assets and taking action to ‘defeat or delay’ one’s creditors, additionally both the legislations need the courts to be provided with full details of a debtor’s property, assets and obligations. The insolvency threshold provided by both the acts is pegged at 500 Rupees (approximately 9€) and commits an “an act of insolvency”.  

The Corporate insolvency is dealt under the Companies Act of 1956. This Act was enacted on the recommendations of the Bhaba Committee set up in 1950 with the object to consolidate the existing corporate laws and as a base for corporate operations in independent India. With the enactment of this legislation in 1956, the Companies Act of 1913 was repealed. The 1956 Act next saw major amendments only in 1988 on the recommendations of the Sachar Committee. The next major overhaul was only in 2002 on the recommendations of the Eradi Committee Report. It was again in 2004 another Committee was constituted to look into the new amendments. The recommendations of this committee headed by Dr. Jamshed J. Irani were drafted into a Bill and tabled and has been passed as the Companies Bill 2009. This 2009 Bill was a leaner version of the 1956 Act and reiterates shareholder democracy, recognises liability of Boards, directors and senior management personnel of companies, provides for new scheme for penalties and punishment for non compliance or violation of the law, harmonizes corporate regulation with action by sectoral regulators, incorporates a new framework for mergers and amalgamations of companies and provides an extensive Insolvency Code based on the principles of UNCITRAL.

This Companies Bill 2009 had been considered by the Central Government based on the Report of the Parliament Committee on Finance and has been entitled the Companies Bill 2011 and later renamed as Companies Bill 2012 - this was set to replace the Companies Act, 1956 which is currently in force. This
revised bill is seen as bringing in comprehensive reforms and codification of law governing the corporate business in India.\textsuperscript{13}

\textbf{2.2. Current Statutory Scheme}

Insolvency laws in India, as discussed above, are segregated into two parts: Consumer Insolvency – which deals with individuals and partnerships firms governed by Provincial Insolvency Act of 1920 and the Presidency Towns Insolvency Act of 1908.

The Corporate insolvency is dealt under the Companies Act of 1956. Besides the Companies Act the other relevant legislations are – the ‘Sick Industrial Companies (Special Provisions) Act, 1985 (SICA) this is currently incorporated into the current amended Companies Act, the Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDDB Act) and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI)\textsuperscript{14}.


The framework for Pre-insolvency rescue schemes are laid down under the Companies Act, 2002 (Ss. 391-396), the Sick Industrial Companies provisions under the Companies Act (Ss. 424A-424L), Corporate Debt Restructuring Scheme, the Asset Reconstruction under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest, 2002 and the guidelines laid down by the Reserve Bank of India\textsuperscript{15}.

There has been a move to unify the forum for filing of the matters relating to corporations. So far India has had multiple forums dependent upon the type of company for rescue. Industrial companies would file to the Board for Industrial and Financial Reconstruction (BIFR) set up under the SICA, as this dealt with the revival and rehabilitation of companies, the other companies would file with the Company Law Board and the liquidation authority under the Companies Act retain with the High Court of each State, with exception to where dissolution is recommended by the BIFR in such a case the High Court orders a dissolution of the company as BIFR is a body of experts and courts generally do not interfere in such recommendations;\textsuperscript{17} similarly with regard to financial intermediaries where the dissolution is recommended by the Reserve Bank of India (RBI) the High Court would always pass the order for

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\textsuperscript{13} \url{http://www.mca.gov.in/Ministry/Monthly_MCA_Newsletter.pdf} (July 2011) hereinafter (Ministry of Corporate Affairs) \\
\textsuperscript{14} This act allows for enforcement of security interest by secured creditors bypassing judicial intervention, in addition to providing a framework for securitisation and reconstruction of financial assets. \\
\textsuperscript{15} With a majority of the banks being Public Sector Banks the Reserve Bank of India as a regulator has been very proactive in laying guidelines and other mechanisms (which would be discussed in detail at a later stage) for reduction of nonperforming assets particularly since the nineties. \\
\textsuperscript{16} The details discussed below at on page 8. \\
\textsuperscript{17} Until the adoption of the amendments the SICA would apply and with it the requirement of the approval of the BIFR under S.22 (1) for launching of proceedings including winding up proceedings is mandatory and imperative.
\end{footnotesize}
dissolution. The forum available to financial intermediaries both under the RDDB Act and the SARFAESI Act are the Debt Recovery Tribunals (DRT). As per the enacted and yet to be enforced amendments, a National Company Law Tribunal (NCLT) and its related appellate tribunal is proposed to be set up which would take the mandate of revival and rehabilitation from BIFR, the High Court jurisdiction with relation to winding up of companies and the jurisdiction and power exercised by the Company Law Board (CLB) which would stand abolished with the NCLT coming into force.

The latest addition to the plethora of recovery laws for financial companies is the ‘Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002’ (hereinafter Securitisation Act) this was specifically targeted for the benefit of banks and financial institutions. Under this Act the banks and financial institutions are empowered to enforce their security interest without judicial intervention. This act was further amended through the legislating of the ‘The Enforcement of Security Interest and Recovery of Debts Law (amendment) Act 2004’ (hereinafter Security Interest Act). The Security Interest Act, 2004 in turn amending the Recovery of Debts Due to Banks and Financial Institutions Act, 1993 (hereinafter DRT). The amendment to the Securitisation Act was a result of a Supreme Court Judgement. Under the amendment - Section 13 of the Securitisation Act, 2002 was recast simultaneously with section 19(1) of the DRT Act. The amendments were made in order to enable the financial intermediaries to withdraw applications under the DRT Act to the Tribunals in order to attach and possess the property under the Securitisation Act.

To give a perspective - the Securitisation Act of 2002 got enacted to empower financial intermediaries to liquidate the assets and the secured interest, which was not possible or provided for under the DRT Act and the DRT Act was enacted to expedite the deciding time for the suits filed by the financial intermediaries in the civil courts of the land.

The objective behind these two acts is recovery of debts via non-adjudicatory procedure. Both of the acts provide for remedies to the secured creditors.

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18 Banking companies are wound up under the grounds provided under S. 38 of the Banking Regulation Act read with S. 616 of the Companies Act; for Non Banking Financial Companies (NBFC) it is the S. 45 MC of the Reserve Bank of India Act, 1934 which applies.
19 The DRT’s were set up under the RDDB Act, 1993 to expedite adjudication and recovery of debts owed to financial intermediaries. However this was limiting in the sense it did not empower possession of securities which was sought to be repaired by the SARFAESI Act, 2002.
20 See Part IB Ss. 10PB to 10FP of the Companies (Second Amendment)Act 2002
21 See Part IC Ss. 10FO to 10GF of the Companies (Second Amendment) Act 2002
22 The main criteria for this act to kick in are:- the debtor must be under a liability to a secured creditor, the account should be non-performing asset (this is determined when the debtor defaults payment within sixty days from the date of notice,), a notice in writing has to be sent to the borrower to discharge its debt, in case of default then a secured creditor, under section 13(4) of the act shall be empowered to take possession of secured assets by way of lease, assignment or sale.
23 See Mardia Chemicals Ltd. And Others. v. Union of India and Others 2004 (4) SCC 311. Mardia Chemicals filed against its consortium of bankers led by the ICICI Bank, on the grounds that while the banks are enabled under the Securitisation Act to attach properties they are not eligible to sell the same. The Supreme Court upheld the Act and at the same time this streamlined the recovery powers of financial intermediaries through the DRT Act as well.
2.3. Legal Reforms

One of the more important reforms is in the dealing of winding up of industrial companies. Post-amendments the insolvent industrial companies Sick Industrial Companies (Special Provisions) Act, 1985 was integrated into the Companies (amendment) Act, 2002. In its original form it was drafted as a special legislation with the aim of securing the timely detection of sick and potentially sic companies and for the remedial measures. The abuse of these ameliorative measures led to its repeal. An Act to repeal SICA was passed in 2003 but is yet to be notified.\(^{26}\) This repeal was aimed at integration of the provisions into the Companies (amendment) Act, 2002.\(^{27}\) The intention was such integration would enable the NCLT to take over the role of BIFR and a diluted version of the Act would enable plugging of the loopholes in the erstwhile SICA.\(^{28}\) The aim of combating industrial sickness is still retained however the escape route mode with benefits has been disabled.

With a view to review the consumer insolvency the Law Commission of India recently convened a committee with INSOL India to propose reforms to the consumer insolvency system. The committee was charged with “examining the existing laws relating to personal bankruptcy in India and the desirability of changes in existing laws in the backdrop of fast increasing and easy availability of credit from banks, financial institutions and other lenders to individuals for private, family or household purposes.” The committee, however, concluded its work without making any recommendations.\(^{29}\)

2.4. Usage of Transnational materials

The Legislative Guide on Insolvency law by the UNCITRAL has been a tool for revising of insolvency laws. India has used this Guide in the review of its own insolvency laws.\(^{30}\) The Companies (Second Amendment) Act, 2002 makes an attempt to assimilate the UNCITRAL principles of having a balance in between reorganization and liquidation.\(^{31}\) The latest legislative reforms, even though not optimum, does provide for an enabling environment encouraging consensual arrangements.\(^{32}\) The newly minted forum of NCLT and its appellate body provides for appointment of members with a transparent process for their selection and appointment keeping in line with the World Bank principles. The rehabilitation procedures which allows for quick and easy access with a timely and efficient administration provide a structure that encourages fair negotiation of a plan under judicial supervision.\(^{33}\)

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28 See above at page 5.
29 (Feibelman, 2010) at page 29
31 See (Batra, 2003); note above at page 3
33 (Batra, 2003) note above.
3. Main Sources

See Bibliography

4. Regulatory Framework

*(A business debtor is being interpreted as a legal personality as opposed to individual.)*

*(Wherever reference is made to the amended version of the companies act it is mentioned as Companies (Second Amendment) Act, 2002; else the provisions discussed below refer to the Indian Companies Act, 1956. Similarly all provisions mentioned below are being quoted from the Act, unless and otherwise specified)*

*(Tribunal and Court has been used interchangeably)*

The procedures for insolvency proceedings prior to the Companies (Second Amendment) Act, 2002, were on a multiple forum basis. The corporate were required to apply to High Courts\(^\text{34}\) for proceedings of winding up and other procedures. The other parallel forums prescribed prior to the amended act are the Company Law Board (CLB),\(^\text{35}\) Board for Industrial and Financial Reconstruction (BIFR) and Appellate Authority for Industrial and Financial Reconstruction (AAIFR).\(^\text{36}\) These forums are currently still functioning and in existence.

It was in an attempt at unification of the forums that led the Government of India (GOI) to constitute a committee under the chairmanship of a retired Supreme Court Judge to review the law relating to insolvency and winding up of companies and other similar laws like ‘The Sick Industrial Companies (Special Provisions) Act, 1985 (SICA). The recommendations of the committee were incorporated in the Companies (Amendment) Bill, 2001 and received the Presidential assent on the 13\(^\text{31}\) of January, 2002 and are known as the Companies (Amendment) Act, 2002.

The Companies (Second Amendment) Act, 2002 provides for setting up of a National Company Law Tribunal (NCLT) and which will handle all matters which were being handled by various abovementioned forums.\(^\text{37}\) Though this provision had been incorporated into the Companies (Second) Amendment Act, 2002, from the 1\(^\text{st}\) of April 2003, it is yet to be constituted as the Amended Act faced a legal challenge and the matter was subjudice on account of a Special Leave Petition (SLP) filed by the Central

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\(^{34}\) India has one Supreme Court which is the highest body in the entire judicial system, and each State or group of States have a High Court under which flows a hierarchy of subordinate courts. Both of these courts enjoy appellate and original jurisdiction.

\(^{35}\) The CLB has been functioning as an independent quasi-judicial body from 1991 and has been set up be the Central Government under section 10E of the Companies Act, 1956.

\(^{36}\) These forums dealt with matter relating to merger/amalgamation, acquisition and reconstruction, revival and rehabilitation besides winding up. Both the BIFR and AAIFR focused solely on industrial companies duplicating procedures already being filed at the High Court level.

\(^{37}\) All backlog cases from the High Courts and the CLB would stand transferred to the newly formed tribunal – the NCLT. This is provided through the newly inserted section of 647A in the Companies (Amendment) Act 2002.
Government in the Supreme Court, following the ruling by the Madras High Court\textsuperscript{38} in the matter. Since then the Supreme Court has delivered its verdict\textsuperscript{39} in the matter and necessary amendments are still to be completed paving the way for the constitution of NCLT/NCLAT.\textsuperscript{40} The Ministry of Corporate Affairs is responsible for the formation of the Companies Bill containing the details of the judgement to be introduced in the Parliament. This is believed to be under process.

Under the Indian Companies Act insolvency proceedings which are known as winding up proceedings, the modes of which are provided under Section 425 of the Act and the circumstances under which a company may be wound up is provide under S. 433 of the Companies Act, 1956.

A company may be wound up either by:-

- By the Tribunal (otherwise known as compulsory winding up)
- Voluntarily

*There used exist a third option prior to the 2002 Amendment of the Companies Act - it was winding up voluntarily under which the court orders the same to be continued subject to the supervision of the court. The 2002 Amendment replaces the word ‘Court’ for Tribunal in current usage. As mentioned above till the enactment of the Tribunal the currently existing forums would continue to play a decisive role.

While S.425 lists the modes of winding up, S. 426 considers all individual members of the corporate as contributories, if any of such contributories are adjudged insolvent, his assignors in insolvency would represent them for all the purpose of winding up. The circumstance under which a company may be wound up by the court is stated under S. 433. If it is proved to the court that the company is unable to pay its debts, an order for the winding up of a company may be made.

4.1. Compulsory winding up

Winding-up by the Tribunal, also otherwise known as compulsory winding –up may be ordered in cases mentioned in S.433 of the Companies Act. The Tribunal will make an order for winding up on an application by any of the persons enlisted in S. 439. When a shareholder of a company petitions for winding up s/he must show prima facie that there are assets available for distribution amongst the creditors. An order for the winding up of a company operates in favour of all the creditors and the contributories of the company as if made on the joint petition of a creditor and of a contributory.

\textsuperscript{38} The case challenging the NCLT was filed by the Madras Bar before the High Court of Madras. The writ petition was brought forward by Sri R. Gandhi of the Madras Bar Association challenging the constitutionality of the formation of NCLT/NCLAT as such a constitution is seen as ceding of jurisdiction from the High Court and other forums to a quasi-judicial body. It may be noted that the Madras High Court held that the formation of the Tribunal to be legal and in order however it held certain provisions made in Parts 1B and 1C of the Companies (Second) Amendment Act, 2002 which contained regulations on the tenure of the President/members of NCLT to be defective and hence unless such provision were duly amended by removing the defects it would be unconstitutional to constitute NCLT/NCLAT to exercise the jurisdiction now exercised by the High Courts or the Company Law Boards.

\textsuperscript{39} The judgement was delivered on the 11th of May 2010 holding up the legality of formation of NCLT. See \textit{Union of India v. R. Gandhi/Madras Bar Association} [2010] 100 SCL 142.

\textsuperscript{40} See Para 2.9 at page 19 of the Annual Report 2010-11 of the Ministry of Corporate Affairs, GOI, \url{http://www.mca.gov.in/Ministry/pdf/MCA_AR1011_English.pdf} (last visited 29th March 2011)
4.2. Voluntary winding up

Voluntary winding up procedures for a company which resolves to be dissolved is provided within the Companies Act S. 497(5). In such a situation there is no intervention from the Tribunal. In a voluntary winding up the company and its creditors are left free to settle their affairs independent of the Tribunal. A voluntary winding up is deemed to commence at the time when the resolution for voluntary winding up is passed.\(^{41}\) A voluntary winding up may be further subdivided into – members’ and creditors’\(^{42}\) winding up. A members’ winding up is possible only if the financial health of a company is solvent. In a creditors’ winding up the assumption is that the company is insolvent. The rights of appointing liquidator rests with the creditor’s rather than the members.

4.3. Provisions Applicable to all forms of winding up:\(^{43}\)

In every mode winding up there are certain aspects of commonality. The rules that prevail and observed are with regard to – provable debts,\(^{44}\) valuation of annuities\(^{45}\) and future and contingent liabilities,\(^{46}\) and the rights of secured and unsecured creditors respectively.\(^{47}\)

One of them is proof of debts. All debts payable on a contingency, and all claims against the company, present or future, certain or contingent, ascertained or sounding only in damages, are an admissible to proof against the company, however, this provision applies to where the assets of the company are sufficient to pay all its debts and liabilities as well as meet the costs of liquidation.

In cases of insolvency – where every company in liquidation is deemed to be insolvent until it is proven otherwise, and every kind of debt and liability, however difficult of valuation, is provable unless declared by the Tribunal to be incapable of being fairly valued.\(^ {48}\) The object behind this enactment is to have parity and equality of treatment towards creditors in the same class and to have a \textit{parripassu} in payment.\(^ {49}\)

4.4. Special Proceedings for Particular Types of Debtors:

When special proceedings of insolvency are considered, the companies belonging to the government, cooperative societies, unregistered companies, industrial companies and financial intermediaries – both banking and non-banking are usually counted.

4.5. Credit Institutions and Insurance Companies

\(^{41}\) See S.486 of the Companies Act, 1956. This would remain so even when a petition for winding up in the Tribunal follows. See S. 441 of the Companies Act.

\(^{42}\) See Ss. 500-509 of the Companies Act.

\(^{43}\) See Ch. V (Ss. 528-537) of the Companies Act.

\(^{44}\) See S. 528 of Companies Act, as well as S. 529(1)(a)

\(^{45}\) See S. 529(1)(b)

\(^{46}\) See S. 529(1)(b)

\(^{47}\) See S. 529(1)(c)

\(^{48}\) (Chandratre, 2007) at page 622

\(^{49}\) (Chandratre, 2007) at page 626
For winding up of banking and non-banking companies, it is the Banking Regulation Act under S.38\textsuperscript{50} read with S. 616 of the Companies Act which applies. The winding up procedure of a banking company is under the provision of the Banking Regulation Act. The provisions of the Banking Regulation Act require the High Court to wind up a banking company on a mere application by the Reserve Bank of India (hereinafter RBI) on any of the grounds enumerated in the section.\textsuperscript{51} With regard to winding up of Non-Banking Financial Companies (NBFC’s) it is the S. 45 MC of RBI Act, 1934 brought in by RBI Amendment Act. 1997, which empowers the RBI to file a petition for winding up of the NBFC’s.

4.6. Other Regulated Businesses (industrial and government companies, foreign companies)

4.6.1. Industrial Companies

Industrial Companies and winding up of industrial companies have an incredibly complex scenario in India leading to multiple agencies and legislations being applied, here a gist of them is sought to be provided, by no means does this claim to be exhaustive.

With regard to the industrial companies, the Companies (Second) Amendment Act, 2002 has incorporated Ss424A to 424L in Part VI A which deal specifically with revival and rehabilitation of sick industrial companies. These sections have been incorporated from the now repealed Sick Industrial Companies (Special Provisions) Act, 1985 (hereinafter SICA). The grounds for winding up of a sick industrial company is specified in S. 424G,\textsuperscript{52} however for the procedure to follow first an enquiry has to be made for determining whether any industrial company has become a sick industrial company.\textsuperscript{53} As per the Companies (Second) Amendment Act, 2002, the ‘Tribunal’ may wind up a sick industrial company on the grounds specified in section 424G wherein the opinion of Tribunal, the company cannot make its net worth positive within a reasonable period and it is just and equitable to wind up. The reasoning behind the elaborate procedure for detecting the viability of the industrial company to continue its business is the intention which is provided in the enactment of the SICA. This Act was enacted as a special provisionary measure for the timely detection of sick and potentially sick industrial undertakings.

\textsuperscript{50} For decision on constitutional validity of S.38 of the Banking Regulation Act see Joseph Kuruvilla Vellukunnel v. RBI, AIR 1962 SC 1371

\textsuperscript{51} See case above (n) and as well as Bank of Karnad Ltd, Re (1994) 15 Corp LA 130 (Bom), the court stated that it had no option but to order winding up, when the RBI applies for it, the reasoning being that the Central Banker would be in a better position to decide whether the affairs of the banking company were being so conducted as to be prejudicial to the interest of the depositors withing the meaning of 38(3)(b)(iii) of the Banking Regulation Act.

\textsuperscript{52} This procedure is followed only when the Tribunal is of the ‘opinion’ that the company is not likely to become viable in future and that it is ‘just and equitable’ that the Company be wound up. The section does not confer on any person a right to seek an order that a company shall be wound up; it confers power of the court to pass an order of winding up in appropriate cases. A company will not be wound up merely because it is unable to pay its debts so long as it can be revived or resurrected by a scheme or an arrangement or when it has still prospects of coming back to life. See Rishi Enterprises, In re (1992) 73 Com Cases 271(Guj).

\textsuperscript{53} The definition of a ‘Sick Industrial Company’ as provided under the repealed SICA S.3(1)(o) – “Any industrial company which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth and is registered for not less than three years. This definition has in the past been misused in impeding recovery and in availing of unjustified remissions and concessions through manipulation of accounts of the company in any financial year to justify the definition provided under SICA and escape further liability.

\textsuperscript{54} For an explanation of concept of a sick industrial company see Krimpex Synthetics Ltd. V. BIFR, (1996) 4 Comp LJ (AAIFR)
or companies, for this the most effective way would be providing for the speedy determination by a Board of experts of the preventive, ameliorative, remedial and other measures which need to be taken with respect to such companies and the expeditious enforcement of the measures so determined and for matters connected therewith or incidental thereto. The trouble with the SICA were two-fold: first was the assessment criteria which based it on erosion of 50% of the net worth of a company and the second was the suspension of all legal proceedings once a procedure has been initiated under SICA, these two provisions (S.22 & S.23 respectively) have had an effect of converting the fair intentions of the government policy of encouraging industries (salvaging and rehabilitation appear to be the main aims) into mechanisms to defeat recovery of debts from financial intermediaries. The powers conferred under the Act are pretty wide including the fact-finding power by the conduct of an enquiry into the working of a sick industrial company – to verify and record by the constituted board  to forward the same recorded opinion to the High Court basing on which the Court would decide if a said company would need to be wound up. The interesting aspect here is under the Companies Act the High Court is bound to act in accordance with the order passed by the Appellate Authority for Industrial and Financial Reconstruction (AAIFR) and yet – the AAIFR is subject to the writ jurisdiction of the High Court under Article 226 of the Constitution of India, which provides the High Court overriding powers of quashing such an order or opinion of the AAIFR.

Till the Tribunals under the Amended Companies Act are instituted the BIFR and the AAIFR would continue to play their respective roles.

4.6.2. Foreign Companies

The provisions dealing with foreign companies are provided under Ss. 591-602 of the Companies Act. Such companies are defined to have been incorporated outside India with an established place of business within India. A foreign company carrying on business in India may be wound up by the Court in India. Winding up proceedings of a foreign company are treated as unregistered companies. Foreign creditors are not given any specific special treatment for priority of payment and if the debt is to be paid in a foreign currency then the prior approval of RBI is necessary for a decree.

4.6.3. Government Companies

The definition of a ‘government company’ is provided under the S.617 of the Companies Act. It is defined as any company in which at least fifty one percent of the paid-up share capital is held by the Central Government, or by State Government or Governments or partly by each and would also include a company which is a subsidiary of a government company and has been thus defined.  

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55 The board referred to is Board for Industrial and Financial Reconstruction (BIFR), there is an appellate board (Appellate Authority for Industrial and Financial Reconstruction (AAIFR)) too, which is quasi judicial in nature, so it is only after the hearing of the appeal of the Board that the case may reach the High Courts of the land. It is provided for in the act that no Civil Court shall have jurisdiction in respect of any matter which the appellate Board is empowered to determine.

56 This definition has been generating quite a bit of confusion in the past and I believe would continue to do so as long as it is not made apparent that only companies incorporated under this Act can come under the purview of this section. There is many an institution which is seen as extensions of government but have not been awarded the status of government companies, notable of them is the Life Insurance Corporation of India, the other example at the other end of the spectrum would be the Steel Authority of India Ltd. Which though is wholly owned by the Government of India has by virtue of its incorporation under the Companies Act, a corporate personality of its own and does not
5. Consumer Bankruptcy

A proceeding of insolvency against individuals/entrepreneurs is determined under the Presidency and the Provincial Insolvency Acts. (cf ) The Presidency-Towns Insolvency Act goes back to 1909 and the Provincial Insolvency Act to 1920. Both of these legislations protect the debtor from arrest or detention, the purpose being to quantify the debts outstanding and to have the assets distributed amongst the creditors in an equitable fashion. Once declared insolvent an individual is subject to certain disqualifications in respect of civil rights and right to hold public offices. However there are no special proceedings available in a sense that no categorization exists in between the natural persons subject to the insolvency proceedings especially when compared with the rescue mechanisms available for the companies. Additionally many of the conditions of these two Acts do fall under criminal courts resulting in huge procedural delays. An insolvent may at any time after the order of adjudication apply to the Court for an order of discharge, the Court shall appoint a day for hearing the application and may depending on the circumstances either grant an order of absolute discharge with or without conditions or suspend the operation of the order for a specified time or refuse an absolute order of discharge. The jurisdiction of insolvency cannot extend to non-resident foreigners, for such an intercession the

fall under the definition of a government company. The nationalised banks do fall under the definition of government companies, however, the insolvency proceedings are not allowed to be presented as they come under the definition of banking companies. For more on nationalised banks see: Nagendra Kumar Jain v. DJ. Moradabad, (2002) 1 Comp. LJ 95 (All).

See S.31 1920 Act Protection order.

- (1) Any insolvent in respect of whom an order of adjudication has been made may apply to the Court for protection, and the Court may on such application make an order for the protection of the insolvent from arrest or detention.
- (2) A protection order may apply either to all the debts of the debtor, or to any of them as the Court may think proper, and may commence and take effect at and for such time as the Court may direct, and may be revoked or renewed as the Court may think fit.
- (3) A protection order shall protect the insolvent from being arrested or detained in prison for any debt to which such order applies, and any insolvent arrested or detained contrary to the terms of such an order shall be entitled to his release: Provided that no such order shall operate to prejudice the rights of any creditor in the event of such order being revoked or the adjudication annulled.
- (4) Any creditor shall be entitled to appear and oppose the grant of a protection order, but the insolvent shall be prima facie entitled to such order on production of a certificate signed by the official assignee that he has so far conformed to the provisions of this Act.

See Ss. 38& 39 of 1909 Act and Ss. 41,42&43 of the 1920 Act.
foreigner must have committed an act of insolvency during his residence with the jurisdiction of insolvency courts.  

6. Corporate Bankruptcy

See above at  
6.1. Liquidation

When the affairs of a company have been completely wound up or when the OL cannot proceed for want of funds and assets the company would stand dissolved from the date of the order of the Court.  
This power of the Court to order dissolution of a company is not restricted to the reasons given above; the Court is empowered to dissolve the Company for any reason whatsoever.  
A company in liquidation would continue to exist as a legal person till an order of dissolution is passed by the court and the power of the Court would continue till the date of dissolution.

The dissolution of a company unless and otherwise it has been set aside leads to discharge of the debtor and prevents any proceeding being taken against the promoters, directors or officers of the company for any recovery of money or property due or belonging to it or to prove a debt due from it.

While there is no express provision addressing the discovery of additional assets of the debtor after the conclusion of the proceedings, the S.559 does state the power of the Court to declare dissolution of a company void. It states that where a company has been dissolved the Court has two years from the date of the dissolution on an application to make an order declaring the dissolution to be void and to initiate proceeds as if the company has not been dissolved at all. The effect of such an order is to make the assets revert automatically to the company and void ab initio all consequences resulting from such dissolution including any proceedings taken during the interval between the date of dissolution and the date of the order – opening the door for reopening of the proceedings afresh. Additionally this can be read with S.447 which empowers the Court to summon any persons suspected of having property of the company.

6.1.1. Gateway(s) Eligibility to apply and requirements

As per S. 439 of the Companies Act, insolvency proceedings can be applied by the company, by any creditor or creditors, any contributory or contributories, by the Registrar of companies, by any

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59 Insolvency courts do not have jurisdiction to make an order of adjudication, unless the debtor, within a year before the date of the presentation of the insolvency petition has ordinarily resided or has had a dwelling house or carried on business either himself or through his agent within the limits of ordinary civil jurisdiction of the court.
60 See S. 481 read with S. 497 of the Companies Act, 1956
61 See Mathew Philip v. Malayalam Plantations (I) Ltd., (1994)81 Com Cases 38 at 47-48 (Ker-FB). This Kerala full bench decision lays down the operative field of S.481
62 See S. 481 of the Companies Act, 1956
63 This section the Court can summon and examine person(s) who are known or suspected of, possessing any property of the company, is indebted to the company.
64 S.439(a)
65 S.439(b) including any contingent or prospective creditor or creditors
66 S.439(c)
person authorized by the Central Government. The Registrar of Companies is empowered to present a petition for winding up on grounds specified in clauses (d) and (f) as well as S.433(1). This power is however restricted to receiving prior sanction from the Government. This petition can be filed on grounds of inability to pay debts and where the membership of the company falls below the statutory minimum. A company can also petition for winding up, however, it has to be by way of a special resolution if the company is proceeding under S.433 (a). In case of creditors, it has to be the majority in value of the creditors which in turn will be ascertained by the court.

6.1.2. Directors’ Liability

Directors may find themselves liable for acts which take place during the “twilight” period as a consequence of the specific insolvency-related offences provided for by statute or as a consequence of the general fiduciary, common law and in some cases, statutory duties imposed on a director, irrespective of the company’s insolvency, but which may take on particular significance if a company finds itself in financial difficulties.

When a past or present officer of a company commits an offence as provided u/s 536 of the 1956 Act he can be held criminally liable with imprisonment or fine or both. The gravity of the misconduct will

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67 S.439(e)
68 S.439(f&g) for such authorisation the case would have to fall under S.243; and as well as when it falls under clause (h) of the S.433
69 Clause (d) of S.439 states that a petition for winding up can be filed by all or any of the parties mentioned in clauses (a),(b),(c); and S.433(1) states the modes of winding up as either by the Tribunal or Voluntary.
70 A past or present officer of a company commits an offence if he:

(a) does not, to the best of his knowledge and belief, fully and truly discover to the liquidator all the property, movable and immovable, of the company, how, to whom, for what consideration and when it was disposed, except where it has been disposed of in the ordinary course of business;

(b) does not deliver up to the liquidator, or as he directs, all movable and immovable property of the company in his custody or under his control, and which he is required by law to deliver up;

(c) does not deliver up to the liquidator, or as he directs, all books and papers of the company in his custody or under his control and which he is required by law to deliver up;

(d) within the twelve months before the commencement of the winding up or at any time thereafter, conceals any property of the company valued at one hundred rupees or more, or conceals any debt due to or from the company;

(e) within the twelve months before the commencement of the winding up or at any time thereafter, fraudulently removes any property of the company valued at one hundred rupees or more;

(f) makes any material omission in any statement relating to the affairs of the company;

(g) fails to inform the liquidator that a false debt has been proved by any person under the winding up;

(h) after the commencement of the winding up, prevents the production of any book or paper affecting or relating to the property or affairs of the company;

(i) within the twelve months before the commencement of the winding up or at any time thereafter, conceals, destroys, mutilates or falsifies or is privy to the concealment, destruction, mutilation or falsification of any book or paper affecting or relating to, the property or affairs of the company;

(j) within the twelve months before the commencement of the winding up or at any time thereafter makes or is privy to the making of any false entry in any book or paper affecting or relating to the property or affairs of the company;
be reflected in the term of imprisonment or the fine so imposed, in exercising this punitive jurisdiction the court does not seek to compensate the company concerned. The act in question must have occurred in most of the cases either after the commencement of the winding up or within the twelve months preceding the commencement of the winding up. The accused officer/director has to prove that he had no intent to defraud or conceal the true state of affairs of the company or to defeat the law.

6.1.3. Rules of Distribution

After the admission of a petition for the winding-up of a company by the Court an Official Liquidator to be Provisional Liquidator of the company pending final order on the winding-up petition. Traditionally the office of the Official Liquidator has always been attached to the High Court of the State. However in accordance with the amendments such an Official Liquidator (OL) may be appointed from a panel of professional firms of chartered accountants, advocates, company secretaries, cost and works accountants or firms having a combination of these profession. On a winding up order being made the Official Liquidator shall become the liquidator of the company.

Once the winding up order has been made the office of the OL shall taken into custody and control all the property, effects and actionable claims to which the company is or appears to be entitled and shall be deemed to be in the custody of the Tribunal as from the date of the order for the winding up of the company. In doing this a Statement of affairs by the directors would be provided to the OL. This Statement of Affairs would have to be verified by an affidavit and contain the details of the assets and the liabilities, creditors and debtors of the company, and any other information as would be required by the OL. The OL shall conduct the proceedings in winding up the company and perform duties as the

(k) within the twelve months before commencement of the winding up or at any time thereafter, fraudulently parts with, alters or makes any omission in, or is privy to the fraudulent parting with, altering or making of any omission in, any book or paper affecting or relating to the property or affairs of the company;

(l) after the commencement of the winding up or at any meeting of the creditors of the company within the twelve months before the commencement of the winding up, attempts to account for any property of the company by fictitious losses or expenses;

(m) within the twelve months before the commencement of the winding up or at any time thereafter, by any false representation or other fraud, obtains on credit, for or on behalf of the company, any property which the company does not subsequently pay for;

(n) within the twelve months before the commencement of the winding up or at any time thereafter, under the pretence that the company is carrying on business, obtains on credit, for or on behalf of the company, any property which the company does not subsequently pay for;

(o) within the twelve months before the commencement of the winding up or at any time thereafter, pawns, pledges or disposes of any property of the company which has been obtained on credit and has not been paid for unless such pawning, pledging or disposing is in the ordinary course of the business of the company; or

(p) is guilty of any false representation or other fraud for the purpose of obtaining the consent of the creditors of the company or any of them, to an agreement with reference to the affairs of the company or to the winding up.

71 See S.448 of the Companies Act
72 See S.449 of the Companies Act
73 See S.456(1) of the Companies Act
74 See S.456(2) of the Companies Act
75 See S.454 read with S.439A of the Companies Act
Tribunal may impose. The OL can institute or defend any suit, prosecution or other legal proceeding, civil or criminal, on behalf of the company, carry on the business of the company as far is beneficial to the winding up of the company, can sell or transfer any movable or immovable property or actionable claims of the company by public auction or private contract, to sell the whole of the undertaking of the company as a going concern. In essence to all things as may be necessary for winding up the affairs of the company and distributing of the assets. In doing this the OL is empowered to do all acts in the name and on behalf of the company, to prove rank and claim in the insolvency of any contributory for any balance against estate, additionally the OL can take measures to protect the property of the company and making out an inventory of the assets in consultation with secured creditors.

The OL are officers appointed by the Central Government and attached to the High Courts and are under the administrative charge of the regional Directors who supervise the functioning on behalf of the Central Government. In the conduct of the winding up affairs of the companies, the OL act under the directions and supervision of the High Courts. The Central Government has the responsibility in ensuring the performance of the duties and the observation of all the requirements imposed on the OL. There is no provision for multiple insolvency administrators to be appointed.

The OL appointment is dealt with under Section 448 of the Companies Act and this has been widened in the amended version to include professional firms.

In a creditors’ petition for voluntary winding up the creditors have a preferential right over the company to nominate a person to be the liquidator for the purpose of winding up affairs and distributing the assets.

The sale of assets is subject to the sanction of the Court and every sale is a subject to confirmation by the Court. Every sale held by the OL would be subject to terms and conditions approved by the Court. All sales may either be made through public auction or by inviting sealed tenders.

The OL in a winding up acts not merely for creditors but for contributories and for the company as well. An OL is an agent employed for the purpose of winding up of the company and in this respect he is a trustee for the creditors in general.

The sanction of the court is generally obtained before the proceedings are initiated. However if an OL exercises authority without sanction of the court it would not be invalidated. A general sanction for the exercise of authority is generally sufficient.

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76 See S.451(1) of the Companies Act
77 See S.457(1)(a) of the Companies Act
78 See S.457(1)(b) of the Companies Act
79 See S.457(1)(c) of the Companies Act
80 See S.457(1)(ca) of the Companies Act
81 See S.457(1)(e) of the Companies Act
82 See S.457(2)(i) of the Companies Act
83 See S.457(2)(ii) of the Companies Act
84 See S.457(2A-2G) of the Companies Act
85 See S.448 of the Companies Act
86 See note above.
87 See Ss. 500-509 of the Companies Act
88 See S.457(c) of the Companies Act and Rules 272,273 of the Companies(Court Rules)
A report made by the OL is privileged as regards any of the statements contained therein. Creditors or contributories are not as of right entitled to inspect the reports or communications of the liquidator with the Court or the directions sought from the court by the OL. The liquidator’s report normally consists of four parts—a summary of facts relevant for the direction sought, opinion and advice received from the legal advisers, reports of experts, directions sought by the liquidator. The books kept by the liquidator can be inspected by any creditor or contributory subject to the control of the Tribunal.\(^{92}\)

The costs, charges, and expenses incurred by the OL would be a charge on the assets of the company.

Where any liquidator has retained the money which should have been paid into the Companies Liquidation account will have to pay interest on the amount so retained at the rate of 12 per cent per annum,\(^{93}\) and also pay any such penalty as may be decided by the Registrar,\(^{94}\) and would be liable to pay any expenses occasioned by reason of his default,\(^{95}\) and also be liable to have all or such part of his remuneration as the Tribunal may think just to be disallowed and to be removed from his office by the Tribunal.\(^{96}\) Where a liquidator has made a default in filing delivering or making any return, account or other document, or in giving any notice and fails to make good the default within 14 days after the service of the notice requiring him to do so the Tribunal would make an order, based on an application by any contributory or creditor; Registrar, directing the liquidator to make good the default within a prescribed time limit.\(^{97,98}\)

As the OL is an appointee of the Central Government, in every winding up the prescribed fees shall be paid into the public account of India in the Reserve Bank of India to the credit of the Central Government from out of the assets of the company in liquidation and the fees are determined as per Rule 291(2) of the Companies (Court) Rules.\(^{99}\)

While there is no specific provision in the Companies Act for the removal of the official liquidator by the Court the OL apparently can be removed only under S.463 and that removal is also not by the court but by the Central Government.\(^{100}\)

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89 See S.457 of the Companies Act
90 Saldranath Sinha(Dr.) v. Jasoda Dulal Adhikary, AIR 1959 SC 51
91 Amba Tannin Pharmaceuticals Ltd v. Official Liquidator,(1975)45 Com Cases 457 (Bom)
92 See S.461 of the Companies Act read with Rule 286 of the Companies (Court)Rules, 1959
93 See S.555 (9)(a) of the Companies Act
94 See S.555 (9)(a) of the Companies Act
95 See S.555 (9)(b) of the Companies Act
96 See S.555 (9)(c) of the Companies Act
97 See S.556 of the Companies Act
98 See Gulzari Lal Bhargava v. Official Receiver-cum-Official Liquidator, Ammonia Supplies Corp. P. Ltd.,(1972)42 Com Cases 401,404,405(Del)
99 Upon the total assets, including produce of calls on contributories, interest on investments and rents from properties, realised or brought to credit by the Official Liquidator, after deducting sums on which fees are chargeable under clauses (3) and (4) below and the amount spent out of the money received in carrying on the business of the company, upon each year’s collections. On the first Rs. 10,000 or fraction thereof 3 per cent. On the next Rs. 40,000 or fraction thereof 2 per cent. On the next Rs. 50,000 or fraction thereof 1 per cent. Above Rs. 1,00,000 ... 3/4 per cent. Where the Official Liquidator realises property for secured creditors other than debenture-holders. On the amount realised for each secured creditor.- On the first Rs. 10,000 or fraction thereof 4 per cent. On the next Rs. 40,000 or fraction thereof 2 1/2 per cent. On the next Rs. 50,000 or fraction thereof 2 per cent. Above Rs. 1,00,000 1 1/2 per cent
100 Ss.522to527 has been omitted by the 2002 amendment act and will stand omitted once they come into effect till then these provisions would continue to exist. These sections deal with the power of court to appoint of revoke liquidators, S.524 confers plenary power of
6.1.3.1. Types of creditors and their priority

The main types of creditors as per the Indian Companies Act, 1956 are – secured, unsecured, foreign creditors. The unsecured creditors must prove their debts before the liquidator under the special procedure set out under S.528, they cannot apply to the court under the general procedure of S.446 (2) (b) this is applicable only to secured creditors where the remedy of proof is available to be placed in front of the OL. The general rule with foreign creditors is that where reciprocity exists between India and the country of the creditor, the application furnishing proof of debt is entertained, however in the absence of such a reciprocity agreement this rule would not apply.

The order of priority among the creditors is set in two sections – Ss. 529-A and 530. S.529-A which speaks of overriding preferential payments was inserted by the 1985 amendment to the Companies Act, this was done in order to protect the legitimate dues of the workers. The dues of the workmen rank now pari passu to the secured creditors in the event of winding up. The impact of this section was felt on the priority so far enjoyed by the secured creditors who could realise the security remaining outside the winding up and now acting in association with OL, who would act as the representative of the workmen, would need to set aside ‘workmen’s portion’ as defined in the section. This would be deducted from what is realised and applied rateably for the discharge of the ‘workmen’s dues’. The portion of the secured debt which cannot be realised as it has been appropriated towards workmen dues would be treated as payable in preference to all other debts, thereby bringing the secured creditors into the winding up procedure for the unsatisfied portion of their claims. As this is a later day insertion it overrides S.530 and makes the workmen of the company secured creditors by operation of law to the extent of their outstanding dues- provided there is a secured creditor of the company. It is due to the overriding nature of S. 529-A that S.530 priority would come into play only if there is any balance left after satisfying the claims under S.529-A will the government dues or employee dues get any satisfaction. It is the taxes which gets a priority, all other government dues below the preferential payment scheme.

6.1.4. Treatment of avoidable dispositions and executor contracts

If in the course of the winding up it appears that any business of the company has been carried on with intent to defraud creditors, they would be held personally liable. The extent of this liability is laid out in S.542 (2), where the court makes a declaration under the section, the discretion lies with the Court to

appointment and removal of a liquidator on the court in the case of winding up subject to its jurisdiction although the extent of the courts powers is not delimited by the section, it is implicit in the section that an order for removal of a liquidator should be passed only for some good cause shown and not in an arbitrary manner and without justifiable reasons.

101 See Indian Bank v. V.S. Perumal Raja,(1993)76 Com Cases 787(Mad.)
102 See Shanmugam(A) v. Official Liquidator,(1992)75 Com Cases 181,196 (Mad)
103 See the Supreme Court decision in Official Liquidator v. P.A. Tendolkar,(1973)43 Com Cases 382
make an order without limiting the order to the amount of the debts of those creditors so defrauded. The Court is empowered to give any further directions as it deems fit for the purpose of declaration of a charge on any debt or obligation due from the company to the person liable or on any mortgage or charge on any of the company’s assets so held due to the fraudulent transfer. The burden of proof lies with the OL under Ss. 542 & 543.104

6.1.5. Position of employees

Under the provisions of winding up under the Indian Companies Act, there is a clear distinction between workmen and employees. Once a winding up order is made it acts as an automatic discharge to the officers and employees of company, except when business of the company is continued.105 Any contributions of employees under the Employees State Insurance Corporation Act and Gratuity Act do not form part of the assets of the company so as to be available for creditors.106 The overriding preferential payments were inserted in 1985107 to enable the legitimate dues of workers to rank pari passu with secured creditors.108 A redundancy benefit is an entitlement and would be included in the pari passu payment. Following and being subject to the overriding preferential payments is the provision for preferential payment. All government dues in the nature of taxes, cesses, and revenues due from the company, all wages and salary not exceeding four months within the twelve month and not exceeding a sum of 20,000 Rupees,109 all accrued holiday remuneration110 becoming payable to any employee on the termination of the employment, all sums due to any employee from a provident fund, a pension fund, a gratuity fund, or any other fund for the welfare of the employees and maintained by the company, and any expenses of investigation under S. 235 or 237, as far as is payable by the company, any compensation under the Workmen’s Compensation Act, 1923, shall all rank equally amongst themselves and be paid in pari passu to each other.111

6.2. Rescue

India has a long-standing formal scheme for insolvency proceedings with an established body of case law. At the same time it lacks very clearly from the point of view of a data bank – unified or otherwise. There is hardly any data available about how many cases are filed, the length of the proceedings and about the procedure of discharge and the practical effects of discharge. As the proceedings of an insolvency suits are not published it is difficult to deduce reliable information about filing rates. A notable case in this regard is from the State of Andhra Pradesh Mohammed Abbas v. Massod Bin Mohammed Al-Khaili, 2007 A.L.D 1(A.P.) 60. The reason why it is so notable is because the high court

105 See S.445(3) Companies Act
107 See S.529A of the Companies Act.
109 As per notification by the Central Government in the Official Gazette dated 17th February 1997
110 Redundancy benefit is deemed to be wages for that period.
111 See S.530 of the Companies Act
demanded that the district court clerks from every district of the State report on the insolvency petitions pending. The framework for Pre-insolvency rescue schemes are laid down under the Companies Act, 2002 (Ss. 391-396), the Sick Industrial Companies provisions under the Companies Act (Ss. 424A-424L), Corporate Debt Restructuring Scheme, the Asset Reconstruction under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest, 2002 and the guidelines laid down by the Reserve Bank of India.

6.2.1. Compromises

Corporate Compromises in India may be delineated on the lines of Companies Act and the guidelines as laid down by the RBI. The courts in India have always had the view that whenever a choice is available to the court in between the revival of the company and its winding up, the court favors the revival of the company. As this is seen to create the jobs and preserve the assets of the company as against their disposal and distribution.

6.2.1.1. Statutory Provisions for Corporate Rescue

6.2.2. Rescue Procedures

The Chapter V of the Companies Act Ss. 391,394,394-A and 395 deals with compromises, arrangements and reconstructions. S.390 which provides for the interpretation of Ss. 391 and 393, especially clause (b) which while providing the explanation for the “arrangement” extends its ambit to include a re-organization of the share capital of the company by the consolidation of shares of different classes, or by the division of shares of different classes or, by both those methods, in essence all modes of reorganizing the share capital, including interference with preferential and other special rights attached to shares can properly form part of an arrangement with members.

The provisions of Ss. 391 to 394 apply to companies against whom there is a winding up petition and are desirous of avoiding the winding up by resorting to a scheme of rearrangement under the approval of the court.

S.391 provides the power to compromise or to make arrangements with creditors and members of the company subject of course to the Competition Act, 2002. This section is deemed to be a complete code by itself.

Once a scheme of compromise and arrangement falls within the section it can be sanctioned even if it involves doing Acts for which the procedure is specified in other sections of the Act. It is an alternative to liquidation. It may be, but not compulsorily, read with proceedings under sections 397 and 398 where such proceedings are sought to be decided on the basis of a compromise. An arrangement under

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112 Feibelman, 2010) at page 37-38
113 See Current Statutory Scheme on page 5
114 See, Re, Wearwell Cycle Co.(I) Ltd. (1998) 94 Com Cases 723 (Del). See also, Re, Champaran Sugar Mills Ltd. (1999)2 Comp LJ 434 (All). Wherein, one unit of the Sugar Mills was handed over to worker’s society on an experimental basis to prevent winding up.
this section can take a company out of winding up.\textsuperscript{115} The pendency of a winding up petition or even passing of a winding up order does not prevent the court from considering any proper scheme for rescuing the company.\textsuperscript{116} Even when a winding up order has been passed every member has a right to file an application under S.391 for the revival of the company.\textsuperscript{117} The only scenario where this section cannot override is where the management or control has been taken over under S. 18FA of the Industries (Development and Regulation) Act, 1951, any application under this section is precluded from being entertained.

Schemes of compromise and arrangement under sections 391 to 395 can only transfer such rights, powers, duties and property as are capable of being lawfully transferred by a part to the scheme. The difference between 391 and 395 is that they operate in different fields. A scheme under S.395 may not even come to court unless the dissenting minority challenges the proposed offer. Under 391 the dissenting minority challenges the scheme as unfair, whereas under S. 395 they have to prove that the price offered is unfair.

S.391 provides the Court with the widest discretion to approve any sort of arrangement in between the company and its shareholders.\textsuperscript{118} The scheme of compromise or arrangement takes effect from the date when it is arrived at subject to the sanction of the Court.

Under S.392 of the Companies Act the court has the power to supervise the carrying out of the revival scheme and also in the course of implementation of the scheme. When a scheme is workable whether with or without modification the court has no power to pass a winding up order. The court must attempt to find out what modifications, if any, are necessary to make a scheme workable and if necessary, may proceed suo motu in this regard.\textsuperscript{119} The court in making an order under this section, has the power to substitute one sponsor for another, and, strictly speaking omission of the original sponsorer and substituting another in his place would not change the basic fabric of the scheme.\textsuperscript{120} The Gujarat HC has held in Tungabhadra Industries Ltd. V. National Dairy Board, 1983 Tax LR 2527(Guj) that to construe this section and section 391 narrowly would defeat the purpose for which they were enacted. However the power of the court under this section does not go beyond the implementation of a scheme already sanctioned under S.391 with or without modifications.

S. 394 speaks of provision for facilitating the reconstruction and amalgamation of companies.

An amalgamation should not only be beneficial to the companies, but should also be in the interest of creditors and members of both the transferor and transferee companies and should be in the public interest. And the court in exercise of its discretion under s. 391 and 394 of the Act has to see that the scheme as a whole having regard to the general conditions and background and object of the scheme is reasonable and fair.

\textsuperscript{115} See Re, Vasant Investment Corporation Ltd., (1982)52 Com Cases 139 (Bom)
\textsuperscript{116} See Re, Calcut Bank Ltd (1938) 8 Com Cases 313, 314 (Mad)
\textsuperscript{117} See Re, Bengal National Textile Mills Ltd., (1986)59 Com Cases 956, 968 (Cal)
\textsuperscript{118} See Re, National Bank Ltd, (1966)1All ER 1006
\textsuperscript{119} See S.K. Gupta v. K.P Jain (1979) 49 Com Cases 342 at 354(SC) and see also Mansukhlal v. M.V. Shah, Official Liquidator of Hathisingh Manufacturing Co, (In Liquidation), 1979) 46 Com Cases 279 (Guj)
\textsuperscript{120} See S.K. Gupta v. K.P Jain (1979) 49 Com Cases 342 (SC).
If the court finds that the scheme of amalgamation is beneficial to the members of both the companies and the affairs of the company which is going to be dissolved, the transferor company has not been conducted in any manner prejudicial to the interest of its members or merits or demerits of the scheme. The court shall not dwell upon or interfere with the collective wisdom of the shareholders of the company.\textsuperscript{121} Even though the creditors or other affected persons are not entailed to vote on scheme of amalgamation, the court is bound to consider their interests also. If the amalgamation would prejudicially affect the public interest, and that of the amalgamated company and various other interests affected by the scheme, the court should evolve the best way in which their interests could be protected.\textsuperscript{122}

The role and purpose of the Official Liquidator (OL) is laid out in\textit{Kirti Plastics P. Ltd, Re (1993) 78 Com Cases 138 (MP)} where the court said that the OL functions as an agent of the court and his report is needed to satisfy the court that the affairs of the company which is going to be dissolved were not conducted in a manner prejudicial to the public or members’ interest.

Besides these provisions statutory rescue provisions can be found both under SICA and under SARFAESI acts. Under the incorporated provisions S.424A imposes a responsibility for preparation of revival & rehabilitation scheme, such a reference has to be made within 60 days of final adoption of the accounts. Such a reference has to be made even when banks and financial institutions take over the assets under the SARFAESI Act. S. 424C empowers the NCLT to decide on its own if the company is capable of reviving of its own within a reasonable time, if not it will direct any operating agency to prepare a scheme for revival. It is only on a confirming itself that winding up is the last available option will the Tribunal under S.424F will give the order of winding up and can appoint any officer of the OA to act as the liquidator. The Tribunal can also sell off assets of the sick company and distribute the proceeds in accordance with S.529A. The significant improvement is in the S.424G which directs that the winding up should be completed within one year from the order of winding up.

Similarly under the SARFAESI S.13 an Asset manager may be appointed with the sole functioning of managing the assets and not selling or transferring it. The other rescue modes mentioned are rescheduling of the repayment of the debts owed by the borrower. Enforcement of security interests in accordance with the provisions of the act, settlement of amounts due from the borrower.\textsuperscript{123}

6.2.3. Treatment of pre-pack arrangements

Under S. 537 of the Companies Act when a company is under the process of winding up by the Tribunal, then any attachment or sale of any assets of the company without the leave of the Tribunal, such a sale would be void and any sale proceeds would have to be handed over to the Official Liquidator. Sale or transfer of assets, payment which is done by or against a company within six months before the commencement of its winding up which if done within three months prior to the presentation of an

\textsuperscript{121} See Shankaranarayan Hotels P. Ltd v. Official Liquidator, Government of Karnataka (1992)73 Com Cases 63 (Mad.)

\textsuperscript{122} See Telesound India Ltd. Re, (1983) 53 Com Cases 926, 940 (Del)

\textsuperscript{123} See S. 9 of SARFAESI Act, 2002
insolvency petition would be deemed to be a fraudulent preference of its creditors and shall be invalid accordingly.\textsuperscript{124} The liability for such fraudulent conduct of business, on an application by the Official liquidator or creditor or contributory, the Tribunal would declare such persons to be personally liable without limitation of liability for all or any of the debts or other liabilities of the company.\textsuperscript{125}

\textbf{6.3. Cross border insolvency rules}

The Legislative Guide on Insolvency law by the UNCITRAL has been a tool for revising of insolvency laws. India has used this Guide in the review of its own insolvency laws.\textsuperscript{126} The Companies (Second Amendment) Act, 2002 makes an attempt to assimilate the UNCITRAL principles of having a balance in between reorganization and liquidation.\textsuperscript{127} The latest legislative reforms, even though not optimum, does provide for an enabling environment encouraging consensual arrangements.\textsuperscript{128} The newly minted forum of NCLT and its appellate body provides for appointment of members with a transparent process for their selection and appointment keeping in line with the World Bank principles. The rehabilitation procedures which allows for quick and easy access with a timely and efficient administration provide a structure that encourages fair negotiation of a plan under judicial supervision.\textsuperscript{129}

\textbf{6.4. Law reforms}\textsuperscript{130}

The Companies Act which provides the legal framework for the corporate entities in India has seen as many as 24 amendments since 1956. Some of the major amendments to the Act were made through Companies (amendment) Act of 1988 on the recommendations of Sachar Committee and then again in 1998, 2000 and finally in 2002 though the Companies (Second Amendment) Act of 2002 as a consequence of Eradi Committee Report.\textsuperscript{131} This Eradi committee was set up by the Government of India in 1999 and was headed by Justice Eradi – a superannuated Judge from the Supreme Court of India.\textsuperscript{132} The report submitted contained a recommendation for a self-contained law for company reorganization and liquidation. The report was submitted in the year 2000. Parallel to this was the, Narasimham Committee and later on the Andhyaruujina Committee both of which suggested that the banks and

\textsuperscript{124} See S.531 of the Companies Act
\textsuperscript{125} See S.542 of the Companies Act with Rule 11(18) of the Companies (Court) Rules 1949
\textsuperscript{127} See (Batra, 2003); note above at page 3
\textsuperscript{129} (Batra, 2003) note above.
\textsuperscript{130} See Legal Reformson page 6
\textsuperscript{132} This Committee was set up in the year 1999 and was given the objectives of examining and recommending changes to the then existing Companies Act, 1956. Its various recommendations were adopted in the 2002 Amendment Act restructuring the Act and leading to a new regime of corporate rescue. The proposed recommendations were introduced as a Bill in the Parliament as on 23\textsuperscript{rd} October 2008 which then was referred to the Department Related Parliamentary Standing Committee on Finance. However this Bill lapsed due to the dissolution of the 14\textsuperscript{th} Lok Sabha (Lower House of the Parliament). The Ministry of Corporate Affairs then reintroduced the Bill as Companies Bill 2009 on the 3\textsuperscript{rd} of August 2009 in the Lok Sabha without any changes excepting for the Bill year and the Republic Year.
financial institutions be **given the power to take possession of** securities and sell them without court intervention.\(^{133}\) It was these recommendations which led to the enactment of the SARFAESI Act, 2002. One of the more important reforms is in the dealing of winding up of industrial companies. Post-amendments the insolvent industrial companies Sick Industrial Companies (Special Provisions) Act, 1985 was integrated into the Companies (amendment) Act, 2002. In its original form it was drafted as a special legislation with the aim of securing the timely detection of sick and potentially sic companies and for the remedial measures. The abuse of these ameliorative measures led to its repeal. An Act to repeal SICA was passed in 2003 but is yet to be notified.\(^ {134}\) This repeal was aimed at integration of the provisions into the Companies (amendment) Act, 2002.\(^ {135}\) The intention was such integration would enable the NCLT to take over the role of BIFR and a diluted version of the Act would enable plugging of the loopholes in the erstwhile SICA.\(^ {136}\) The aim of combating industrial sickness is still retained however the escape route mode with benefits has been disabled.

With a view to review the consumer insolvency the Law Commission of India recently convened a committee with INSOL India to propose reforms to the consumer insolvency system. The committee was charged with “examining the existing laws relating to personal bankruptcy in India and the desirability of changes in existing laws in the backdrop of fast increasing and easy availability of credit from banks, financial institutions and other lenders to individuals for private, family or household purposes.” The committee, however, concluded its work without making any recommendations.\(^ {137}\)

### Bibliography


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136 The details discussed on page 8.

137 (Feibelman, 2010) at page 29


10. Mardia Chemicals Ltd. and others v. Union of India and Others, 2004(4) SCC 311.


