

CHAPTER VIII

WINDING UP AND DOCTRINE OF DISCLOSURE

1. STATEMENT OF AFFAIRS (Section 454) :

This section reproduces section 177-A of the previous Companies Act with some drafting improvement. The only change of substance is that under sub-section (3), while there was no limit fixed under the Previous Act for the extended time, a limit of three months is fixed under the present section.

The primary duty of the Official Liquidator is to take into custody or under his control, all the assets of the company¹. No liquidator would be able to perform this important duty unless he is able to go through the books and records and satisfy himself about the position of the assets of the company. In order to enable Official Liquidator to perform his duty satisfactorily, section 454 requires for making statement of the affairs of the company to the Official Liquidator by the directors of the company. As per the section, the directors are required to make and submit a statement as to the affairs of the company within 21 days of the passing of the winding up order or appointment of provisional liquidator. This suggest that section applies not only to cases where a winding up order is made but to all cases where a provisional

liquidator is appointed. The object of the section is to facilitate the speedy administration of winding up and enable the liquidator to get himself apprised without delay of all the relevant facts relating to the affairs of the company.

The matters requires to be disclosed in the statement are :

(a) the information as to assets of the company, debts and liabilities of the company, it must also state separately the cash balance in hands, at the bank and also the negotiable instruments if any held by the company.

(b) the particulars of creditors and debtors of the company and in case of secured debts, the particulars of securities, the value of security and date on which they were given. The Official Liquidator is authorised to ask for any additional information from the company.

Persons liable to make statement :

The above statement is required to be made and submitted by the directors, manager, secretary or other Chief Officer of the company. Further they are required to make and submit the statement of their own accord, whether or not the Official Liquidator called on them to do so, within 21 days of the relevant date or such extended time.

It is only in the case of any other officers and persons mentioned in clauses (a) and (b) that the Official Liquidator has to call on them to submit the statement.

In the case of Sipso Agencies (P) Ltd. v. Gajraj Singh,² the question was as to whether past directors are liable under section. In this case where all the directors claim to have resigned several years before the winding up. D.K. Kapur J. held that the ex-directors can be directed to submit a statement of affairs as required by section 454, as they would come within the clause (a) of sub-section (2), even though they might have resigned long, earlier than one year.

The requirement of filing the statement as to the affairs of the company by the directors and officers is a statutory provision. In spite of this, in practice directors and other officers often disown their responsibility and placed ignorance about the availability of books, papers and assets. The position is worse when there has been a deadlock in Board, because in such case the responsibility for the possession of the books is passed on from one officer to the other. The outcome in any case is the non-availability of the books and other necessary records with the official liquidator. Even when books are ultimately made available, they are often incomplete and the liquidator

has to go through and reconstruct the records before taking further proceeding. The delay in getting over these preliminaries is one of the important reason for the delay in disposal of the winding up proceedings.

The reasons for this state of affairs may be :

(a) it is natural that by the time and order of winding up is made the officers and directors have lost interest in the company and may not be keen to assist the Official Liquidator to rehabilitate the company or to realise its assets, and;

(b) the provisions of section 454 (4) provides that any person making a statement. In many cases, there are no liquid assets available with the Official Liquidator, and he therefore, is not in a position to accept estimate submitted to him, in terms of Rule 129 of the Companies (Court) Rule, 1959. The directors usually take the plea that since no fund has been made available to them, they are not in a position to file the statement of affairs.

In order to improve this situation the Sacher Committee has made following recommendations :

(a) In case where the petition for winding up is filed by the company itself, the petition should be accompanied by a duly approved statement of affairs

complete in all respects with all the information required by section 454. Such a petition should specify as to who has the custody of the books of accounts and papers and must name the officer and/or the directors who would produce the books of accounts, papers, etc. after the order of the winding up is passed by the Court. The statement regarding custody and production of books, must have been approved by the board of directors and the petition must include the averment.

(b) In case where the petition for winding up is not filed by the company itself, provisions should be made enabling the Court at the time of giving directions under Rule 96/99 of the Companies (Court) Rules, 1959 (or at any preliminary stage of the proceedings and before the final order is passed) to direct the company to file (within such time as the Court may allow) a declaration stating clearly :

(i) the place where the books, records and other papers of the company are kept; and

(ii) the names, designation and addresses of the persons who is/are charged with the responsibility of maintaining the books, papers etc. of the company and as to who would file the statement of affairs with the Liquidator and would

hadⁿ_L over control of books, papers and other documents in the event of company is ordered to be wound up.

Such a declaration should be approved and /or verified by the Board of directors of the company as may be required by the Court. The declaration shall be accompanied by consent in writing of the person/persons charged with the responsibility for production of books of accounts and for filing the statement of affairs.

(c) In the event of company being wound up on a petition for winding up and the books of account, papers, documents, etc. and/ or statement of affairs not being fixed with the Official Liquidator within ~~the extended~~ ~~liquidator within~~ the period prescribed under section 454 (2) (or any extended period) all persons, who were directors of the company on the date of filing up of winding up petition (i.e. commencement of winding up) will be deemed to have been in default in complying with the requirements of the section and be dealt with as persons in default.

In addition to these recommendations it has also made following recommendations.

(a) for the deletion of the words 'or the Court' from sub-section (3).

(b) that the provisions for payment of expenses should

not be applicable in the case of persons who were directors at the commencement of the winding up.

(c) In sub-section (5) provisions should be made that the onus of providing that there was reasonable excuse would be on the person who commits the default.

So far as this recommendation is concerned attention may be drawn to the recent judgement of Kerala High Court wherein it was held that mere default in complying with the requirements of the section is not enough. The onus is on the prosecution to show that the default was without reasonable excuse.³

(d) It has also recommended for enhancing the fine for non-compliance with the provisions of the Act.

2. PUBLIC EXAMINATION OF PROMOTER, DIRECTORS ETC. (Section 478 - Section 270 of the English Act:

Section 477 provides for private examination of persons capable of giving information concerning the affairs of the company. Section 478 on the other hand provides for public examination and is available only in a compulsory winding up and is a proceedings against promoters, directors and officers of the company who appears from the Official Liquidator's Report to have been guilty of wrong doing. From the information acquired in these proceedings, as well as from the papers and documents of the company and information

obtained from third parties, the liquidator will learn whether he has good ground for taking proceedings for the recovery of any property or of damages from its officers from any mis-feasance.⁴ It may be noted there that section requires the Official Liquidator, where an order has been made for a winding up, to submit a preliminary report, or further reports stating whether in his opinion any fraud has been committed by any persons in the promotion or formation of the company, or by any officer of the company since its formation. The report under this section shall be made only on the report of the Liquidator. Oral evidence outside the report cannot be received.⁵

The following passage from Gore-Brown⁶, sets out the scope of the jurisdiction of the Court, and the nature of an examination under this section :

"The examination is of a penal character. It is set in motion by the Official Receiver, who is a public officer, acting judicially in making his report and bound to take the responsibility for what he alleges in his report. Upon this report the Court will not 'think fit' to order a public examination unless it 'arrives at a judicial conclusion' that it is bound to do so: and it will not do so unless the further report of the Official Receiver shows that there has been fraud existed. On the otherhand, if

fraud is charged, the report must state facts showing a basis for the charge and connecting person sought to be examined with such facts, and must express the opinion of the Official Receiver that there has been fraud by that person⁷. The person who may be publicly examined are only those promoters and officers against whom a prima facie case of fraud is disclosed, the practice which formerly prevailed of examining the innocent as well as the guilty being wrong but no account of fraud practiced by the company on strangers will be taken for this purpose.⁸

It will be seen from this that foundation for the Court jurisdiction lies in the further report or reports of the Official Liquidator and his stating therein that a fraud has been committed. So unless these conditions as to the person or persons sought to be publicly examined under this section are satisfied, the Court will have no jurisdiction to proceed under this section.

In *Musabhai v. Official Receiver*⁹, it was held that as the public examination is ordered on the further report of the Official Receiver, though the charge in the report need not be such as to support a civil or criminal proceedings, it must contain a prim facie case of fraud. It should not be flimsy or sketchy as to be considered unfair or oppressive.

In *Tejani v. Official Receiver*,¹⁰ it was held that where the official Receiver's report is flimsy, sketchy or unfair, the Court will not exercise its jurisdiction or discretion in making an order for Public examination of the person concerned. However, in the case of *Joseph Augusti v. Official Liquidator, Palam Central Bank* it was held that an application for public examination cannot be resisted on the ground that it indirectly contain accusation of an offence against the respondent and, therefore, offends Articles 20(3) of the Constitution.

In *Karnataka Film Ltd. v. Official Liquidator, Chitrakala Moviton Ltd.* (AIR)¹² it was held that public examination of a director resident abroad cannot be ordered. And in the case of *Official Liquidator v. Krishna Mamath*,¹³ it was held that under the section the Court has jurisdiction to examine only the individual person or persons incriminated and not en mass all the persons mentioned in the section.

In *re. Jewett*, it was held that questions cannot be refused to be answered on the ground that the answer incriminate the person examined, if they are necessary for the case. And in *Hiralal Kalyanmalji Sheth v. Gendalal Mills Ltd.*¹⁵ it was held that vexatious, harassing or annoying questions not relevant for the winding up will not be allowed.

APPLICATION OF LIQUIDATOR TO COURT FOR PUBLIC
EXAMINATION OF PROMOTERS, DIRECTORS ETC. (Section 519):

This section provides that in cases, where the Liquidator is of the opinion that some fraud has been committed by any person in the promotion or formation of the company or by any officer of the company in relation to the company since its formation, he may report to the Court accordingly. The Court may, after considering the report, direct the person or the officer concern to present himself before the Court on the appointed day for public examination.

It may be stated here that, there is no similar provision in the English Act. This section was introduced in Parliament during the passage of the Bill. It was neither in the original bill nor suggested by the Select Committee.

The noticeable discrepancy in the section is that the title of the section read as 'an application of liquidator' where the body of the section refers only to the report to be made to the Court by the Liquidator. This requires to be corrected.

As regards the public examination, a question arise as to what consideration should guide the Court.

In the case of Central Tipperah Tea Co. in Re.¹⁶ it was held that "where a prima facie case of fraud has been made out by the liquidator in his report, the Court should

make an order for public examination. It is not necessary at this stage to adjudicate on the question : is the director of the company guilty of the fraud alleged... The only question that the Court can go into at this stage is if the Court has jurisdiction to make an order for a public examination of the directors and in determining this question of jurisdiction, the Court is to be satisfied, that the report of the Liquidator contained a finding of fraud, and that such a finding of fraud is against the director against whom an order of the public examination is sought, and finally that the directors sought to be examined are shown to have taken part in the business of the company or in other transaction from which a finding of fraud has been made. If these conditions are satisfied, the Court has jurisdiction to make an order for public examination of the directors.

So far as question of jurisdiction is concerned, it may be stated that Official Liquidator's report containing prima facie case of fraud is sufficient to give jurisdiction to the Court under section 519.

3. PUBLICATION OF RESOLUTION TO WIND UP VOLUNTARY (Section 485) . :

As per section 484 a company may be wound up voluntarily by passing ordinary or special resolution as the case may be.

The applicability of section 484 is subject to a very important condition laid down under section 485 i.e. disclosure or resolution of winding up to the public by publication in the Official Gazette and News Papers. It provides that within fourteen days of the passing of the resolution, the company shall give notice of the resolution by advertisement in the Official Gazette and also in some news paper circulating in the district where the registered office of the company is situate. The object of this section is to bring to the notice of all concern about the winding up of the company, particularly creditors and other persons dealing with the company.

It may be submitted that expression 'advertisement in the Official Gazette' is not proper. It should 'by Notification in the Official Gazette' and also by advertisement in the newspapers'.

3-A. DECLARATION OF SOLVENCY :

A winding up of a company may be compulsory or voluntary. The voluntary winding up may be (a) Member's voluntary winding up, or (b) creditor's voluntary winding up.

In this connection section 488 which is analogous to section 283 of the English Act, provides that in the case of member's voluntary winding up, two directors or the majority of the directors, are required to make at the

meeting of the Board of Directors and file with the Registrar a statutory declaration of the solvency of the company verified by an affidavit to the effect that they have made full enquiry into the affairs of the company, and that having done so, they have formed an opinion that the company has no debts or that it will be able to pay its debts in full within such period as may be specified in the declaration but not exceeding three years from the commencement of the winding up.

This declaration, in order to be valid (a) must be made within five weeks of the meeting at which the resolution to wind up the company voluntary was passed:

(b) must embody a statement of assets and liabilities as at the latest practicable date before the making of declaration : (c) it is accompanied by a copy of the auditor's report on the profit and loss accounts of the company for a period commencing from the date upto which the last such account was prepared and ending with the latest practicable date immediately before the making of declaration and the balance sheet of the company made out as on the last mentioned date.

It may be submitted that this section was incorporated on the recommendation of the Company Law Committee, which

observed "the present section does not state what is to happen if the debts of the company are not infact, paid within a period of three years as required under the declaration or if the assets realised, are found to be insufficient for the payments of debts... Drawing the attention towards the deficiency of section 207 of the previous Act and Committee observed that under section 207 of the present Act, there is no obligation on the directors of the company to proceed with the winding up within a reasonable period of time, after the declaration of solvency has been made.¹⁷

3-B. EFFECT OF NOT MAKING DECLARATION :

In *Shri Raja Mohan Manucha v. Lakshminath Saigal*¹⁸ it was held that if the declaration of solvency is not made in accordance with law, the resolution of winding up and all subsequent proceedings will be null and void. In another case it was held that failure to satisfy the conditions in clause (a) and (b) of sub-section (2) makes the declaration 'of no effect' i.e. a nullity, a mere error or omission while it may expose the declarant to the penal consequence will not prevent the statement from being a statement for the purpose of satisfying the requirement of the section.¹⁹

In addition to provide more security, to the Sacher Committee has recommended that the particular required to be

stated therein should also contain a statement regarding the address where the books and other records of the company are kept and also the name/names, address and designation of person/persons who is/are charged with the responsibility of producing books records, etc. and also statement of affairs of required by liquidator.²⁰

4. DUTY OF DISCLOSURE OF LIQUIDATOR :

Section 495 which is analogous to section 288 of English Act is complementary to section 488 and it imposes a statutory duty on the Liquidator in case of voluntary winding up to call a meeting of the creditors where he is of the opinion that the company will not be able to pay in full within the period stated in the declaration of solvency or that period has expired without debts having been paid in full. Under this section liquidator is bound to disclose the facts of inability of the company in question to pay its debts full. Further in addition to this disclosure, liquidator is also required to lay a statement of assets and liabilities of the company.

In respect of nature of disclosure, it was held that this summoning of meeting of creditors is analogous to the filling up of a declaration of inability to pay debts.²¹

It may be stated that this section provides an opportunity to the creditors to decide whether or not they should

exercise their right of petitioning for a compulsory winding up by the Court.

Section 496 imposes another duty on the liquidator to call general meeting of the company and at the meeting liquidator is required to lay before the meeting an account of his acts and dealings and of the conduct of winding up during the preceding year. This section is analogous to section 289 of the English Companies Act, and section 208-D of the previous Act. The object of this section is to provide an opportunity to the members to know the latest state of affairs in winding up. This becomes possible because the duty of the liquidator is not only to submit an account at the end of each year of the winding up but also particulars as to the position where the liquidation stood.

The above provision shows that duty of disclosure begins with the formation of a company, it continues during the life time of the company, that is when the company is going concern and it also continue during the proceedings of winding up of the company. The principle behind these provisions is that the position of the state of affairs of the company must be constantly brought to the notice of the members, creditors and person dealing with the company including general public, to enable them to take

proper action in a given situation particularly when their interests are likely to be prejudicially affected.

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R e f e r e n c e s :

1. Section 456 of the Act.
2. (1978) 48 Comp. cas. 30 (Delhi)
3. Official Liquidator v. K.Indira Kartha, 1982 Tax. L.R. 2509 : (1983) 54 Comp. cas. 644 (Ker.)
4. Gore-Brown p. 719.
5. Re Great Kruger Gold Mining Co., "xpartge Barnard (1892) 3 Ch. 307.
6. ~~41~~ 1st Ed. Page 721
7. Re Civil Naval and Military Outfitters (1899) 1 Ch. 215
8. Re Medical Battery Co. (1894) Ch. 444.
9. (1963) 33 Comp. cases 299 (P.C.) (C.A.) (Eastern Africa)
10. (1963) All E.R. 429 (P.C.)
11. (1963) 1 Comp. L.J. 41 (F.B.) (Ker.) See also Official Liquidator v. Haridas Mundra (1970) 2 Comp. L.J. 460.

12. (AIR) (1952) Mad. 481
13. (1959) 29 comp. cas. 171.
14. (1929) 1 Ch. 208
15. (1966) 46 Comp. cases 142, (S.C.
16. (1966) 2 Comp. L.J. 82 (98-9) Cal.
17. Para 216 of the Report.
18. (1963) 33 Comp. cas. 719 (All.)
19. De Courcy v. Clement (1971) 1 All E.R. 681 ;
(1971) 41 comp. cases 796 Ch.D.)
20. Para 15-48 of the Report.
21. Re Res Films Ltd. (1963) All. E.R. 383

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