

## **Report of The Advisory Group on Bankruptcy Laws**

**Dr.N.L. Mitra**  
**Vice-Chancellor,**  
**National Law University, Jodhpur**

May 9, 2001

Dear Dr. Reddy,

I have the pleasure of submitting to you the report of the Export Committee on Bankruptcy here with this letter. I am indebted to you for reposing faith on me to handle such an important national issue. The Group was composed of economists, lawyers, financial experts, liquidation functionaries and academics. An action research group who used to prepare papers, comparative study reports, and global standards supported it. The last ten months' exercise conceived a wholesome bankruptcy system that the country may adopt. The members have the benefit of examining various previous committee reports and some learned works. I am really thankful to all of your staff who have energized the expert group with all logistic support. I also thank you profusely for occasionally participating in the discussion and providing important advice.

Thanking you,

Sincerely yours,

N.L.Mitra

### ***ACKNOWLEDGEMENT***

India does not have a clear policy and comprehensive law on corporate bankruptcy. When this Advisory Group was constituted comprising economists, legal practitioners, official liquidators, solicitor, chartered accountant, banking experts and academics, it was a good fist of intellectual discourses. The Group was backed up by a research team who supplied comparative data as well as critical reviews of various contemporary legal systems on bankruptcy. Often in the debates, it was observed that there are not only ideological confusions on the subject but also conceptual misgivings. The members of the Group had a very detailed deliberation and each one of them contributed to the final outcome very significantly. I have personally enjoyed working with this wonderful team of experts. I take this opportunity to congratulate each one of them for their significant contribution. There were intense debates on many issues but at the end a very wholesome consensus.

I must thank the authorities of the Reserve Bank of India especially Dr.Y.V. Reddy, Deputy Governor, and Chairman of Standing Committee on International Financial Standards and Codes for reposing faith on me for piloting this very important and economically significant task. I am also indebted to him for constant advice and logistic support, the Convenor, Mr.K. Kanagasabapathy, Adviser-in-Charge and Mr. S. Arunachalaramanan, Nodal Officer for providing all types of secretarial support even in later hours. We are also grateful to the Regional Directors in charge of Bangalore and

Kolkata office for hosting two important series of meetings. I must confess that I was overwhelmed by the hospitality of the staff of Reserve Bank of India at various places.

The Group produced two Interim volumes. The first comprising the interim report with articles on comparative study and the second volume comprising scholarly articles and critical comparative analysis between two major legal systems as well as national and international standards. The Final Report which contains the ultimate outcome of the study comprises of the final report, an illustrative draft bankruptcy code and several international standards. I hope that the literature that is produced on bankruptcy now can be academically as well as practically critiqued by various interest groups especially by the chambers of commerce, financial institutions and academics. It would be nice if public seminars are organised in various metropolitan cities on this subject in association with various chambers of commerce, FICCI and CII.

I sincerely thank my research staff, especially Mr.K. Feroz Ali who constantly supported out studies and furthered the interest of research and Mr.K.N. Sunil Kumar, Nodal Officer, Reserve Bank of India. My final advice to the Reserve Bank of India authorities is that the materials may be published and printed in two volumes as follows:

- (1) Volume one shall contain the final report, various international standards in annexure and the draft code.
- (2) Volume two containing all essays on bankruptcy, economics law and practice and management system that were received from various authors along with the comparative analysis.

These two volumes may be made available at a price to all academic institutions and other bodies. At the end I must also thank Hon'ble Mr. Arun Jaitely, Minister in Charge of Law, Justice and Company Affairs for providing me an opportunity to place the views of the Advisory Group in front of him and his officials. I also thank everyone who is some way contributed to the deliberation or facilitated the deliberation.

**Dr.N.L. Mitra**  
**Chairman, Advisory Group on**  
**Bankruptcy Laws**

## MEMORANDUM

### Constitution of Advisory Group on “Bankruptcy Laws”

A Standing Committee on International Financial Standards and Codes has been set up by Governor, Reserve Bank of India on December 8, 1999 with the objectives of identifying and monitoring developments in global standards and codes pertaining to various segments of the financial system, considering all aspects of applicability of such standards and codes to the Indian financial system, chalking out the desirable road map for aligning India's standards and practices in the light of evolving international

practices, periodically reviewing the status and progress in regard to codes and practices, and making available its reports to all concerned organizations in public or private sector (copy of Governor's Memorandum in Annexure).

The Standing Committee in its first meeting held at New Delhi on January 13, 2000 decided to constitute non official Advisory Groups in ten major subject areas encompassing 43 different standards/codes. In this regard, one of the subject area identified is "Bankruptcy Laws". Accordingly, an Advisory Group on "Bankruptcy Laws" under the Chairmanship of Dr. N. L. Mitra, Director, National Law School of India, University, Bangalore is constituted with effect from February 8, 2000 with the following as members.

1. Shri Bimal Kumar Chatterjee, Bar-at-Law
2. Shri H. Banerjee, Official Liquidator, GOI, Chennai
3. Shri Cyril Shroff, C/o Amarchand & Mangaldas & Suresh A. Shroff and Co.
4. Dr. T.C.A. Anant, Professor, Delhi School of Economics, Delhi
5. Shri S. Krishnaswamy, Chartered Accountant, Bangalore
6. Dr. Shubhashis Gangopadhyay, Professor, ISI, New Delhi

Shri K.Kanagasabapathy, Adviser-in-Charge, Monetary Policy Department, Reserve Bank of India/Dr. R. Kannan, Adviser, Department of Economic Analysis and Policy will be convenors to the Advisory Group.

The terms of reference of the Advisory Group are as follows :

- (i) to study present status of applicability and relevance and compliance of relevant standards and codes;
- (ii) to review the feasibility of compliance and the time frame over which this could be achieved given the prevailing legal and institutional practices,
- (iii) to compare the levels of adherence in India, vis-a-vis in industrialized and also emerging economies particularly to understand India's position and prioritize actions on some of the more important codes and standards,
- (iv) to advise a course of action for achieving the best practices appropriate to us; and
- (v) to help sensitise the public opinion on the above matters through its reports.

The Chairman may co-opt other non-officials as members and officials as special invitees and decide to have meetings on schedules and at places of his convenience.

Secretarial assistance to the Advisory Group will be provided by the Reserve Bank of India. The Reserve Bank will also provide the following facilities to the Chairman and Members and special invitees to the Advisory Group :

- a) reimbursement of return air fare by executive class to attend the Advisory Group meetings

- b) provision of local transport and local hospitality
- c) reimbursement of a sum of Rs. 500/- per diem to outside members to meet incidental expenses.
- d) necessary arrangements for conducting the meetings preferably in the RBI premises

The Advisory Group is expected to submit its Reports as and when they are ready and a final report in any case within a time frame of one year from the date of the first meeting.

**September 14, 2000**

**( Y. V. Reddy )**

**List of Members/Special Invitees of Advisory Group on "Bankruptcy Law"**

- |   |                 |
|---|-----------------|
| 1. Dr. N. L. Mitra,<br>Director, Centre for Business Law Studies,<br>Bangalore.                           | Chairman        |
| 2. Shri Bimal Kumar Chatterjee,<br>Bar-at-Law, Calcutta – 700 019.  | Member          |
| 3. Shri Cyril Shroff,<br>Amarchand & Mangaldas & Suresh A. Shroff & Co.,<br>Prabhadevi, Mumbai 400 025.   | Member          |
| 4. Dr T.C.A. Anant,<br>Delhi School of Economics, University of Delhi,<br>Delhi - 110 007.                | Member          |
| 5 Shri S. Krishnaswamy,<br>Chartered Accountant, Bangalore - 560 004.                                     | Member          |
| 6. Shri H. Banerjee,<br>Joint Director (Legal),<br>Ministry of Law, Justice & Company Affairs,<br>Kanpur. | Member          |
| 7. Dr. Shubhashis Gangopadhyay,<br>Professor, Indian Statistical Institute,<br>New Delhi - 110 016.       | Member          |
| 8. Shri S.H. Bhojani,<br>Amarchand & Mangaldas & Suresh A. Shroff & Co.,<br>Prabhadevi, Mumbai 400 025.   | Special Invitee |
| 9. Shri N.V. Deshpande,   | Special Invitee |

Principal Legal Adviser,  
Reserve Bank of India, Mumbai – 400 001.

10 Shri M.S. Verma,  
Chairman,  
Telecom Regulatory Authority of India,  
New Delhi 110 001.

Special Invitee

11. Dr. R.H. Patil,  
Former Managing Director,  
National Stock Exchange of India, Mumbai.

Special Invitee

## **Report of The Advisory Group on Bankruptcy Laws**

### **Chapter I - Introduction**

### **Chapter II - Bankruptcy Law in India: Status Report**

### **Chapter III - Basic Issues on Bankruptcy Matters**

### **Chapter IV - Cross Border Insolvency**

### **Chapter V - Final Recommendations**

## **CHAPTER I - INTRODUCTION**

### **1.1 Constitution of the Advisory Group**

The Governor of the Reserve Bank of India constituted a Standing Committee on International Financial Standards and Codes with the objectives of identifying and monitoring developments in global standards and codes pertaining to various segments of the financial system, considering all aspects of applicability of such standards and codes to the Indian financial system, chalking out the desirable road map for aligning Indian standards and practices in the light of evolving international practices, periodically reviewing the status and progress with regard to codes and practices, and making available this report to all concerned organisations in public and private sector. The Committee in its meeting held at New Delhi on January 13, 2000 decided to constitute non official Advisory Groups in ten major subject areas encompassing 43 different standards/codes in this regard. One of the subject areas identified is "Bankruptcy Laws". Accordingly an Advisory Group/Committee was constituted with effect from February 8, 2000 with the following members:

1. Dr. N. L. Mitra, (Chairman), Director, National Law School of India University, Bangalore;
2. Shri. Bimal Kumar Chatterjee, Senior Advocate, Bar-at-Law, Calcutta;
3. Shri. H. Banerjee, Official Liquidator, Government of India, Chennai;
4. Shri. Cyril Shroff, Solicitor, Mumbai;
5. Dr. T.C.A. Anant, Delhi School of Economics, Delhi;
6. Shri. S. Krishnaswamy, FCA, Former Chairman of the Institute of Chartered Accountants, Bangalore Branch;
7. Dr. Shubhashis Gangopadhyay, Indian Statistical Institute, New Delhi;

8. Shri. K. Kanagasabapathy, (Convenor), Adviser in Charge, Monetary Policy Department, Reserve Bank of India; and
9. Dr. R. Kannan, (Convenor), Adviser, Department of Economic Analysis and policy are the convenors of the Advisory Group.

The Advisory Group in its first meeting, co-opted Shri. S. H. Bhojani, Deputy Managing Director, ICICI as its member. The Advisory Group also requested Shri. N.V. Deshpande, Principal Legal Adviser, Reserve Bank of India to be the special invitee and attend all meetings of the Advisory Group and enrich it with his active participation in the deliberations, which he kindly accepted.

### **1.2 The terms of reference of the Advisory Group**

The terms of reference of the Advisory Group are as follows:

- (1) To study present status of applicability and relevance and compliance of relevant standards and codes;
- (2) To review the feasibility of compliance and the time frame over which this could be achieved given the prevailing legal and institutional practices;
- (3) To compare the levels of adherence in India, vis-à-vis in industrialised and also emerging economies particularly to understand India's position and prioritise actions on some of the important codes and standards;
- (4) To advise a course of action for achieving the best practices appropriate to us ; and
- (5) To help sensitise the public opinion on the above matters through the reports, seminars and workshops.

The relevant codes stated in the first point include:

- (1) Convention on Insolvency Procedures (European Union, November 1995);
- (2) UNCITRAL Model Law on Cross Border Insolvency (United Nations Commission on International Trade Law (UNCITRAL), May 1997);
- (3) Cross-Border Insolvency Concordat [International Bar Association's Insolvency and Creditors Rights Advisory Group (Advisory Group J)]; and
- (4) Orderly and Effective Insolvency Procedures suggested by IMF.

### **1.3 Objective of the Enquiry**

The first meeting of the Advisory Group was addressed by Dr. Y.V. Reddy, Deputy Governor, Reserve Bank of India who brought out the background of setting up of the Standing Committee on International Financial Standards and Codes. He, in particular, mentioned the role of G-7 and G-20 meetings and commitments made at the national level to bring about adherence to international best practices and codes in different areas which would ultimately integrate the national system with the international body. He also pointed out that the financial stability forum has identified 43 different codes in which international best practices are proposed so as to bring a standard in the development of national system according to those codes. He emphasised the need for setting up of the expert group to enquire into the consequences of India's both ongoing reform programme and the need for a consolidated law for bankruptcy to replace the existing laws. He opined that the bankruptcy laws could be studied under two heads: laws existing in India and cross border insolvency issues. Following the broad outline explained by the Deputy Governor, the Advisory Group discussed at length regarding the objective to be achieved

by the Advisory Group. The Advisory Group shall highlight the importance of having a whole-some bankruptcy policy of the country which shall be reflected into an efficient bankruptcy law and practice that would facilitate efficient servicing of the need of the corporations requiring timely intervention of restructuring and a very efficient exit system which maximises the protection of the interest of the creditors and the investors with quick liquidation procedure and well laid down game rule for dispensation of the claims. With that aim in view the Advisory Group discussed the following bounds (a) Corporate bankruptcy to be emphasised by the Advisory Group; (b) integrating bankruptcy law with insolvency situation and cross border insolvency; (c) need for following an international accounting standard for achieving transparency; and (d) an efficient liquidation method.

#### **1.4 Methodology to be followed**

The methodology followed by the Advisory Group was as follows:

- (1) The Advisory Group commissioned papers on various issues on bankruptcy system, economic rationale and law and practice. These papers were put into volume two of the Interim Report. While discussing over these papers the Group identified various legal principles for further deliberation;
- (2) The Advisory Group prepared analysis of bankruptcy law and practice of countries like US, UK, Japan and France. The comparative study indicated the various system deficiency that we have especially in the view of IMF guidelines;
- (3) The Advisory Group has critically analysed the cross border legal provisions in relation to bankruptcy law in India. In this connection, the Advisory group looked into the UNCITRAL model law, European community law, Committee J Report (concordat convention) and the IMF guidelines;
- (4) The Advisory Group discussed various aspects of bankruptcy issues and problems with experts from various sectoral interests like banks and financial institutions, industry and regulators in five rounds of plenary and group meetings.
- (5) The Advisory Group also made all discussions, papers and reports available on the Internet and received various comments from the public; and
- (6) Finally, the Group felt that a seminar and workshop be held to disseminate its findings.

#### **1.5 Strategy**

The Advisory Group decided that it would seek to formulate a framework for a national policy on bankruptcy and draft illustrative legislation for this purpose. Further in view of the fact that the Government of India was planning a reform of bankruptcy law it was felt that a certain number of issues requiring immediate attention be brought out in the form of a special report. These were;

- (1) Regarding delays in settling the claims of the stakeholders that can be avoided, if during the winding up proceeding, the company courts perform dual role of a civil and company court.
- (2) Reputed firms of chartered accountants/auditors/ law firms can be appointed instead of liquidators to decide on and compute the claims of all the stakeholders in a time bound scheme. The liquidator may continue to represent the interest of the state and the labour.

(3) The firm should submit the final statement to the court and disputes should only be allowed on the final allocation and not on the procedure followed.

(4) There should be a definite cut-off date for the fixation of the claim of the workers. The interest on the claim should also be specified. Claims of workers shall be based on company records which should be treated as conclusive evidence. Further, there should be a provision to ensure that objections to company records are dealt with in a strictly time bound manner on an on going basis. Objections raised at the time of liquidation with no prior history of disputes should not be considered.

(5) There is a critical need to bring in more professional inputs to the process of valuation of company's assets. This is particularly important in the context of the secured creditor opting for the sale of his securities, outside the winding up.

(6) The appointment of valuers and auctioneers should be done in a manner consistent with commercial practice and remuneration to these should be incentive compatible. The preparation of the inventory of assets and the valuation of the same should be simultaneously done.

## **1.6 Interim Recommendations**

This Advisory Group noted that the Government of India is actively considering the implementation of the recommendations of the Justice Eradi Committee by amending some provisions of the Companies Act. This group had the privilege of studying the Justice Eradi Committee Report. It was felt in view of this report and the steps the Government of India may take in reforming the law relating to corporate insolvency and restructuring of sick companies an interim report shall be submitted immediately.

The interim report reads as follows:

**1. In view of the following reasons this Group recommends a separate comprehensive Bankruptcy Code should be introduced to deal with corporate bankruptcy:**

- (a) Bankruptcy proceeding is based on the fundamental objective of asset value maximisation and hence the law has to facilitate protection of assets against all risks of further decay and destruction;
- (b) Bankruptcy law and practice aims to create facilities for reorganisation, restructuring on voluntary basis, empowering the stakeholders to agree on a new priority of future contractual obligations;
- (c) Bankruptcy law and practice, therefore, has to be based not on adversarial process but to create a new ambience to either make a restructuring possible on renegotiations or initiating fast track insolvency and winding up proceedings. Hence, the same is not to be a part of the Companies Act;
- (d) A wholesome bankruptcy code should corporate restructuring, fast track winding up in the case of voluntary arrangement under sections 391 to 395 of the Companies Act may be retained in the Companies Act. All issues relating to winding up to be transferred to the Bankruptcy Code.
- (e) Bankruptcy code shall deal with restructuring of the companies acceptable to all parties through renegotiations replacing Sick Industrial Companies Act; and
- (f) In the changing situation of growing cross-border investment, trade and commerce, cross-border insolvency problems are bound to increase both for Indian Companies having cross-boundary entities or ventures as well as foreign entities having Indian



subsidiary and ventures. A comprehensive Bankruptcy code is bound to address such issues taking into consideration international practices.

**2. This Group recommends a Special Bankruptcy Bench in each High Court** sitting all the days as the workload demands, because:

- (a) In spite of the fact that tribunalisation of justice is now a settled fact especially after *L. Chandrakumar [(1997)3SCC,261]*, there is a philosophical debate going on as to the nature, extent, structure and power. Even Justice Eradi Committee commented that in order to make National Tribunal able to quicken the dispute resolution, Article 323A & B of the Constitution is to be amended. This Group does not think that such a step, by-passing the judiciary, is necessary or possible;
- (b) A special bench of the High Court as a full time Bankruptcy Court shall serve all purposes as well as quickening the issue of the procedure recommended;
- (c) A special bench of the High Court will be able to bring multi-dimensional knowledge necessary for restructuring/reorganisation and bankruptcy proceedings; and
- (d) A special bench shall add validity of action in all renegotiated proposals and on the failure of restructuring process, quicken the insolvency proceeding.

**3. This Group recommends a Trustees to be appointed by the court from empanelled professional chartered accountant firms, consultants, financial institutions and law firms** for (i) managing the company as a going concern, (ii) initiating the process of negotiation for time based restructuring of the company and (iii) failing which, initiate insolvency proceedings to wind up the company and dissolve its affairs. The remuneration of the Trustee shall be incentive-compatible and not time based. Trustee can appoint financial advisers, managers, liquidators, auctioneers to help the Trustee in its functions but the remuneration of these experts are to be borne by the Trustee and not the company. The company shall continue to be responsible to meet its usual business prime cost and other overhead expenses. The Trustee shall be empowered to run the affairs and place only periodical reports to the court for further instructions. Any petition objecting any conditions/settlement contained in the Report can only be filed in the court after such periodical Report is placed and within the time specified by the court. The court shall settle those disputes on continuous day-to-day hearing within a time frame. The Trustee shall be appointed immediately on the filing of the bankruptcy petition, if it is filed by the Debtor Company itself. If the petition is filed by a creditor or creditors, the petition is allowed on the prima facie proof that the company failed to meet the claim as stipulated under section 434 of the Companies Act. Some of the members of this Group preferred the test of Non-Performing Assets i.e., failure to pay two demands consecutively as per the guideline of the Reserve Bank of India, but most of the members of this Group preferred the test of trigger as laid down in section 433(e) read with section 434.

**4. The road map of the bankruptcy proceedings** shall be as follows:

- (i) Application for initiating bankruptcy proceedings;
- (ii) Appointment of Trustee: empowerment of the trustees like power of trustees to supersede the Board; operational and functional independence; accountability to the Court including the power of the court to remove trustees in case of mismanagement; relationship with current management; monitoring or substitution; day-to-day operation etc.

- (iii) Time bound restructuring/reorganisation plan:
  - who should submit;
  - procedure of acceptance: 75% of the value of the creditors and 50% of the members present in the meeting;
  - mechanism to sell off;
  - pro-active initiative of the trustee
- (iv) Number of time bound attempts for restructuring;
- (v) Decision to go for insolvency and winding up; and
- (vi) Strategies for realisation and distribution.

**5. Bankruptcy proceeding for Banks and financial institution:** Bankruptcy proceedings against banks and financial institutions have a very special significance especially for two reasons. Firstly it affects the domain of the monetary system and management, and secondly, it is the responsibility of the Central Bank to protect the interest of the depositors. This special position was discussed in details and it was also noted that in several developed countries there is a separate bankruptcy code for banks and financial institutions. The separate distinct responsibility of the Reserve Bank of India as the central bank was discussed in detail. Basically, the bankruptcy proceedings have to start in the case of the Banks and financial institutions only after the *statutory moratorium period* of six months followed by another six months if that is needed. Protection of depositors' interest is one of the cardinal principles of commercial banking and hence must be observed during the process of the bankruptcy proceedings, as well. The protection of depositors' interest has to be ensured either *through deposit insurance protection* taken by the banks and financial institutions or by insurance taken by the depositors. It is suggested in the meeting that deposit insurance premia must be risk-based, which shall give a market signal to the depositors about the credit quality of the banks and financial institutions. After detailed deliberations the Group came to the conclusion **that the same law and procedure and the same court system can conveniently handle the bankruptcy proceedings in the case of banks and financial institutions, as well** excepting that trustee to be appointed in consultation with the RBI and from an approved panel prepared in consultation with the RBI. The Trustee shall be responsible for the upkeep of assets and preparation of final list of liabilities during the statutory and declarative moratorium. Besides, the restructuring plans submitted by any party or at the initiative of the Trustee are to be considered in consultation with the RBI. The court shall at all stages consult the Reserve Bank of India for smooth and effective bankruptcy operation.

**6. Bankruptcy proceedings of PSU and Government Companies shall also be proceeded under the same procedure and authority *mutatis mutandis*.**

**7. This Group also recommends that while drafting the substantive and procedural rule of bankruptcy, international standards for both national and cross-border insolvency must be taken into consideration and based on Indian situation the same can be suitably incorporated.**

## CHAPTER II – BANKRUPTCY LAW IN INDIA: STATUS REPORT

### 2.1 Introduction

India does not have a comprehensive policy or law on bankruptcy. Individuals are declared insolvent in the event of individuals' inability to meet his/her total liability. A Corporation may be wound up if it unable to pay for its debt. In the case of individuals there are two Insolvency Acts, one for the presidency towns and other for the rest of the country, the former is The presidency-Towns Insolvency Act, 1909 and the later is The Provincial Insolvency Act, 1920. The first Indian Insolvency Act was promulgated in 1848. It was formulated on the same lines as the contemporary British Act. Thereafter, there were several attempt to amend or replace the Act but nothing happened before the Provincial Act was passed in 1907 followed by the Presidency-Town Act in 1909. The 1907 Act was replaced in 1920. Provisions of both the statutes are similar, though the Presidency-Towns Act contains provision for official assignee, procedure of the court in details and limitation provisions. Both these statutes exclude corporations from insolvency proceedings to be conducted under these statutes (Sec.8 of the Provincial Act and Sec.107 of the Presidency-Towns Act).

Bankruptcy and Insolvency is specified in the entry 9 of the List III (Concurrent List) of the Seventh Schedule under Article 246 of the Constitution of India. Both the statutes were amended over a dozen times by Union and State legislatures. Some of the common features of these statutes are, definition for acts of insolvency (Sec.9 of the 1909 Act, Sec.6 of 1920 Act); petition procedure and adjudication (Sec.10 –29; Sec 90-100 of 1909 Act; Sec 7 – 34 of 1920 Act); administration of properties (Sec 46-76 of 1909 Act; Sec.45-67 of 1920 Act) and discharge of the insolvent (Sec.38-45 of 1909 Act, Sec.41-44 of 1920 Act). Both the statutes prescribe certain offences and attached criminal liability for some acts of the debtor. Offences are: undischarged insolvent obtaining credit, criminal liability after discharge or composition. An insolvent has several disqualifications as well. These provisions are almost identical.

### 2.2 Terminological confusion

There is a deep- rooted confusion in the meaning and content of several terms used, in this context, sometimes interchangeably. These terms are: bankruptcy, insolvency, liquidation, dissolution. During pre-independent period India never used the word, 'bankruptcy' in its legal system. Insolvency was used for denoting an individual or a firm not able to meet the liability. In the case of a company, the system included winding up and dissolution. Bankruptcy and insolvency, both these words are used in the Constitution of India. But there was no statute or regulation legislated upon bankruptcy. If bankruptcy denotes a condition of inability to meet a demand of a creditor, bankruptcy is dependent upon the **cash test**. If the liquidity position is bad, so much so, that the debtor is unable to pay the debt of a creditor, the debtor is said to be bankrupt. That the asset value is sufficient to meet the liability ultimately, is no reasoning to argue against bankruptcy. On the other hand, insolvency is a condition when a person is apparently, unable to meet entirely the liability from the realisation of entire asset. This is therefore, is known as **asset test**. Presently in the law and practice, there is no such difference in the

use of these words<sup>1</sup>. A wholesome bankruptcy policy and the road map shall certainly include both the situation and the tests mentioned above. The difference between the two situation is that there is a possibility of reconstitution or restructuring between the two situation and the resultant two tests. Parties to the contract, i.e., the debtor and the creditor can renegotiate on the basis of their respective rights and obligations at any time. This provision is also statutorily recognised in the Companies Act.<sup>2</sup>

### **2.3 Corporate Bankruptcy**

There is no policy on the corporate bankruptcy system in India. Restructuring is a genuine treatment of corporate financial ailment. The following are the legal provision for corporate restructuring and the manner in which the same is to be made presently:

#### **(1) Reduction of share capital:**

The need for capital reduction may arise due to: (a) in respect of share capital not paid up; (b) any paid up capital which is lost, or is unrepresented by available assets; or (c) any paid-up share capital which is in excess of the wants of the company. In all the above cases, a corporate doctor shall advise capital reduction with a view to adjust the relation between capital and assets of the corporation [*In re. Indian National Press (Indore) Ltd.* (1989) 66 Com.Cases 387, at 392(MP)]. The Supreme Court of India summed up the procedure for such reduction as prescribed in Section 100 –104 of the Companies Act in *Punjab Distilleries India Ltd. V. CIT* [(1965) 35 Com.Cases 541 at 544 as follows:

- (i) The company is empowered by its articles to reduce the capital;
- (ii) there will be a special resolution by the general body of a company for reduction of capital in the manner envisaged in the scheme for reduction;
- (iii) the company will file an application in the court for an order confirming the reduction of the capital;
- (iv) creditors are to be notified about the proposal for reduction and filing of the petition to the court for confirmation and settlement of list of objecting creditors;
- (v) after the confirmation of the court to the proposal for reduction , it will be registered by the Registrar of the Companies;
- (vi) the Registrar shall certify the substitution of the corresponding part of the memorandum of association; and
- (vii) implementing the scheme of the reduction.

This type of financial restructuring may be difficult because the Court may give an order to include the word “and reduced” with the name of the company and to continue to provide a standing notice to the public for reducing the capital of the company for the time stipulated in the order through the inclusion of the word as a part of the name.

## **(2) Compromise or arrangement with the creditors :**

A company may make a compromise or an arrangement with the creditors under Sec. 391 of the Companies Act. The arrangement contemplated by the section includes a reorganisation of the share capital of the company. The arrangement under that section is very wide and can take a company out of winding up [*In re. Vasant Investment Corporation Ltd.* (1982) 52 Com.Cases,139(Bom.)]. 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 [*In re. Calicut Bank Ltd.* (1938) 8 Com.Cases 313(Mad.) or a scheme being considered by the creditors independently in usual course [*In re. Bengal National Textile Mills Ltd.*(1986) 59 Com Cases 956(Cal)]. The procedure for such compromise or arrangement is as follows:

- (i) an application is to be made by the company, or any creditor or any member of the company to the court for an order to be made by the court for holding a meeting;
- (ii) If a majority in number of three-fourths in value of the creditors or members, as the case may be , present and voting in person or by proxy agree to any compromise or arrangement, the scheme shall be binding;
- (iii) if sanctioned by the court.;
- (iv) a certified copy of the order of the court is to be filed with the Registrar.

Where a High Court makes an order, it shall have the power to supervise the carrying out of the compromise or arrangement. Section 394 provides for facilitating reconstruction and amalgamation of companies.

## **(3) Restructuring under the Sick Industrial Companies(Special Provisions)Act :**

A quasi-judicial body, the Board for Industrial and Financial Reconstruction (BIFR) was established to secure timely detection of sick and potentially sick industrial companies, 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. The provision under this special Act is only meant for industrial companies and not for any other companies. The procedure of restructuring is as follows:

- (a) The undertaking must be a sick company which is –
  - (i) a company registered for not less than five years;
  - (ii) (ii) at the end of any year its accumulated loss is equal to or exceeding the total paid up capital and free reserve;[section 3(o)]
- (b) The Board of Directors shall within 60 days from the date of finalisation of the audited accounts of the year in which the company has fallen sick, make a reference to the BIFR [section 15];
- (c) The BIFR may make inquiry into the working of sick industry either by itself or through an operating agency and may appoint one or more

persons to be special director of the company for safeguarding the financial and other interests of the company [section 16];

- (d) The BIFR may make any of the following order: 1) If it comes to the conclusion that the company given reasonable time, to make its net worth higher than the accumulated loss [section 17]; or 2) If the above is not possible, the BIFR may direct an operating agency to submit a scheme of reconstruction within 90 days which may concern the financial reconstruction; change in or take over of management; amalgamate with any other company; sale or lease out or rationalisation of management and personnel. 3) The scheme may provide for financial assistance by way of loans, advances or guarantees or relief or concessions or sacrifices from the Central Government [section 18]. 4) If BIFR comes to the decision that the company cannot be revived, it may record its opinion to recommend winding up on the ground of just and equitable and refer the matter to the appropriate High Court for winding up of the company [section 20].

Similar provisions have been incorporated in the case of possible or potential sick companies of at least 4 years standing and having an erosion of fifty percent of its net worth [sections 23 and 23A]. 1993 Amendment incorporated details about proceedings on report of loss of fifty percent net worth.

Finally, a company goes into winding up for financial reasons through several modes. Section 433 specifies the grounds on which a company may be **wound up by the court**. Clause (e) of the section specifies one such ground namely, when the company is unable to pay its debts. Inability to pay debts is the most common ground for winding up of a company. The meaning of the term "debt" has been so elaborated by Lindley L.J., "a debt is a sum of money which is now payable or will become payable in the future by reason of present obligation"<sup>3</sup>. In another case<sup>4</sup> it was held, "in order to bring the case within the purview of clause (e) the court must be satisfied in the first instance that, there are in fact debts in the sense that there is a liability of the company *in presenti*". The Court also rejected as too broad a submission the contention that liabilities which may crystallise in future would also be relevant for the purpose of determining whether the company is unable to pay its debts.

#### **(4) Debt under the Companies Act**

The word debt cannot be extended to include unliquidated damages or an unidentified sum incapable of ascertainment immediately, It must be a definite and ascertained sum. A Company is deemed unable to pay a debt if the company is unable to pay the debt exceeding rupees five hundred after expiry of 3 weeks from the date of issuing of the notice claiming the payment by the creditor. Section 434 deals with the position when a company shall be deemed to be unable to pay its debts. This section has the following provisions:

### **(a) Statutory Notice**

Firstly, if a creditor to whom the Company owes a sum exceeding Rs. 500 then due, has served on the company a notice demanding payment, and the company neglects to pay or otherwise satisfy him then, such a creditor can approach the court for an order of winding up. The debt must be really due and presently payable. If there is a *bona fide* and reasonable dispute as to a substantial part of the debt on which the petition is based, winding up will be refused, because, "when a debtor company believes even wrongly that it justified in law to refuse payment, such a refusal cannot be regarded as neglect to pay". Where a petition to wind up a company is to bring pressure upon the company in order to make it pay the petitioner cheaply and expeditiously, when the company desires to dispute the debt in the civil court, the petition is an abuse of the process of the court and is liable to be dismissed<sup>5</sup>.

The effect of a notice under section 434 is to raise a presumption under the statute as to the inability of the company to pay the debt and its consequent insolvency, rendering the company liable to the extreme penalty of losing its existence by being compulsorily wound up by the court. This statutory notice, therefore, is always construed strictly and it must comply with all the requirements of the statute in totality. Here it may be noted that the power of the court to order winding up is discretionary even after the requirements of the notice are complied with. In this connection the following observation of the Supreme Court sums up the law succinctly<sup>6</sup>: "The wishes of the creditor will be tested on the ground whether the case of the persons opposing the winding up is reasonable. Secondly, whether there are matters which should be inquired into and investigated if a winding up order is made. It is also well settled that a winding up order is not made on a creditor's petition if it would not benefit him or the company's creditors generally".

### **(b) Decreed debt**

A company is deemed as being unable to pay its debts if execution or other process issued on a decree or order of any court in favour of a creditor is returned unsatisfied in whole or in part. This is also a ground on which a creditor can file a petition for winding up. It may be noted here that a creditor may not choose to proceed under this provision and may instead serve a statutory demand under section 434(1)(a).

### **(5) Commercial insolvency**

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. It has been held that for obtaining an order for winding up on this ground it should be shown that the company is, "plainly and commercially insolvent, that is to say that its assets and existing liabilities are much as to make the court fully satisfied that the existing and probable assets would be insufficient to meet the existing liabilities"<sup>7</sup>

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Here it may be noted that what has to be ascertained is not whether the assets of the company if converted into cash would be sufficient to meet its liabilities, but whether the company is insolvent in a commercial sense, i.e., a perusal of the balance sheet of the company must show that its assets are not sufficient to meet its liabilities. This however is not a rigid formula and the court may refuse to hold the company insolvent on other considerations including that of public interest. Thus we can see that section 434 splits the concept of inability to pay debts under three sub-headings. This however, does not mean that these clauses are mutually exclusive. It was held in a case<sup>8</sup> that even if a creditor has obtained a decree, he can claim winding up under any of the other grounds and need not confine himself to the category of decree holders only.

**(6) Other modes of winding up and striking the name off the register**

There are other modes of winding up which are voluntary and subject to the supervision of the court. Voluntary winding up of a company may be made as under:

- (1) member's voluntary winding up; and
- (2) creditors' voluntary winding up.

**(a) Members' voluntary winding up**

A company may go for voluntary winding up by passing a special resolution, submitting a statement of solvency and appointing one or more liquidators for such purpose. The liquidator shall forthwith summon a meeting and prepare a statement of assets and liabilities of the company in order to proceed with the task of winding up proceedings.

**(b) Creditors' voluntary winding up**

If the members of the company resolving to go for voluntary winding up can not submit a certificate of solvency the voluntary winding up procedure is regulated by the creditors with the help of a liquidator or liquidators appointed by the creditors. Both Members' voluntary winding up and creditors' voluntary winding up are cost and time efficient modes of liquidation.

**(c) Striking the name off the register**

Apart from the aforesaid procedures of exit, there is another easy way of exit according to the provisions of section 560 of the Companies Act which provides for striking the name of the company off the register. This section provides that where the Register of Companies has reasonable cause to believe that a company is not carrying on business or in operation, he shall send to the company by post a letter inquiring whether the company is carrying on business or in operation. This letter should be followed by a reminder and if no answer is received the Registrar shall publish a Notice in the Official Gazette with a view to striking the name of the company off the Register. If the Registrar either receives answer from the company to the effect that the company is not carrying on business or in operation or does not within one month after sending the second letter receive any answer, he may publish in the Official Gazette and send to the company by a Registered Post a

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<sup>8</sup> *Seethai Mills Ltd. v. M.perumalsamy*, (1980) Comp.Cas.422(Mad..).



notice that on the expiration of three months from the date of that notice the name of the company mentioned therein will be struck off the register and the company will be dissolved unless a cause is shown to the contrary.

Further if in any case where a company is being wound up, the Registrar has reasonable cause to believe either that no liquidator is acting or that the affairs of the company have been completely wound up and any returns required to be made by the liquidator have not been made for a period of six consecutive months, the Registrar shall publish in the Official Gazette and send to the company or the liquidator, if any, a like notice as is provided in sub-section (3) of section 560.

At the expiry of the time mentioned in the notice referred to in sub-section (3) or (4) of section 560 the Registrar may, unless cause to the contrary is previously shown by the company, strike its name off the register, and shall publish notice thereof in the Official Gazette and on the publication in the Official Gazette of such notice the company shall stand dissolved.

The procedure for striking off the company's name has been simplified under "Fast Track S. 560 Scheme". A defunct company's name may be struck off the register under section 560 within one month on compliance of certain formalities and payment of a lump sum fee for filing the overdue statutory documents/returns.

#### **(d) Winding up by the court**

According to section 439 a petition has to be filed for the purposes of winding up by the court. The persons who may file such a petition are the following: (a) the Company; (b) Creditors; (c) Contributories; (d) Registrar and (e) the Central Government. In so far as the first three are concerned the section also says<sup>9</sup> that a petition may be presented by all or any of them, meaning thereby that it is not necessary that petition under section 439 must always be presented by only "one" of them. All or any of them together may present a joint petition on the prescribed grounds.

#### **(7) Conduct of winding up proceedings**

Every winding up, whether it be by the Court or a voluntary winding up, is conducted in accordance with set rules and pattern. One of the first acts undertaken in a winding up is the appointment of a Liquidator, who takes under his charge all of the Company's assets and manages the affairs of the Company in a manner which would prove to be the most beneficial to the interests of the creditors, shareholders and the Company itself. Since a Liquidator is required to take into his charge the assets of the Company, he has the right to apply to the Court for recovery of any property of the Company in possession of other person. One of the most important assets of the Company is the 'uncalled capital' of the Company, because as Section 36(2) specifies, "all money payable by any member to the Company ... shall be a debt due from him to the Company". If some amount remains unpaid on the shares of a member, the Liquidator has the power to make a call on those shares. For this purpose, a Liquidator has to draw up a "list of contributories". A contributory is defined under Section 428 as " a person liable to contribute to the assets of a Company in the event of winding up and includes the holders of any shares which

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<sup>9</sup> Clause(d) of Section 439.

are fully paid up". Of these contributories, the Liquidator has to make two lists: List A of the present members and List B of the past members.

**(i) Liability of Contributors under List A**

List A is drawn up on the basis of the names appearing in the "Register of Members", at the time of commencement of the winding up proceedings. . If a person knowingly allows his name to appear on the register, he is later estopped from denying his liability as a member, i.e., he cannot be permitted to plead that though his name appears on the register he is not in reality a member. Such is the case because, a member's liability during winding up does not arise *ex contracta* ( from a contract) but is *ex siege* ( by virtue of his name appearing on the register). The situation, however, would not be the same if there is a total absence of an element of contract, for example, if shares are allotted to a person without his applying for them. In such situations, the Liquidator cannot place his name on the list of contributories<sup>10</sup>.

Here it is important to note that although a member may owe the Company some money on the face value of his shares, he cannot be forced to pay anything until and unless there is a Court order to that effect and the Liquidator serves a call notice on the member in accordance with the order<sup>11</sup>. Such an order will be passed by the Court only if it is assured that the financial situation of the Company is so bad that unless such a call is made, the liabilities of the Company cannot be discharged [Section 470(1)]. The Liquidator, however, can make a call on the shares without sanction of the court in case the winding up is voluntary.

Once a valid call is made by the Liquidator, the contributories' liability becomes a statutory debt, i.e., a new liability to pay the unpaid balance commences. In one case,<sup>12</sup> it was observed thus: "It is settled in a long course of decisions that the members of a Company in liquidation are liable in respect of unpaid calls even though the calls were made by the Company before it went into liquidation and the suit of the Company for its realisation had become barred by time. The principle of these decisions is that Section 429 creates a new liability on the shareholders in respect of such calls, which is distinct from and independent of the rights which the Company had against them before the winding up."

Certain other points to be noted in regard with liability of present members:

- a) If the list does not include a person's name, he may give notice to the Liquidator to make good the default. If the Liquidator fails to act within 14 days, the Court can issue necessary directions under Section 556.
- b) If a contributory dies either before or during winding up proceedings, then his liability automatically passes on to his legal representatives [Section 431].

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<sup>10</sup> *H.H.Manabendra Shah v. Official Liquidator*, (1977) 47 Comp Cas 356(Del)l.

<sup>11</sup> *In re Sonardih Coal Co. Ltd.*, AIR 1930 All 617

<sup>12</sup> *Pokhar Mal v. Flour and Oil Mills Co. Ltd.* [AIR 1934 Lah 10 1 5]

c) If a contributory is adjudged insolvent, his place is taken by his assignee in insolvency proceedings [Section 431(1)].

d) If the contributory is a Company which is itself in the process of being wound up, the Liquidator of this Company will be the contributory on behalf of the Company.

**(ii) Liability of Past Members**

Under certain specified circumstances even the past members may be held liable as contributories, in accordance with the qualifications and conditions laid down in Section 426 which are the following:

- 1) If a past member has ceased to be a member for more than a year before the commencement of winding up proceedings, he cannot be made liable;
- 2) The liability of a past member is limited to only those debts which were incurred by the Company during the period when he was a member that is he cannot be made liable for any debts incurred by the Company after he ceased to be a member;
- 3) A past member's liability to contribute does not arise unless, in the opinion of the Court, the present members cannot satisfy in full the Company's liabilities. Thus, the liability of past members is only secondary, the primary liability being that of the present members.

**(iii) Unlimited Liability of some Officers**

This has been dealt with by section 427. Here it is interesting to note the provisions of section 322 which lays down that even in the case of a limited company the directors or managers are to have an unlimited liability if a specific provision to this effect is present in the Memorandum. Such members are not only liable as an ordinary shareholder in winding up proceedings, but are also required to make additional contribution as if they are members of an unlimited Company. The unlimited liability attaches to both present and past officers but in case of past officers qualifications under Section 426 apply.

**(iv) Payment of Liabilities by Liquidator**

Once the Liquidator makes a call, collects the unpaid call money, converts the assets into cash, determines the value of total available assets and the extent of the Company's debts, his primary duty then becomes the paying off of the liabilities of the Company. Any person having a claim against the Company has the right to claim it from the Liquidator. A secured creditor need not go through the usual channels for claiming his debt since he has the right to realise his security in settlement of his claim, but he is required to compensate the Liquidator for expenses incurred by him in preserving the security from being realised by other creditors. But he has been given an option of relinquishing his security and proving his claim like the other unsecured creditors. Previously, under this scheme, a secured creditor could override the claims of all other creditors, including the legitimate claims of the workmen. But since the Amendment Act of 1985, which amended Section 529, workers' claims are now equated with those of the secured creditors, by providing that the security of every creditor shall be subject to a *pari passu* charge in favour of the workmen, i.e., whenever a secured creditor wants to

enforce his security, the Liquidator shall have the power to represent the workmen in order to enforce the presumed charge in their favour. The amendment Act further added section 529-A providing for payment of the workmen's dues in priority of *all* other dues, and if the available assets are not sufficient to pay off all the liabilities in full, the payment shall abate in equal proportion. Section 530 which provides for 'preferential payments' has also been made subordinate to the provisions of Section 529-A. Once the Liquidator settles the list of claimants, i.e., persons to whom the Company owes money, he or she is required to start making payments to them out of the available assets in hand.

#### **(8) Preferential Payments**

Section 530 of the Companies Act specifies certain payments in priority to all other debts subject to payment of workmen's dues and debts due to secured creditors on a *pari passu* basis. This is a very important provision for the purposes of the present discussion as it brings out the pro-creditor and pro-dispensation bias of the Indian law. The payments to be made first are called 'preferential payments'. They have to be paid in priority to all other debts. These are:

1. All revenues, taxes, cesses and rates due to the Central or a State Government or to a local authority. The amount should have become due and payable within twelve months before the winding up.
2. All wages or salary of any employee, in respect of services rendered to the Company and due for a period of four months only within twelve months before the winding up and any compensation payable to any workman under Chapter V-A of the Industrial Disputes Act, 1947. The amount is not to exceed one thousand rupees in the case of any one claimant.
3. All secured holiday remuneration becoming payable to any employee on the termination of his employment before, or by the effect of the winding up.
4. All amount due in respect of contributions payable during the twelve months before the winding up, under the Employees' State Insurance Act, 1948 or any other law.
5. All amounts due in respect of any compensation or liability for compensation under the Workmen's Compensation Act, 1923 in respect of death or disablement of any employee of the Company.
6. All sums due to any employee from a provident fund, a pension fund, gratuity fund or any other fund for the welfare of the employees maintained by the Company.
7. The expenses of any investigation held in pursuance of Section 235 or 237 in so far as they are payable by the Company.

After retaining sums necessary for meeting the costs and expenses of winding up, the above debts have to be discharged forthwith to the extent assets are sufficient to meet them. Where the Liquidator carries on business for beneficial winding up, the taxes that become due on the profits are expenses of winding up. The fee payable to a chartered accountant for preparing the statement of affairs is also an expense of winding up. The preferential claims rank equally among themselves and have to be paid in full. But when the assets are Insufficient to meet them, they shall abate in equal proportion. By virtue of the provision in Section 178 of the Income Tax Act, 1961, Income Tax authorities have been claiming preference over other preferential

payments. But the Courts have always held that there is nothing in the Income Tax Law which interferes with or abrogates the provisions for priority of debts laid down in Section 530(1)(a) of the Companies Act<sup>13</sup>.

### **(9) Insolvency Laws and Preferential Payments**

If a Company is being wound up on grounds of insolvency section 529 becomes applicable providing for application of insolvency laws to the payment of debts of the insolvent Company. Section 46 of the Provincial Insolvency Act, 1920 provides that if there have been mutual dealings between the debtor and the insolvent (creditor), only that amount which remains after giving a set-off can be recovered from the debtor. This right of set-off is also available to insolvent companies regardless of the provisions of Sec. 530. This apparent conflict between Sections 529 and 530 was attempted to be resolved by the Supreme Court which held<sup>14</sup>:

“It is true that section 530 provides for preferential payments, but the provision cannot in any way detract from full effect being given to section 529 and in fact the only way in which these two sections can be reconciled is by reading them together so as to provide that whenever any creditor seeks to prove his debt, the rule enacted in Section 46 of the Provincial Insolvency Act would apply and only that amount which is ultimately found due from him at the foot of the account in respect of mutual dealings should be recoverable from him and not that the amount recoverable from him should be recovered fully while the amount due to him should rank in payment after the preferential payments. We find that the same view has been taken by the English Courts on the interpretation of the corresponding provisions of the English Companies Act, 1948, and since our Companies Act is modelled largely on the English Companies Act, we do not see any reason why we should take a different view, particularly when that view appears fair and just”.

Finally, if any surplus amount is left it is utilised in paying back the shareholders in accordance with their rights, with the 'preference shareholders' being paid off first wherever the articles provide that the preference shareholders would be entitled to their arrears of dividends whether earned, declared or not in the event of winding up. Such a provision would entitle them to claim arrears even if the Company had neither commenced business nor earned any profits<sup>15</sup>. This dividend which is paid to the members is not construed as their income but deemed to be a refund of capital, even in cases where the dividend includes profits earned by the Liquidator [cases where he carries on the Company business for a more beneficial winding up]. If dividends remain unclaimed by either the creditors or contributories for a period of 6 months they should be deposited in the Reserve Bank, from where they can be claimed by any person after obtaining a Court order. If the dividends remain unclaimed for a period of 7 years the amount is transferred to the Investor Protection Fund [section 205C].

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<sup>13</sup> Avtar Singh, *Company Law*, (9<sup>th</sup> Edition, Lucknow: EBC) at 506-508.

<sup>14</sup> *Official Liquidator v. Laxmikutty*, (1981)3 SCC 321.

<sup>15</sup> *Globe Motors Ltd. v. Globe United Engg. and Foundry Co. Ltd.*, (1975)45 Comp Cas 429 (Del)

### **(10) Fraudulent Preference**

Under the insolvency laws we have a concept of 'fraudulent transfers' which implies that a transfer or conveyance made by a debtor in favour of some particular creditor with intention to give a preferential treatment to that creditor or to defraud other creditors, such a transfer would be void if made within 3 months of an insolvency petition being presented against him and he is adjudged an insolvent. This concept of 'fraudulent transfers' is present in Company law also under section 531 and states that any transaction with a creditor entered into by a Company in preference of other creditors within six months prior to the date of commencement of winding up is to be deemed a fraudulent preference of its creditors and is accordingly invalid.

But if a Company makes payment to a creditor who is pressurising the Company with a threat of a suit and attachment of property, then such a payment cannot be called 'fraudulent' provided the debt was really due<sup>16</sup>. In the final analysis, whether a transaction is fraudulent or not depends entirely on the 'intention of the debtor' and nothing else. Further, under Sec. 532 a transfer or assignment by a Company of all its properties to a trust/trustee for the benefit of all its creditors is also void.

### **(11) Voluntary Transfer**

Under Sec. 531 -A, a transfer of property whether movable or immovable or any delivery of goods by the Company within a period of one year prior to the presentation of a winding up petition is void as against the Liquidator, unless the following conditions are satisfied:

- a) the transfer/ delivery was made in the usual course of Company business; and
- b) the transfer was in favour of a purchaser or encumbrancer in good faith and for real and valuable consideration.

### **(12) Transfer of Shares**

When a Company is undergoing voluntary winding up, any transfer of shares or change in the status of member after commencement of such proceedings is void, unless a prior permission of the Liquidator is taken (Sec. 536). The same position prevails in case of winding up by Court or under supervision of Court, with the difference that such a transfer is valid if permission of Court is obtained either before or after the making of the transfer. In respect of attachments executions etc., the Liquidator has been given a free hand in deciding what is just, fair or reasonable in all such cases of transfers (either of shares or property ), attachment, distress of

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<sup>16</sup> In *Official Liquidator v. Venkatratnam* [(1966)1 Comp LJ 243 (Andh)], one of the creditors of a motor transport company sued the Company for debt and attachment of its buses before delivery of judgement. A compromise decree was passed by the Court, under which three of the Company buses were given to the creditor. A few days later the Company went into liquidation. The Liquidator claimed the buses back on the ground that it was a fraudulent preference of creditors and hence the transfer was invalid. Rejecting the claim the Court said: "If a debtor prefers one creditor to another on account of pressure that is put upon him, the payment cannot be regarded as a fraudulent preference .... Persons in charge of the management thought that it is profitable to discharge the debts by allotting some of the buses to the creditors".

property or execution put in force without leave of Court, after commencement of winding up. Such transfers can be avoided (Sec. 537)<sup>17</sup>.

### **(13) Proceedings against Delinquent Officers**

Once a Company goes in for winding up, the Liquidator takes into his charge all the books and papers of the Company. While going through these books, or during the course of his investigation he may come across information about the underhand dealings of some of the officers. These dealings may be either in their self interest or in connivance with the company defrauding the creditors either in general or at least some of the creditors by giving a preferential treatment to one or more creditors. When the Liquidator comes across these instances he has been given the power under various sections of the Act to prosecute these defaulting/delinquent officers and in some instances he can also make them pay back to the company the amount which the Company has lost due to their default (be it intentional or unintentional i.e., through negligence). The basic objective of these provisions seem to be that the Directors and other officers of the Company owe a fiduciary duty towards the Company and hence should be held liable when they fail in their duty by not acting in the best interests of the Company, creditors and shareholders. Since a Liquidator takes the overall charge of the Company on his appointment, he is automatically put in a fiduciary position and so is duty bound to prosecute such officers.

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<sup>17</sup>The effect of this section was seen in *Rajratna Naranbhal Mills v. New quality Bobbin Works* [(1973)43 Comp Cas 131 (Guj)] where a suit for recovery of debt was filed against the Company by a creditor who also got some shares of the Company attached on the same day. Later, a winding up petition was presented against the Company. After this, but before passing of a final order, a consent decree was passed in execution of which these attached shares were sold and a winding up order was passed later, and the Liquidator sought an order declaring the sale of shares as void and the consequential relief of recovery of the sale proceeds. Under section 537(1) any attachment or sale of a Company property without sanction of Court after commencement of winding up is void. and under Sec. 441(2), the commencement of winding up is from the time of presentation of petition. In view of these provisions, the Court had no option but to declare the sale void (as it had taken place after commencement of winding up) and the Liquidator entitled to the sale proceeds.

## CHAPTER III – BASIC ISSUES ON BANKRUPTCY MATTERS

### 3.1 Do we require a comprehensive Bankruptcy Law?

Life of a corporate entity has ups and downs like an animate person. There may be many reasons for the same. Only a very competent **Corporate Doctor** can diagnose the disease and administer therapy. Unfortunately, we are still talking about good corporate governance, as if, such a thing is *ubiquitous* and an immortal one, once found shall remain constant for all times to come. Like any animate person the health of a *lega persona*, i.e., the *corporate health* is also subjected to innumerable *virus* and *bacteria*. *Bacteria* in corporate entity may originate, as for example, due to bad governance inefficient management, financial malfunctioning, and short supply of finance or technology obsolescence. External causes for *virus* infection may be on account of change of consumption habit, new products coming in the markets, or even inflation or deflation in the economy. For some of these reasons, a corporate entity may be restructured and for some other reasons the quick death of the entity is perhaps better for the economy as a whole. Unfortunately in India there is no corporate doctor to effectively diagnose and administer proper therapy at proper time. The corporate law has not provided for any such measures that ensures good governance and at the same time does not adequately protect of the health of an entity.

However, the analogy has limitations. Governance principles are effective only up to voluntary and mutually beneficial negotiations. The need for a bankruptcy law comes about in the context of a renegotiation of a set of contracts. When a company is unable, or unwilling, to meet its contractual obligations to its stakeholders, the contracting parties will have to decide whether the contract terms will be enforced or be allowed to be breached. In other words, the contracts may have to be negotiated. The bankruptcy court provides the framework within which such renegotiations can take place. The bankruptcy institution, therefore, must give a very special emphasis on the lowering of costs of transactions during bankruptcy procedures. Indeed, this must be its primary objective.

It was observed that, in this context, bankruptcy procedures are irrelevant if companies never face financial distress. Financial distress opens up the possibility of a breach of contractual obligations. Consequently, all aspects of bankruptcy law will have to be restricted to analysing such situations. For instance, shareholder protection should not be a concern, or have the lowest priority, in a bankruptcy procedure. This is because the shareholders are residual claimants and financial distress implies that the corporation is valueless even after it meets only some of the claims that are senior to those of the shareholders. Shareholders' protection is better served by other parts of corporate law where the express intention is to draw up the rules governing transactions between shareholders and the corporation.

If the bankruptcy institution is to provide a framework for renegotiation, then its involvement in effecting a particular outcome is minimised. On the other hand, it has a non-trivial role to play in terms of ensuring that the most efficient solution is achieved at minimum cost. In other words, instead of being a decision maker, the bankruptcy institution should facilitate decision-making. It should play an enabling role rather than be a judge of what is an acceptable reallocation of existing claims. Of course, for this to have any meaning, it must ensure that the negotiating parties voluntarily accept all reallocations. This is best achieved when the parties have information, the capability to evaluate the meaning of alternative propositions, are not coerced into accepting reallocations that are not favourable to them, and, most importantly, know how the court



will settle the dispute if it cannot be voluntarily resolved by the parties. The institution then has the following role:

- (1) Gives legal sanction, and enforces, all claim reallocations that have been voluntarily agreed to by the parties;
- (2) Ensures that all agreements are indeed voluntarily; and
- (3) Follows a consistent and precisely defined allocation rule when parties cannot come to a renegotiated outcome.

There is no such structured law in India. At present the only interceptive way of restructuring based on renegotiation, if any, is provided in the Sick Industrial Companies (Special provisions) Act, 1985. This Act is, however, seriously flawed. Detailed discussions of the limitations of this Act are available in various committee reports on the subject. The provision in the Act has two major limitations.

Firstly, the restructuring proposals are not based on effective voluntarily renegotiation but rather than a top down command approach. These do not provide for any space for financial<sup>18</sup> prudence nor does it provide for opportunity of timely intervention. Secondly, the definition of sickness itself is completely inadequate for the purpose.

A company is sick only when at the end of any financial year accumulated losses equal or exceed its entire net worth. This is not the initial sickness stage. It is simply the final *coramin* stage. In most of the cases the stage for restructuring is over<sup>19</sup>. Besides, if one examines the nature of the function of the Board and the manner in which it is constituted, there is no possibility of infusing the diagnostic capability of financial prudence.

The Advisory Group therefore recommended the adoption of a comprehensive legal regime in bankruptcy, which has to include, *inter alia*, (a) clear consistent objectives (b) an effective trigger for the operation of the bankruptcy code; (c) professional institution to carry on bankruptcy proceedings, such as Trusts; (d) Reorganisation based on renegotiation on voluntary basis; (e) time-based decision making and implementation of restructuring and winding up.

### **3.2 Objective of Bankruptcy law**

The Advisory Group debated over the objective of the Bankruptcy law in greater details and finally zeroed down to the most important objectives. Objective of the bankruptcy code may be many like (a) maximisation of realisation of assets; (b) securing the interest of the various contesting groups in claim settlements; (c) quick and efficient distribution; (d) a fair opportunity for all entities for restructuring on renegotiation; (e) lubrication of a quick exist system; (f) minimising the conflicts and making conflict resolutions preferably on the basis of a time scale; (g) introducing a system comparable to contemporary legal system of the world; (h) standardising the system incorporating global principles of bankruptcy with transborder interest etc.

The Advisory Group narrowed down to three basic objectives, namely, (1) ***maximisation of value of assets***; (2) ***facilitating restructuring based on renegotiation***; and (3) ***quick and fast track liquidation***.

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<sup>18</sup> Section 17 of the SICA stipulating power of the Board to make suitable order on the completion of the enquiry into the question of sickness.

<sup>19</sup> The Report of the High Level Committee on Law Relating to Insolvency and Winding Up of Companies 2000, (Eradi Committee Report).

The Advisory Group examined further to find out the place of these objective in the body of the statute itself. This is generally done by adding a preamble to the statute, which is an international model of legal drafting. The other method is stipulating these objectives in the extended name of the statutes. This is a common law practice. The Parliamentary practice is that while introducing a Bill there is a statement of objectives submitted along with the Bill. The Advisory Group examined in detail the purpose of all these methodologies. The fundamental purpose is that while interpreting the statute the judicial body may have some *lights* for interpretations of any sentence or a clause or a word. The common law judges of old tradition do not like to take recourse to any instrument of interpretation, either using an internal tool box or an external one. Preamble or long title, these are internal tool box kits which judges often use for interpretation, of course to the dislike of the traditional common law judges who refused to interpret anything outside the text of the law. It has been noted that the Indian judiciary is found of interpreting law on the basis of certain objective criteria. The difficulty here is that objective criteria determined through subjective characters make wide variations in interpretations. Judges may even refer to legislative debate, objective statement, statute *ex pari materia*, contemporaneous *ex positio* as external tool kit instruments. Based on these discussions it was decided to formulate a law simply written based on self-explanatory language. Further there is no requirement of providing any internal or external tool kits for interpretation. Therefore the Advisory Group does not recommend any preamble nor does it recommend inclusion of any value-loaded principles in the extended name of the statute. Therefore it was suggested an extended name as follows: “ **An Act to consolidate, codify and amend the law and procedure on corporate bankruptcy**”

### **3.3 Trigger operation**

There are various options about trigger operation for initiating bankruptcy operation. Some such options are (a) cash test; (b) solvency or asset test; (c) net worth test; (d) continuous asset depletion through continuous loss test and (f) irretrievable break down test.

#### **(a) Cash test:**

According to Section 434 of the Companies Act prescribes that a company failing to pay a debt for rupees five hundred on the debt failing due or make it secured or compound for it to the satisfaction of the creditor, is deemed unable to pay its debts. According to members this test is quite simple and clear though the amount seems to be very unreasonably low so that any claimant may unnecessarily vex an entity for frivolous grounds.

#### **(b) Solvency test:**

It is a test to challenge the petition for bankruptcy in which the management/promoters are able to submit a certificate stating that the entity has ability to pay for its entire debt because its total realisable assets are more than its total debt. Since it is a reversal test it is not beneficial as a market signal.

#### **(c) Net worth test:**

According to Section 3(1)(ga) of the SICA, net worth means the sum total of the paid-up capital and free reserves. If the accumulated loss is equal or more than the entire net worth in a financial year the company is sick requiring treatment. This known as Zero or Negative net worth test. The members felt that this balance sheet driven test shows a symptom of entity in ‘red’ but is not a good test for an entity as a going concern requiring treatment.

**(d) Continuous asset depletion test:**

This is a continuous loss test as well. If a company sustains continuous loss for a number of years, the company may be in bankruptcy situation. This is not a necessary condition. In infrastructure projects there is a high gestation period. But the depletion theory may not be operative due to special nature of the project and project finance.

**(e) Irretrievable break down test:**

A company's sub-stratum may be lost due to non-viability of the objectives; technology obsolescence; complete market break down and for many other such reasons. Any irretrievable break down will require an intervention of a bankruptcy system.

After detail discussion the members unanimously were of opinion that a bankruptcy trigger system must be simple to operate, there having a clear market signal and not subjected to misuse. From that point of view the Advisory Group recommended the test laid down in the Section 434 with the following amendment. The amended section shall stand as follows:

**“ (1) A company shall be deemed to be unable to pay its debts-**

**(a) if a creditor, by assignment or otherwise, to whom the company is indebted in a sum *exceeding rupees one lakh* the due, has served on the company, by causing it to be delivered at its registered office, by registered letter, speed post, courier, fax , telex , electronically communicable medium or by any other means, a demand under his hand requiring the company to pay the sum so due as per the contract entered into by the creditor with the company, and the company has for three weeks thereafter failed to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor.....”**

The Advisory Group also feels that any misuse of the provision for intentionally causing harm on the reputation of an entity be severely dealt with as is provided in the Bankruptcy Code of all countries. Section 110 of 11U.S.C. stipulates penalties on persons who negligently or fraudulently prepare and submit bankruptcy petitions. The Advisory Group recommends such a type of provision in order to ensure that the bankruptcy proceedings are not misused. A provision like the following may be included in the Bill:

**“ Penalty for persons who negligently or fraudulently file a bankruptcy petition: If a bankruptcy petition is rejected due to the petition being filed negligently or fraudulently, the petitioner may be directed to pay a compensation equal to (a) actual damage caused to the debtor and (b) all reasonable costs that the debtor had to pay for contesting the petition. In calculating the actual damage caused the Court may take into consideration the loss of reputation and the harassment caused”.**

**3.4 Appointment and responsibilities of Trustees**

The Advisory Group critically reviewed the structure and function of official liquidators and also noted various critical remarks of the functioning of the institution both by Justice Eradi Committee and also the Report of Omkar Goswami Committee. The Advisory Group is of the same opinion with that of the Justice Eradi Committee in so far as recommending that knowledge based specialised professional institutions are required to handle bankruptcy cases. While there is not professional institution developed for handling bankruptcy cases it is quite possible to develop institutions with experts taken from Chartered Accountant firms, financial institutions, corporate law firms, company

secretaries, financial analysts and other professionals. In the present system of liquidation it was found that official liquidators not only suffer from absence of specialised knowledge but also they do suffer from absence of infrastructure. The institution is very ill equipped.

Thus we address the following issues.

**(a) Who can be a trustee:**

The Advisory Group looked into various structural frameworks and strongly recommends the form of trusteeship for the same purpose. Trustee can be constituted from multi-professional agencies or may be enlisted by the respective courts from professional firms like chartered accountants, cost accountants, company secretaries, corporate professional consultants, law firms, financial institutions and professional entities having expertise in the job of bankruptcy matters. The Advisory Group, therefore, recommends that the **judicial body** responsible for corporate bankruptcy proceedings may list professional bodies and entities from whom bankruptcy trustees may be appointed.

**(b) When the trustee to be appointed:**

It is also recommended that if the debtor files a bankruptcy petition the judicial body shall appoint the trustee as soon as the petition is filed. In the event that the petition is filed by the creditor/creditors, the trustee is to be appointed as soon as the petition is allowed.

**(c) Functions of the trustee:**

The trustee shall have the following functions

- (1) The trustee takes full charge of the entity as if it is the CEO of the entity. The trustee may continue with the board of the entity or dispense with the same to assume the responsibility of an administrator;
- (2) The trustee shall prepare a statement of affairs and a statement of realisable assets and claims. The trustee shall also prepare a list of security interest created against the assets and a list of secured claims. This is to be place before the judicial body. Any contest against such lists is to be heard by the judicial body and the list either amended or unamended be approved;
- (3) The trustee shall simultaneously proceed with negotiations for reorganisation or restructuring with different stakeholders. The trustee itself may prepare a proposal for the consideration of all parties or may allow time-based opportunities for the submission of proposal by the debtor or the creditor. The task of the trustee shall be to created a climate of renegotiation based upon a definite predetermined time frame and on voluntary basis;
- (4) The trustee may appoint necessary professional consultants or other functionaries but the compensation of the trustee should be incentive compatible it could be as a percentage of the realised net value of the entity but should not be time based. The judicial body shall approve as soon as the trustee is appointed;
- (5) If a proposal meets the approval of the stakeholders, the trustee shall place the same for judicial approval. All disputes must be resolved in a fixed time period;
- (6) If the renegotiation fails, the entity then goes for compulsory winding up with the trustee as the chief institution for carrying on the winding up keeping the objective of the bankruptcy law in view, i.e. that the trustee's task is asset value maximisation. His options are (a) selling the concern as a going concern; (b) selling the assets in pieces

and paying the liabilities piece-meal; or selling assets and meeting liabilities in bundles.

(7) Submission of the statement after liquidation to the judicial body at the end.

(8) In case of cross border implications, he has to claim foreign receivable and assets and also meet the foreign claims.

#### **(d) Liability of the trustee**

The trustee appointed under the bankruptcy code shall not be covered by the Indian Trust Act. And therefore, his powers and functions shall be governed by bankruptcy code only. No civil or criminal action shall lie against the trustee without the approval of the bankruptcy court. The trustee shall be protected for all acts done in good faith.

### **3.5 Approval of Reorganisation Proposal**

(1) The reorganisation proposal is formulated on two principles: (a) the voluntary principle; and (b) proportionate right in relation to the claim based on his realisable claim arising from absolute priority rule.

(2) A reorganisation plan can be considered provided 50% of the members attending and voting and having 75% of the total realisable claim agree to accept the proposal.

(3) The scheme must provide for dissenting claim holders to be paid or made secured their share of the realisable claim. As for example, suppose the approved realisable value of all assets is Rupees one lakh. It covers an asset worth rupees eighty thousand put as a security against a claim of rupees sixty thousand rupees, can only fetch fifty thousand. Suppose the total claim amount is one lakh and twenty thousand of which creditors holding claim of rupees one lakh agree to go with the scheme. Creditors worth rupees twenty thousand, who are unsecured, do not agree to the scheme proposed by the majority. Total unsecured credit shall amount to Rupees sixty thousand plus rupees ten thousand of the secured credit not covered by the security. So the minority shall have to be paid or made secured the following amount:

$$\frac{20,000 \times 50,000}{70,000} = \frac{1,00,000}{7} = 14285.71$$

### **3.5 Judicial Institution**

The present legal system has dualism on account of which there are system delays at various stages. As for example, the scheme of restructuring or amalgamation under sections 391 and 395 requires approval of the court. This attempt of restructuring on absolute voluntary basis is based on the principle of contract sovereign and not at the instance of anyone. The Sick Industrial Companies (Special Provision) Act prescribes on the other hand, interventionist restructuring at the behest of BIFR *only for industrial companies*. The winding up, on the other hand, is in the jurisdiction of the Company Court. Such a dualism is undesirable. It has been further argued that winding up of a company has to be necessarily a judicial process because a company is a creation of law. No Company can go on winding up and liquidation without a judicial order and through a judicial process.

In this connection the constitutional status and function of the BIFR has been clinically reviewed. Though there is a provision for inclusion of expert members in the Board but not in the appellate authority, the Board and the Authority both do comprise people from the profession, corporate system and management. A systematic effort of involving experts in financial management, organisational behaviour and

professional knowledge has not been incorporated in these bodies. These bodies carry on restructuring efforts under a “**command**” structure, often at a time when no restructuring is possible. The BIFR procedure is notoriously dilatory. Therefore, the debtor often takes the shelter of BIFR, firstly, to avoid payment of claims and secondly, to extract whatever worth remains in the asset. Most often than not, the debtor does not have any intention to sit with the creditor for giving restructuring attempt a fair trail. Under the “**command**” system BIFR ignores the claim of the banks and financial institutions or imposes additional liability. The ridiculous position that banks and financial institutions are now in, on non-performing assets (NPA) is due to such command mode of restructuring attempt in which (a) the debtor goes to BIFR to legally avoid claims of payment; (b) he takes a dilatory process and keeps the corporate assets at his command; and (c) tries to see that the assets are siphoned or its value is depleted by misuse and misappropriation and finally leaves the whole affair without keeping any asset for appropriation. In most of the cases, the debtor (the promoter of the company or the management) does not have any genuine intention for attempting restructure. In many cases, the debtor may even encourage the workers for denying access to the security interest on any asset that the lending institutions have a claim on.

The Advisory Group is of the opinion that the formalistic design or facility created for parties to restructure and renegotiate must have a veil of juristic neutrality, that is, absence of any privilege or favour to any of the parties. The formalistic procedure of restructuring, as for example, chapter 11 restructuring of the US Code, is a simple, creation of neutral environment for the parties to renegotiate. It is only an additional opportunity for voluntary renegotiation for reorganisation of the borrower institution. Any effort for restructuring must be based upon a voluntary effort between all the creditors, secured and unsecured the members of the company, its promoters and management. There is no place for any command. In case the parties want, the Trustee can provide expert’s advice either from in-house or from external expert agencies hiring services of such agencies.

The Advisory Group has also examined the details of conflicting decisions on tribunalisation of justice. Tribunalised justice is a special character of civil law system. In a common law culture, there is an emphasis on judicial form and formalities. The conflict between the two systems is nothing new in India. Both the systems, that is the common law and the civil law systems, are now coming closer, common law systems adopting structure of administrative authority including administrative justice for the management of various state functions; and the civil law system on the other hand, incorporating the principles of accusatorial system and judicial process. In India, we have under the present constitutional paradigm partially adopted tribunalised form of justice under article 323 A and 323 B<sup>20</sup>. But there are also judicial observations. It is true that in *L. Chandrakumar*<sup>21</sup>, Supreme Court finally gave its nod in favour of tribunalised system of justice. But the reservation of judiciary against the erosion of judicial power especially at the High Court level is quite evident. It is not possible to oust the jurisdiction of the High Court under Articles 226 and 227 without amending the provision of Article 323B.

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<sup>20</sup> Article 323A provides for administrative tribunals to decide on the disputes relating to service of government employees which may exclude jurisdiction of all courts excluding only of the Supreme Court. Under Article 323B tribunalisation is allowed in matters of dispute relating to taxation, foreign exchange, import and export across custom frontiers, industrial and labour disputes, land reform, ceiling of urban properties, procurement rent control and tenancy issues.

<sup>21</sup> (1997)3 SCC,261

*Besides the Advisory Group also agrees with the IMF guideline suggesting that insolvency proceedings should be conducted under the authority of a court of law.*<sup>22</sup> In the context of that observation the Advisory Group discussed in details the possibility of avoiding the dualism in the system so that the whole process can be put into a straight line to avoid delay. In that context the following two methods have been discussed.

(i) Constituting a National Tribunal with benches at the jurisdiction of each High Court to receive and deal with all petitions for bankruptcy, restructuring and finally for insolvency with an appeal lying to the High Court and SLP to the Supreme Court; and

(j) Having a completely dedicated bench in each High Court dealing with the entire matter of bankruptcy; reorganisation( similar to reorganisation under Chapter 11 of the US code); and insolvency proceedings ensuring fast track liquidation, the only appeal being by way of a special leave petition to the Supreme Court.

The proposal (i) has two problems. Firstly, no question can be finalised at the stage of tribunal. Litigation may travel up and down in interlocutory matters. Secondly, it attracts a constitutional design in which avoidance of High Court's power is not possible without amending Article 323 B. Another matter has to be seriously discussed. Tribunalised justice as envisaged in (i) has not been taken in India in the way as has been designed in civil law society. The tribunals in the civil law society not only comprise of legal experts but also have specified professional experts in it (like the structure of Income Tax Tribunal in India, which has been functioning satisfactorily). **But unfortunately in India, tribunals are constituted with retired High Court judges. Therefore, these are as good or as bad as our court systems.**

It is also observed that an introduction of a professional expert agency to handle bankruptcy proceeding shall strengthen the existing court system. The bankruptcy court shall provide predictability and certainty to the whole system of bankruptcy proceedings. This will meet the basic objective of professional expediency and quick judicial process.

The members after looking into the pros and cons decided to recommend that it is advisable to avoid doubts in which any provision of the constitution may be required to be amended. The members also felt that a completely dedicated bench for bankruptcy matters (not the company court) can ensure the result with a time based bankruptcy system. It will also provide the strength to the system, which has to be absolutely a voluntary and negotiated deal for reorganisation. *Therefore, the Advisory Group recommended a dedicated bench in each High Court to deal with bankruptcy matters and the same to be constituted any further delay.* The Advisory Group also felt that it would be easier for building infrastructure facilities of the High Court

### **3.7 Priority principles**

According to corporate law, the overriding priority claims are (a) workmen's dues and (b) debts due to secured creditors. Debts due to the workmen shall stand pari pasu with

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<sup>22</sup> An insolvency law will need to provide for an institutional framework for its implementation. Since the adjudication of disputes is a judicial function, insolvency proceedings should be conducted under the authority of a court of law where **judges will, at a minimum**, be required to adjudicate disputes between the parties on factual issues and, on occasion, render interpretations of the law. the judiciary will only be able to fulfil this function if it is made up of independent judges with particularly high ethical and professional standards. See, Orderly and Effective Insolvency Procedures: Key Issues, IMF 1999 at 8.

secured debt.<sup>23</sup> The claim of the workers has to be quantified on a cut off date, the date for filing the bankruptcy and should be reflected in the statement of affairs. This should be based on company records as certified in the audit process. Disputes without a prior history of claims should not ordinarily be entertained at this stage. This should be notified to the workers and any dispute should be settled within 15 days. Subject to the overriding preferential payments the following are treated as preferential payments: (a) government dues; (b) employees claim; (c) companies contribution to statutory funds including employees provident fund, pension fund, workmen's compensation fund etc.; (d) expenses of investigation.<sup>24</sup> All costs, charges and expenses of winding up shall be payable from the assets of the company in priority to other claims subject to the rights of the secured creditors.<sup>25</sup>

The Advisory Group discussed about super-priority to be given to the reorganisation fund made available by banks and financial institutions. The Advisory Group is of the opinion that one of the main drawback of SICA is that it did not provide any super-security to the institution supplying the reorganisation fund. While agreeing to the fact that such demand for super-priority is logical and what can be expected, it is observed that the basis should be left to the parties entering into the contract. The modalities of super-specialisation must be left to the stake holders to agree upon allotment of such super-priority. The law may provide for creating such super-preference if all the stakeholders agree, as spelt out earlier. The enforceability of such contract is based upon the agreement of the parties and not on any other consideration or command. The Advisory Group is of the opinion that the present arrangement of priority determination under sections 529 A and 530 of the Companies Act is quite rational and can be retained. The only proviso is that claim of all parties must be fixed as on the date of application for winding up.

### **3.8 Special Procedure for Banks and Financial Institutions**

The Advisory Group debated over two possible contentions because of the special considerations for banks and financial institutions in view of the monetary system and its regulatory mechanism in countries like USA there are separate bankruptcy laws for these institutions. The other contesting view is that the same bankruptcy code may deal with bankruptcy petitions against banks and financial institutions as well. Of course, there has to be a regard for special status of these entities for which special provisions can be provided for. The members by and large accepted to recommend the latter suggestion and recommend special provisions for banks, financial institutions, non-banking financial institutions and insurance companies.

Bankruptcy proceedings against banks and financial institutions have a very special significance especially for two purposes. Firstly it affects the domain of the monetary system and management, and secondly, it is the responsibility of the Central Bank to protect the interest of the depositors. This special position was discussed in details and it was also noted that in several developed countries there is a separate bankruptcy code for banks and financial institutions. The separate distinct responsibility of the Reserve Bank of India as the central bank was discussed in detail. Basically, the bankruptcy proceedings have to start in the case of the Banks and financial institutions only after the

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<sup>23</sup> Section 529A of the Companies Act.

<sup>24</sup> Section 530 of the Companies Act.

<sup>25</sup> Section 520 of the Companies Act.



*statutory moratorium period* of six months followed by another six months if that is needed. Protection of depositors' interest is one of the cardinal principles in the core of the commercial banking and hence must be highlighted during the process of the bankruptcy proceedings, as well. The protection of depositors' interest has to be ensured either through *deposit insurance protection* taken by the banks and financial institutions or by insurance taken by the depositors. It is suggested in the meeting that deposit insurance premium must be risk-based, which shall give a market signal to the depositors about the credit quality of the banks and financial institutions. After detail deliberations the Advisory Group came to the conclusion *that the same law and procedure and the same court system can conveniently handle the bankruptcy proceedings in the case of banks and financial institutions, as well* excepting that trustee to be appointed in consultation with the RBI and from an approved panel prepared in consultation with the RBI. In the case of an application for bankruptcy proceedings filed by the regulator itself which includes the recommendation of a name for the appointment of a trustee, then the same shall court. The Trustee shall be responsible for the upkeep of assets and preparation of final list of liabilities during the statutory and declarative moratorium. Besides, the restructuring plans submitted by any party or at the initiative of the Trustee are to be considered in consultation with the RBI. The Court shall at all stages consult the Reserve Bank of India for smooth and effective bankruptcy operation.

It was also agreed that Insurance companies and non banking financial institutions and mutual funds must also follow similar provisions with a proviso that the regulatory authority shall propose the name of the trustee and shall closely monitor the winding up of these companies.

### **3.9 Special Provisions for Government Companies**

There is no reason why government companies cannot go through the same procedure for bankruptcy proceedings including winding up and liquidation. However, if the Government does not want a government company or corporation to go for such proceedings it has all the power to save these companies by paying the claims. In case of a government company going into winding up all collections by the trustee shall be deposited into the public fund of India and all payments should be made therefrom.

### **3.10 Time bound Bankruptcy Proceeding**

It may be noted that time-bound procedures are prescribed in various statutes including Civil Procedure Code and Criminal Procedure Code. But unfortunately, such a schedule of time prescribed is usually not observed. In a completely dedicated bench for bankruptcy where the proceedings go on a day-to-day basis, the Advisory Group feels that such a time bound schedule can be well observed. The Advisory Group therefore suggest the following schedule to be prescribed in the bankruptcy code itself. The schedules are given by way of a road map. However, it should be noted that adherence to such schedules is possible only if the court is provided with adequate resources, skilled man power and modern infrastructure.

- (1) If the bankruptcy application is filed by the borrower company, the court shall appoint the trustee *immediately* on receiving the petition which will empower the trustee to take over the management of the company as well as all assets and liabilities. Such a step can be taken within a week.
- (2) If the petition is submitted by the creditors, the court has to proceed on receiving the response from the company and hearing the parties on a day-to-day

basis to preliminarily examine whether there is any substance in the petition, that is , whether the petition is to be allowed. Such procedure should not take more than a period of six weeks and once the petition is allowed trustees are to be appointed to take over the charge of the company.

(3) The trustee shall thereafter prepare the statement of affairs including the list of the creditors and submit the same along with the latest audit reports available to the courts. The trustee may also submit a primary report as to whether or not there is some chance of restructuring. Such report and statement of affairs submitted to the court shall require not more than 4 weeks time. The existing management shall be responsible to provide all information to the trustee, failing which they should be personally liable to pay compensation and penal liability to all stakeholders affected by the delay, on all costs including interest.

(4) The court at that stage may listen to objections filed on day-to-day basis, which should not take more than 4 weeks time.

(5) The trustee shall simultaneously proceed with the efforts of restructuring by the arrangement of the meeting of the interested parties drawing any scheme of reconstruction by himself for the consideration of the meeting and allowing interested parties to submit restructuring plans. This exercise may be allowed to take place within 8 weeks time and circumstance requiring further time may be explained to the court on which the court may allow time upto 12 weeks. In extra-ordinary circumstances, the court may further extend the time by a further 6 weeks.

(6) After the scheme is agreed upon the trustee shall place the scheme before the court. The court may seek any objections and listen to any petition contesting any term of the scheme before the court approves the scheme to be implemented. The court may require not more than 6 weeks time for this exercise.

(7) The trustee shall then implement the scheme with the help of concerned parties and report about the progress to the court from time to time, but at least once in every quarter.

(8) If there is no scheme of reconstruction possible within the stipulated time or the trustee comes to the conclusion that the scheme is unworkable after attempting the same for some time, the court shall direct the trustee to go for winding up and liquidation.

(9) At that stage of going for winding up, the trustee shall ensure that the realisation of the asset value must be maximised. The trustee may dispose the company as a going concern or sell the assets piecemeal. The trustee shall report to the court about the progress of liquidation once in every quarter and if the liquidation is not complete at the end of the year shall also submit the reasons why it could not be completed.

The Advisory Group strongly feels that such a time bound bankruptcy schedule will ensure better realisation and efficient performance of the bankruptcy system.

### **3.11 Efficient procedure**

The Advisory Group examined the IMF guiding principles for efficient procedure for insolvency. The first overall objective is the allocation of risk among participants in a predictable, equitable and transparent manner. The second objective of an insolvency law is to protect and maximise value for the benefit of all interested parties and the economy in general. An efficient insolvency procedures generally require 2 elements, a legal

framework containing substantive and procedural rules set forth for resolving rights and obligations of the participants and secondly the institutional framework. The substantive issues concerns (a) identity of the debtors that may be subject to insolvency proceedings as for example some may be subject to insolvency regime and some may be insulated from the application of all forms of insolvency procedures; (b) the law must determine when an insolvency proceeding may be commenced, who may request commencement and also the commencement criteria; (c) on whom the management and control of the enterprise shall lie once the insolvency proceedings commence; (d) what type of protection will be available to the secured creditors; (e) what authority the administrator, that is, the trustee should have to interfere with the terms of the contract earlier entered into; (f) how the creditors should be ranked; and (g) will the insolvency law supersede the special protection of the workers under labour law.

IMF guideline on effective insolvency procedure rightly observed that all the liquidation and rehabilitation procedures are often viewed as relatively distinct from each other, there are in fact, considerable overlap and linkages between them, both as a matter of procedure and the terms of substantive issues they address. The liquidation procedure to commence must take into consideration the following issues as suggested earlier: (i) qualification of the debtor; (ii) conditions for commencement of the proceedings; (iii) consequences of the commences of the proceedings including protection of the assets. The procedure must have also clear provisions about specific issues like treatment of encumber assets and secured creditors, protecting the value of the secured claim, avoidance of pre-commencement transactions and transfers which is also to indicate clear understanding of fraudulent preference, set-off of claims, provision for both public auction and private sales of assets for the purpose of maximisation of realisation, determination of priority of distribution and discharge. The Advisory Group went through the various provisions of the companies Act relating to winding up and liquidation and found that with certain adjustments the principles laid down can be followed. Accordingly, provisions concerning the above issues as stated in the Companies Act are kept in the Bankruptcy Code as far as desirable.

## CHAPTER IV – CROSS BORDER INSOLVENCY

### Cross-Border Insolvency in India

The growth of multinationals, operating through several organs such as branches, agencies, franchises, subsidiaries and other forms of collaboration in more than one country, has given rise to the need to harmonise municipal laws of nations with regard to the consequences of insolvency for the operation of their branches, divisions, subsidiaries or agencies spread over the territories of several countries. The principles of Private International Law used to govern the conflict of law between countries. But the rapid growth of international trade, commerce, investment and industries setting the pace of globalization and opening-up of the economies of nations added to the need of formulate specific legal measures for protecting Indian creditors as well.

The question of choice of law arises in all cross border transactions due to (a) development of international trade in which inter-country debtor-creditor relations across the border develops; (b) development of transnational and multi-national institutions through building up transborder organisational structure through permanent establishment, branches or franchises; (c) development of organisational relations through chain organisation structure of subsidiaries, and joint venture and finally (d) development of complexities in modern business relations. Naturally, in all transborder insolvency situations there are claims of national creditor against foreign debtor or national debtor to settle dues to foreign creditors. The present Indian legal system does not contain any provision on any cross -border relations. *In two regards Indian law on insolvency is out-dated. Firstly, Indian law is not comparable to the standard set in international legal requirement and as such stands apart and alone. Secondly, Indian law has not taken into consideration of any cross- border relation.* Some of specific issues in cross-border relation can be discussed below:

#### (a) Origin of a company

The domicile of origin in the case of a company is the country where it is registered, i.e., the place or country of its incorporation. Thus, a company formed under the English Companies Act has an English domicile if it is registered in England. Similarly, a company incorporated under the Indian Companies Act will have an Indian domicile. According to Indian Income Tax Act, a company registered outside India but having its management and control in India, is considered an Indian Company for the purpose of corporate taxation<sup>26</sup>. The domicile of the shareholders have no influence in determining the domicile of the company.<sup>27</sup>

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<sup>26</sup> Section 2(26) of the Income-tax Act, 1961.

<sup>27</sup> Private international law recognises that the fact that majority of shareholders of a company are Indians will not make it an Indian domicile company, even if it is incorporated elsewhere. See, Paras Diwan, *Private International Law* ( New Delhi: Deep & Deep Publications, 1993) at 382. In *Re Travancore National etc. Bank Ltd.*, (1939) Mad. 318, Rao, J., said that the domicile of a company is the place considered by the law to be the centre of its affairs which in the case of (1) a trading company is its principal place of business, i.e., the place where the administrative business of the corporation is carried, and (2) in the case of other corporations, it is the place where its functions are discharged. In short, the test of domicile of a company is the same under the Indian law as it is under the English law. It should be kept in mind that the domicile of the company is entirely distinct and independent from the domicile of its members or shareholders.

### **(b) Indian Law on Corporate Insolvency**

Under the Indian Companies Act, the Indian courts have jurisdiction to entertain winding up proceedings in respect of the following two categories of companies: (a) when the company has been incorporated in India, and (b) when it is an unregistered company.<sup>28</sup> In respect of the former the Indian courts have jurisdiction irrespective of the fact that the entire business of the company is carried on abroad, or that all its members are foreigners. In such winding up proceedings, Indian as well as foreign creditors can prove their debts.<sup>29</sup> The Indian Companies Act does not distinguish between domestic and foreign creditors in so far as winding up of a company is concerned. Part X of the Indian Companies Act deals with the winding up of the unregistered company.<sup>30</sup> Section 584 of the Act relates to dissolved foreign companies.<sup>31</sup> Foreign companies in India fall within the meaning of unregistered companies. A bank incorporated in a foreign country is an unregistered company and winding up proceedings can be filed in India.<sup>32</sup> Winding up proceedings in respect of a foreign company not falling under section 584 of the Companies Act can be filed under section 582 as an unregistered company. In *Mohan Lal v. Chawla Bank Ltd.*,<sup>33</sup> before the partition of India, a company incorporated under the Indian Companies Act, 1913, had its registered office in North Western Frontier Province and a branch office in the United Provinces. After partition it got itself registered as a foreign company. It was obvious, and it was so held, that for the purpose of section 582 its position was that of an unregistered company. A foreign company carrying on business in India can be wound up as an unregistered company under section 582 of the Act. The Indian courts have the jurisdiction to wind up a foreign company whatever be the number of its members, provided it has assets and an office in India.<sup>34</sup> It would make no difference, even if an order for its winding up has been made by a court of competent jurisdiction of the place of the company's domicile. However, just because a winding up order has been made by the court of domicile of

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<sup>28</sup> Part X of the Indian Companies Act.

<sup>29</sup> *Rajah of Vizianagaram v. Official Receiver and Liquidator*, 1962 S.C. 500.

<sup>30</sup> Section 582 of the Companies Act defines an unregistered company thus: "For the purposes of this part, the expression "unregistered company" –

(a) shall not include –

- (i) a railway company incorporated by any Act of Parliament or other Indian law or any Act of Parliament of the United Kingdom;
- (ii) a company registered under this Act; or
- (iii) a company registered under any previous companies law and not being a company the registered office whereof was in Burma, Aden or Pakistan immediately before the separation of that country from India; and

(b) save as aforesaid, shall include any partnership, association or company consisting of more than seven members at the time when the petition for winding up the partnership, association or company, as the case may be, is presented before the Court.

<sup>31</sup> Section 584 runs thus: "Where a body corporate incorporated outside India ceases to carry on business in India, it may be wound up as an unregistered company under this Part, notwithstanding that the body corporate has been dissolved or otherwise ceased to exist as such under or by virtue of the law of the country under which it was incorporated."

<sup>32</sup> *Re Travancore National Bank Ltd.*, 1939 Mad. 318; *Raghubardayal v. The Sarafa Chambers*, 1954 All. 555.

<sup>33</sup> 1949 All. 778.

<sup>34</sup> *Re Travancore National Bank Ltd.*, 1939 Mad. 318; *In re Frontier Bank Ltd.*, 1951 Punj, 145; *In the matter of Indian Companies Act, 1913*, 1949 Lah. 48.

a foreign company, it does not mean that the Indian courts are bound to entertain its winding up proceedings. The court may decline to exercise jurisdiction on practical considerations.<sup>35</sup>

Sub-section (4) of section 588 lays down the circumstances in which a foreign company may be wound up.<sup>36</sup> It appears that the court will have jurisdiction to entertain a petition for the winding up of an unregistered company only if it has “place of business” in India.<sup>37</sup> Part XI of the Companies Act, 1956 lays down provisions of the establishment of place or places of business in India by a foreign company. These provisions are made to regulate the activities of foreign companies operating in India. It appears that an Indian court may decline to exercise jurisdiction over a foreign company if it has no assets situated in India.

Application for winding up can not only be made by any creditor and contributor but also by the company itself.<sup>38</sup> Section 583(3) of the Indian Companies Act, however, lays down that no unregistered company shall be wound up under the Act voluntarily or subject to the supervision of the court. Winding up of the company can be initiated at the instance of Indian as well as foreign creditors.<sup>39</sup> The winding up of the company under the Indian Companies Act is entirely governed by the Indian law. The court has power by the winding up order or by any subsequent orders to direct that all or any part of property, moveable or immovable, belonging to the company or held by trustees on its behalf shall vest in the official liquidator by his official name and thereupon the property or part thereof specified in the order shall vest accordingly.<sup>40</sup>

### **(c) Issues in cross border insolvency**

Cross-border insolvency law endeavours to deal with a multitude to issues. Firstly, it tries to promote co-operation between the courts and other competent authorities of this State and foreign States involved in cases of cross-border insolvency. Secondly, it aims to create greater legal certainty for trade and investment. Thirdly, it stands for the protection and maximisation of the value of the debtor’s assets. On a broader plane, these laws try to facilitate the rescue of financially troubled business, thereby protecting investment and preserving employment.

Under common law and as a general concept insolvency law has followed the principle *of situs* of the assets of the debtor. Differences exist between country to country in the matter of treatment/recognition of assets. Some US states, such as New York, have, for this purpose, defined assets as including all transactions booked in New York, irrespective of the *situs* of the counterparty. In most systems the municipal law allows courts within whose jurisdiction the property of the insolvent party is situated to exercise insolvency jurisdiction.

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<sup>35</sup> *Re Travancore National Bank Ltd.*, 1939 Mad. 318.

<sup>36</sup> These are: (1) if the company is dissolved, or has ceased to carry on business, or is carrying on business only for the purpose of winding up its affairs; (2) if the company is unable to pay its debts; (3) if the court is of the opinion that it is just and equitable that the company should be wound up.

<sup>37</sup> Section 583(2) of the Companies Act.

<sup>38</sup> *State of Madras v. Madras Electric Tram. Co.*, 1956 Mad. 131; *Rajah of vizianagaram v. Official Receiver*, 1962 SC 500.

<sup>39</sup> *Re Travancore National Bank Ltd.*, 1939 Mad. 318.

<sup>40</sup> Section 588(1) of the Companies Act.

The observations made by the Supreme Court of India, in the case of *Raja of Vizianagaram v. Official Receiver*<sup>41</sup>, clearly bring out the legal position of international insolvencies in India.<sup>42</sup> The question before the Supreme Court of India was whether in a winding-up proceeding initiated in India in respect of the business of a foreign company in India, the foreign creditors of that company could prove their claim. The Supreme Court of India, after examining various precedents under English Law, held that under the provisions of the Indian Companies Act and the general principles, foreign creditors can prove their claims in the winding-up of unregistered companies in India.

The Indian laws concerning insolvency and winding-up closely follow the principles of English common law. The Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 are substantially along the lines of Bankruptcy Act 1914 (repealed). Neither of these two Indian Acts makes any reference to cross-border insolvency. Thus, Indian insolvency laws do not have any extra-territorial jurisdiction, nor do they recognise the jurisdiction of foreign courts in respect of the branches of foreign banks operating in India. Therefore, if a foreign company is taken into liquidation outside India, its Indian business will be treated as a separate matter and will not be automatically affected unless an application is filed before an insolvency court for the winding-up of its branches in India. For example, when BCCI was taken into liquidation and liquidators were appointed by British courts, the Reserve Bank moved the High Court in India to wind up Indian branches of that Bank. The overseas liquidator had filed his claim in respect of BCCI branches in India.

At present, the nation is considering the adoption of UNCITRAL Model Law on Cross-Border Insolvency to equip the Indian law with sufficient provisions to deal with international insolvency. The purpose of the UNCITRAL Model of law is to provide effective mechanisms for dealing with cases of cross-border insolvency. This model law, if adopted, will radically change the orientation of Indian law and make it suitable for dealing with the challenges arising from globalization and increasing integration of Indian economy with the world economy.

Sections 13 and 44A of the Civil Procedure Code, 1908 of India contain statutory provisions under which the judgements delivered by the foreign courts of competent jurisdiction in reciprocating territories are treated as conclusive to any matter in

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<sup>41</sup> AIR 1962 SC 500

<sup>42</sup> The Supreme Court of India held, “The Courts of a country dealing with the winding-up of a company can ordinarily deal with the assets within their jurisdiction. It is, therefore, necessary that if a company carries on business in countries other than the country in which it is incorporated, the courts of those countries too should be able to conduct winding-up proceedings of its business in their respective countries. Such winding-up of the business in a country other than the country in which the company was incorporated is really an ancillary winding-up of the main company whose winding-up may have already been taken up in that country or may be taken up at the proper time.... ordinarily the winding-up of the company will be proceeded simultaneously in the various countries where it carried on business whenever the business of the company has ceased to be profitable and the company is reduced to a position in which it is not expected to make good its liabilities. It is the company incorporated outside India which is really wound up as an unregistered company in this country. In fact, there is no separate unregistered company which is being wound up here”.

dispute between the same parties. Those provisions, however, contain certain well-recognised exceptions, namely:

(1) Where the judgement has not been pronounced by a court of competent jurisdiction;

(2) Where it has not been given on the merits of the case;

(3) Where it appears, on the face of the proceedings, to be founded on an incorrect view of international law or a refusal to recognise the law of India in cases in which such law is applicable;

(4) Where the proceedings in which the judgement was obtained are opposed to natural justice;

(5) Where it has been obtained by fraud; and

(6) Where it sustains a claim founded on a branch of any law in force in India. Such decrees passed by the courts of the reciprocating territories can be executed in the same manner as if they had been passed by a district court in India. The courts within the Commonwealth of Nations and some other countries have been declared as courts of reciprocating territories by the Central Government of India.

The Indian law, as it exists today, provides only for the recognition of foreign judgments. Neither the Civil Procedure Code nor any other law deals with the recognition of foreign proceedings. The UNCITRAL Model law caters to this deficiency. The Model law defines “foreign proceeding” as a collective judicial or administrative proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation. In this regard, it may be added, the definition of “foreign judgment” in the Code of Civil Procedure is also inadequate to deal with the situation.<sup>43</sup>

**(d) Incorporating UNCITRAL Model on Cross-Border Insolvency in India:**

The differences in national insolvency laws have important consequences in the case of enterprises with assets and liabilities in different countries. Very often situations arise comprising of any or many of the following issues.

(a) If a branch of an enterprise located in one country becomes insolvent, should creditors in that country be allowed to initiate insolvency proceedings while the enterprise as a whole is still solvent?

(b) If the enterprise as a whole is insolvent, should there be separate proceedings in the various countries where its branches are located? This approach is referred to as the territorialist principle.

(c) Alternatively, should there be a single procedure, based in the country where the head office or place of incorporation is situated? This approach is referred to as the universalist principle.

(d) Should there be a single liquidator or administrator, or one for each country where the enterprise has a place of business or assets?

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<sup>43</sup> Section 2(6) defines “foreign judgment” as the judgment of a foreign court. The same section defines a judgment as the statement given by the judge of the grounds of a decree or order. This definition is restrictive and excludes proceedings on insolvency like reorganisation.



(e) Should the liquidator or administrator appointed in one country be able to recapture assets fraudulently transferred by the debtor to another country?

A comparative study of the domestic laws of various countries reveals incongruity in the positions on these issues.

This diversity of approaches creates considerable uncertainty and undermines the effective application of national insolvency laws in an environment where cross-border activities are becoming a major component of the business of large enterprises. Resultantly, a number of initiatives have been undertaken to improve recognition of foreign proceedings and cooperation in this area. In November 1995 the text of the European Union Convention on Insolvency Procedures was adopted. This Convention sets forth rules for the treatment of insolvencies where the debtor has an establishment or assets in more than one state, including rules on choice of law, cooperation between courts, and the recognition of foreign judicial decisions and orders. The Convention has not been ratified by all members and its prospects for entry into force are still uncertain. In addition, the International Bar Association's Insolvency and Creditor's Rights Committee (Committee J) has developed the Cross-Border Insolvency Concordat, which is also designed to provide a framework for cooperation in multi-jurisdictional insolvencies.

The year 1997 noted a significant development in this area. The United Nations Commission on International Trade Law (UNCITRAL) came out with a Model Law on Cross-Border Insolvency negotiated among more than 40 countries representing a broad spectrum of differing legal systems. One of the distinguishing features of this model law is that it attempts to achieve limited but effective cooperation, compatible with all legal systems and, therefore, acceptable to all countries. Its goals are to ensure cooperation in cross-border insolvency cases through recognition of foreign decisions and access of foreign liquidators or administrators to local court proceedings.

It is essential that a fair and efficient administration of cross-border insolvencies is undertaken so that it protects the interest of all creditors and other interested persons, including the debtor. The UNCITRAL Model Law, which has as its objective the solving of the aforementioned issues, proclaims to provide effective mechanisms for dealing with cases of cross-border insolvency.<sup>44</sup> The Law applies in the following situations where:

- (1) assistance is sought in a state by a foreign court or a foreign representative in connection with a proceeding under the domestic law of a state;
- (2) assistance is sought in a foreign State in connection with a proceeding under the domestic law of a state;
- (3) a foreign proceeding and a proceeding under the domestic law of a state in respect of the same debtor are taking place concurrently;
- (4) creditors or other interested persons in a foreign State have an interest in requesting the commencement of, or participating in, a proceeding under the domestic law of the State.

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<sup>44</sup> Annex I of the Report of the 30<sup>th</sup> session of UNCITRAL (A/52/17)

It is a difficult task to classify the provisions in the companies Act relating to cross-border insolvency into a straitjacket. A company subject to liquidation in India is regarded as a single entity and not as a separate entity. It means that any liquidation or winding up proceedings conducted in India may have a theoretical application in relation to the company as a whole, which includes all its branches within and outside India.

Liquidation in India is conducted in relation to the corporate entity as a whole enabling all the creditors, both national and international, to lodge proof of claim with the liquidator. There is no discriminative treatment of 'foreign' creditors in the sense that only the creditors of the Indian branch are able to lodge proof of claim. The claims are treated equally as per the provisions of section 530 of the Companies Act.

The jurisdiction of the Indian court is 'territorial' as opposed to 'universal' in the sense that if the assets of the company are outside the jurisdiction of India, then the Indian courts and the liquidator will need to obtain the consent of the relevant courts in that jurisdiction for their actions to have effect. In the Indian context, the application of the theory of 'universality' does not mean that the courts will regard only the courts of the company's place of incorporation or principal place of business as having jurisdiction to wind up the company, nor that the Indian courts will automatically defer to apply the insolvency laws of that state alone as being able to determine the making of claims against and the distribution of the assets of that company. The approach adopted by the Indian courts involves a mixture of both the concepts with a wide degree of flexibility taking into account the existence of foreign proceedings and the interest of creditors generally.

Thus, the Indian courts have a statutory jurisdiction to wind up an insolvent company not only if it is an Indian company registered under the Indian Companies Act 1956, but also if it is an unregistered company which includes foreign companies.<sup>45</sup> In the latter case, the Indian courts have jurisdiction to act on various grounds, including if the company is unable to pay its debts or if it is just and equitable that the company be wound up.<sup>46</sup> The Indian courts are prepared to exercise their jurisdiction in relation to a foreign company only if there are assets of the company situated in India, or if the company has carried on business in India through a branch or its agents, or if there is a reasonable possibility of benefit accruing to creditors of the company from the making of a winding up order in England. Indian courts may refuse to exercise their jurisdiction to wind up a foreign company where proceedings are already under way elsewhere or may be commenced, in some other more appropriate jurisdiction. The courts do exercise their discretion in favour of making the foreign company subject to a winding up procedure in India, it is to be noted that where the foreign company is in liquidation in its country of incorporation, any winding up in India will be regarded as ancillary thereto; as a result, the functions of the Indian liquidators will be to realise

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<sup>45</sup> Section 584 deals with the power to wind up foreign companies, already dissolved. The section reads, "where a body corporate incorporated outside India which has been wound up as an unregistered company under this Part, notwithstanding that the body corporate has been dissolved or otherwise ceased to exist as such under or by virtue of the laws of the country under which it was incorporated."

<sup>46</sup> Section 583 of the Companies Act enumerates the circumstances in which an unregistered company may be wound up.

the assets of the company in India and to settle a list of creditors who have lodged claim in India. In the BCCI case, the proceedings arose out of the liquidation of the Bank of Credit and Commerce International SA, a company incorporated in Luxembourg, yet carrying on business through branches in England, India and numerous other countries around the world, which was the subject of winding up proceeding both in Luxembourg and England. The English proceedings were regarded as ancillary to the principal liquidation in Luxembourg. Thus the claims of all creditors of the bank on a worldwide basis were admissible for proof in the English liquidation, although the English law of insolvency set-off of claims as distinct from the Luxembourg law of insolvency set-off had to be applied. The court stated that the ancillary nature of the winding up proceedings in England did not relieve the court from the obligation to apply what is by statute a mandatory provision of English insolvency law. Even if they had such a discretion to disapply this provision of English law, they would not do so if this would have a discriminatory effect on how all creditors were treated under the application of the rule. In India, as soon as the insolvency of BCCI was sensed, the Reserve Bank of India quick approached the courts to wind up the Indian branch so as to protect the interest of the depositors.

#### **(e) Recognition of Foreign Decisions**

First, it is necessary to distinguish between a foreign insolvency proceeding being recognised in India and the consequences which may follow from such recognition. Under English law, foreign liquidation proceedings may be entitled to recognition in England on different bases, namely, where the liquidation is conducted under or is recognised by the law of the place of incorporation of the company, or where the company has submitted to the jurisdiction of the foreign court, or where the company has carried on business within the foreign jurisdiction. However, even though a foreign insolvency proceeding falls within one of these bases for recognition, this does not mean that recognition will be granted, given that the English courts retain a discretion to refuse recognition in certain circumstances, namely, if to grant recognition would be contrary to public policy, or if the foreign proceeding constitute a fraud or are in breach of natural justice as applied by the English courts, or where there is an attempt to enforce a foreign penal or revenue law through those proceedings. English law however does not draw any distinction between foreign proceedings that are not insolvency proceeding like rehabilitation.

Secondly, Indian law does not recognise a foreign insolvency official as having the locus to represent a foreign company. The English Insolvency Act does have provisions for cooperation between courts exercising jurisdiction in relation to insolvency.<sup>47</sup> The English Act however does not recognise the standing to represent a foreign company.

Indian courts thus are unlikely to give any aid and assistance to a foreign liquidator or other insolvency official if this would be prejudicial to the company's creditors on the basis of how those creditors are or would have been treated under any equivalent

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<sup>47</sup> Section 426 (4) of the Insolvency Act states that the courts having jurisdiction in relation to insolvency law in any part of the United Kingdom shall assist the courts having the corresponding jurisdiction in any other part of the United Kingdom or any relevant country or territory.

Indian law insolvency proceedings. The English courts did not grant full recognition to a court order made by a US bankruptcy court which purported to restrain legal proceedings by creditors on a worldwide basis against a US company (carrying on business and having assets in England) subject to chapter 11 proceedings.<sup>48</sup>

The Maxwell Communications Corporation case is a good example on how co-operation between the courts of different countries can result in efficient bankruptcy. In this case, when the Maxwell Communications Corporation collapsed in 1991, there were simultaneous administration proceedings in the UK and Chapter 11 proceedings in the US, as Maxwell has most of its creditors in UK and most of its assets in US. In the various court proceedings which resulted from the collapse, and which involved different companies within the Maxwell group, both the English and American courts co-operated together in combining the application of the US chapter 11 proceedings with the English administration proceedings, taking into consideration their respective decisions on a case-by-case basis. English law is also endowed with statutory provisions where by the English courts are required to give assistance to the insolvency courts in Scotland or Northern Ireland, and in any 'relevant' country or territory which has been designated as such under secondary legislation.<sup>49</sup> Using this provision the English courts have rendered assistance in several cases involving issues of cross-border insolvency. The lacunae in the Indian law necessitate immediate attention to equip the Insolvency regime.

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<sup>48</sup> See, Charles D. Booth, Recognition of Foreign Bankruptcies: An Analysis and Critique of the Inconsistent Approaches of United States Courts, 66 Am. Bankr. L.J. 135 (1992). The English court refused to discharge *Mareva* injunctions freezing the company's UK assets brought by UK creditors, on the basis that as the US organisation procedure envisaged only the continuation of the business in the US (and the discontinuation of business in Europe) then there could be no possible benefit to English creditors in seeing the UK assets repatriated to the US. This case has been criticised for not applying the principle of comity in recognising the US restraining order as an overriding or paramount consideration binding on the English court.

<sup>49</sup> Section 426 of the Insolvency Act, 1986.

## CHAPTER V -FINAL RECOMMENDATIONS

- (1) **Need for a comprehensive bankruptcy code:** The Advisory Group recommends a comprehensive corporate bankruptcy code which will incorporate the provisions relating reorganisation on renegotiation (similar to Chapter XI proceedings of US Bankruptcy Code ), corporate insolvency leading to winding up and liquidation of a corporate entity and settlement of all other related issues including cross-border claims and counter claim settlement and cross-border corporate insolvency.
- (2) **How comprehensive is the code:** The advisory group discussed about how comprehensive the Code to be, whether the code to include individual insolvency! Though it was felt that without individual insolvency system being straightened, the total system management can not be built up specially because rural and agrarian bias of the economy, the task of the group would be kept focused and confined to corporate bankruptcy. However it was suggested that a separate study be made on individual insolvency.
- (3) **Streamlining Companies Act:** With the legislation passed on a comprehensive Bankruptcy code Company Law can be streamlined and simplified which would contain company formation, capitalisation and finance, management, corporate governance, accounts and accountability issues, investors' protection, reorganisation on bipartite renegotiations and enabling provisions for winding up according to Bankruptcy code.
- (4) **Long title of the Bankruptcy Code:** The objectives of the code shall be (a) *maximisation of value of assets*; (b) *time bound restructuring on renegotiation on a voluntary basis*; (c) *failing restructuring there shall be a quick and fast track liquidation*. But the Advisory Group, however, suggested that these objectives must be reflected in the procedure and not in any perambulatory note or long title providing for any external tool for interpretation of any codified prescription. As such, the long title shall read as follows:

**“An Act to amend, consolidate and codify law relating to corporate bankruptcy and insolvency.”**
- (5) **Repeal of SICA:** Since the comprehensive code shall include all issues relating to corporate bankruptcy, restructuring, renegotiations, restructuring and liquidation institutions, fast track procedure of liquidation. the Advisory Group recommends the complete repeal of Sick Industrial Company (Special Provisions) Act and abolition of BIFR. the existing proceedings pending before the BIFR shall be transferred to the Bankruptcy court having jurisdiction. **Bankruptcy Institutions:** The Advisory Group recommends the introduction of a professional bankruptcy institution, known as the Trustee, to be appointed by the Bankruptcy court from a designated panel for conducting restructuring on voluntary basis and failing restructuring, to initiate fast track liquidation. The trustees can be appointed only from professional bodies like Chartered Accountants firm, law firm, cost accountants of companies secretaries' organisation, a financial institution, companies having professional expertise and corporate managers' organisation. *The Court shall prepare of a panel of trustees from such professional bodies from which a trustee is to be appointed by the court.*

The court shall direct the issue a public notice notifying the appointment of the trustee. Trustees appointed this procedure shall be governed by the bankruptcy code to the exclusion of any other central or state Act governing the Trustee.

- (6) **Trustees' role as administrator/regulator of the entity:** One of the critical questions in bankruptcy cases is, who shall remain in custody of the corporate properties and administer the same once there is a bankruptcy petition. The most critical provision in the SICA is that the promoter/management bringing the entity to the BIFR remains in possession and creates incentives for stripping off assets. Therefore, creditors are against most restructuring proposals. It is therefore recommended that if the owner/promoter/existing management files the petition for the bankruptcy of a company, the possession of the company with its entire assets and liabilities must be vested with the Trustee immediately without any loss of time. That ensures the first principle of maximisation of asset value. If a creditor files the petition the possession of the company's assets and liabilities shall vest on the Trustee as soon as the petition is allowed.
- (7) **Trustee to be Liquidator:** The office of the official liquidator shall be closed and all powers and functions therein shall be exercised by the Trustee.
- (8) **Trigger point:** The Advisory Group after examining many trigger points came to the conclusion that the immediate trigger point is *the cash test*. The test provided in Section 434 of the Companies Act explaining when a company is deemed to have been unable to pay a debt, is a trigger point, simple and self-evident. Therefore, such a trigger test is the best. It is suggested that a minimum default limit *be raised to rupees one lakh* from the present prescription of rupees five hundred. Therefore, if a company fails to pay a debt of not less than rupees one lakh, on the claim being due, as soon as the payment is rightly asked for or is unable to secure it, the trigger is immediately operative.
- (9) **Who can apply for bankruptcy proceeding:** Once the trigger of a cash test is operative, the debtor itself or the concerned creditor may apply for bankruptcy proceedings. Whenever on the basis of audit accounts or other information available to the management it is satisfied that it is not in a position to pay its liabilities the management must bring the matter before the Board of Directors. If they fail to do so, they shall be personally liable for the payment of the liabilities. The Board shall make independent examination as to whether the company is competent to pay or not and this examination concludes that the company is unable to pay, the Board shall apply for bankruptcy proceedings. In case of any delay or non-observance, the members of the Board shall be personally liable for such liabilities. Such failure on the part of the Board of Directors renders them unfit to hold similar position in any company.
- (10) **Coverage of Bankruptcy Proceedings:** A bankruptcy application is for starting a renegotiation for reorganisation, rescheduling payments, restructuring the organisation and failing of renegotiations proceed to corporate insolvency, winding up and liquidation of assets and payment of liabilities and dissolution of - the organisation in a strictly time bound manner.

(11) **Judicial institution:** For the reasons explained in detail in the chapter, the advisory group strongly recommends that the country needs a uniform and unitary judicial system in bankruptcy matters including validating the reorganisation attempts on voluntary basis with parties agreeing to readjust their respective rights and obligations. It is therefore recommended that there shall be a dedicated bench at every High Court to deal with issues in bankruptcy. The proceedings of the Bench shall be on a stipulated time basis.

(12) **Approval of Reorganisation Proposal**

- (i) The reorganisation proposal is formulated on two principles: (a) the voluntary principle; and (b) proportionate right in relation to the claim based on his realisable claim arising from absolute priority rule.
- (ii) A reorganisation plan can be considered provided 50% of the members attending and voting and having 75% of the total realisable claim agree to accept the proposal.
- (iii) The scheme must provide for dissenting claim holders to be paid or made secure their share of the realisable claim. As for example, suppose the approved realisable value of all assets is Rupees one lakh. It covers an asset worth rupees eighty thousand put as a security against a claim of rupees sixty thousand rupees, can only fetch fifty thousand.. Suppose the total claim amount is one lakh and twenty thousand of which creditors holding claim of rupees one lakh agree to go with the scheme. Creditors worth rupees twenty thousand, who are unsecured, do not agree to the scheme proposed by the majority. Total unsecured credit shall amount to Rupees sixty thousand plus rupees ten thousand of the secured credit not covered by the security. So the minority shall have to be paid or made secured the following amount:

$$\frac{20,000 \times 50,000}{70,000} = \frac{1,00,000}{7} = 14285.71$$

(13) **Power and function of the Trustee:**

- (a) The Trustee shall have the power to appoint any expert for the purpose of conducting bankruptcy proceedings and matters incidental thereto.
- (b) The Trustee may itself draw a scheme for restructuring and place the same before the parties for guiding renegotiation or may receive restructuring plan for discussion from both the debtor and the creditor providing them definite time period.

(14) **The remuneration of the Trustee:** The remuneration to be fixed by the court for the trustee shall be incentive oriented, and efficiency compatible, as such, proportionate to the principle of maximisation of value of realisable assets. The remuneration must not be based on periodicity.

(15) **Time bound bankruptcy proceedings:** The Advisory Group prescribes a time-bound procedure as detailed below:

- (a) If the bankruptcy application is filed by the borrower company, the court shall appoint the trustee *immediately* on receiving the petition which will empower

the Trustee to take over the management of the company as well as all assets and liabilities. Such a step can be taken within a week.

- (b) If the petition is submitted by the creditors, the court has to proceed on receiving the response from the company and hearing the parties on a day-to-day basis to preliminarily examine whether there is any substance in the petition, that is, whether the petition is to be allowed. Such procedure should not take more than a period of six weeks and once the petition is allowed Trustees are to be appointed to take over the charge of the company.
- (c) The Trustee shall immediately after his appointment prepare an inventory of assets and shall ensure protection of such assets. Thereafter, he shall submit a preliminary report annexing a statement of affairs, list of assets, list of secured and unsecured creditors and the latest annual audited balance sheet. Such report shall also provide the recommendation of the trustee as to whether there is any chance of restructuring. Such report and statement of affairs submitted to the court shall require not more than 4 weeks time.
- (d) The Court at that stage may listen to objections filed on day-to-day basis, which should not take more than 4 weeks time.
- (e) The Trustee shall simultaneously proceed with the efforts of restructuring by the arrangement of the meeting of the interested parties drawing any scheme of reconstruction by himself for the consideration of the meeting and allowing interested parties to submit restructuring plans. This exercise may be allowed to take place within 8 weeks time and circumstance requiring further time may be explained to the Court, upon which the court may allow further time upto 12 weeks. In extraordinary circumstances, the Court may further extend the time by a further 6 weeks.
- (f) After the scheme is agreed upon the trustee shall place the scheme before the Court. The Court may seek any objections and listen to any petition contesting any term of the scheme before the Court approves the scheme to be implemented. The Court may require not more than 6 weeks time for this exercise.
- (g) The Trustee shall then implement the scheme with the help of concerned parties and report about the progress to the Court from time to time, but at least once in every quarter.
- (h) If there is no scheme of reconstruction possible within the stipulated time or the Trustee comes to the conclusion that the scheme is unworkable, the Court shall direct the trustee to go for winding up and liquidation.
- (i) At that stage of going for winding up, the trustee shall ensure that the realisation of the asset value must be maximised. The trustee may dispose the company as a going concern or sell the assets piecemeal. The trustee shall report to the court about the progress of liquidation once in every quarter and if the liquidation is not complete at the end of the year shall also submit the reasons why it could not be completed.

**(16) Retransfer of the company to the management after the scheme is implemented:**

The Trustee shall periodically at least once in a quarter in every year submit a report about the progress of the scheme to the court. On the report of the trustee the court may authorise the company to be given back to the management of the company after the scheme is implemented. The court may direct transfer earlier to the



implementation of the scheme for the management to implement the scheme if recommended by the trustee. The creditors may file objections. The matter of transfer is to be decided by the court after disposing petitions and at the best interest of the company and its creditors.

- (17) **Special provisions for Banks and Financial Institutions:** The Reserve Bank is the authority to regulate banks and financial institutions in the interest of the macro-economic management. As such these institutions have many special interests to be looked into while proceeding for bankruptcy proceedings. It has been discussed in detail and it was finally suggested that there is no need for a separate statute. Special procedures for Banks and Financial Institutions have to be made in a separate chapter providing for the compulsory moratorium system, appointment of trustee on the advise of the Reserve Bank and special winding provisions for liquidation as stipulated in the Banking Regulation Act.
- (18) **Other institutions:** Some institutions have special significance. Institutions like Insurance, Non banking financial institutions, tele-communication etc. have special significance for which reasons these are put to under different regulatory bodies. Institutions of these nature may also go for bankruptcy. In such cases the trustee is to be appointed on the advise of the respective authority. The authority may have some supervisory power at the stage of restructuring and winding up. The special procedure has to provide for the appointment of the Trustee by the Court in consultation with such regulatory authority from an approved panel prepared in consultation with the same authority. The Court shall at all stages consult the regulating authority for smooth and effective conduct of the bankruptcy operation.
- (19) **Special protection:** The Advisory Group is of the opinion that protection of depositors' interest has to be ensured either through deposit insurance protection taken by the banks and financial institutions or by insurance taken by individual depositors.
- (20) **Public Sector Undertaking and government companies:** The Advisory Group is of the opinion that no different procedure is required for public sector undertakings and Government companies as the recommended procedure can effectively deal with the same.
- (21) **Priority of claims:** The Advisory Group recommends adherence to the principles of priority as laid down presently in the Companies Act. Issues concerning super-preferences for institutions providing additional funds for restructuring be based upon agreement between the parties.
- (22) **Workers' claim:** The Advisory Group is of the view that workers claims must have equal treatment with the secured creditor which shall also include workers claim on provident fund and other benefits like workmen's compensation, gratuity etc.
- (23) **Other priority system:** The Advisory Group expressed its satisfaction with the present priority system and suggests that it shall continue the preferential claim status

for Government debts, with the Government having the power to release the institution from such debt in appropriate cases.

(24) **Cross-border bankruptcy principles:** The Advisory Group recommends the formulation of cross-border insolvency principles in the following matters:

- (a) When assistance is sought by a foreign court or a foreign representative in connection with a foreign proceedings.
- (b) When assistance is sought in a foreign state in connection with a proceeding under Indian law.
- (c) A foreign proceeding and a proceeding under Indian law in respect of the same debtor are taking place concurrently.
- (d) Creditors or other interested persons in a foreign state having an interest in requesting the commencement of or participating under Indian law.
- (e) Authorisation of the Trustee to act in a foreign state.
- (f) Right of direct access wherein a foreign representative is entitled to apply directly to a court in India.
- (g) Application by a foreign representative to commence a proceeding under Indian law.
- (h) Participation of a foreign representative in a proceeding under Indian law.
- (i) Access to foreign creditors to proceeding under Indian law.
- (j) Notification to foreign creditors of a proceeding under Indian law.
- (k) Application for recognition of foreign proceeding – In India, we have only provisions in the Code of Civil Procedure for the recognition of foreign judgment. Foreign proceedings can include efforts like reorganisation. It is, therefore, essential to recognise foreign proceedings not just foreign judgments.
- (l) Relief that may be granted upon recognition of foreign proceedings.
- (m) Protection of creditors and other interested persons.
- (n) Intervention by a foreign representative in proceedings in India.
- (o) Co-operation and direct communication between a court in India and foreign courts or foreign representatives.
- (p) Co-operation and direct communication between the Trustee and foreign courts or foreign representatives.
- (q) Commencement of a proceeding under Indian law after recognition of a foreign main proceeding.
- (r) Co-ordination of a proceeding under Indian law and a foreign proceeding.
- (s) Co-ordination of more than one foreign proceeding.
- (t) Presumption of insolvency based on recognition of a foreign main proceeding
- (u) Rule of payment in concurrent proceedings.

(25) **An orderly and effective insolvency procedures:** Procedures shall have to be laid down clearly stipulating (1) requirement of commencement of the liquidation proceedings; (2) qualification of the debtor (3) establishing and protecting the assets; (4) treatment of encumbered assets and secured creditors; (5) avoidance of pre-commencement transactions and transfer by stipulating grounds of fraudulent preference; (6) financial contract and netting; (7) priority of distribution and discharge. Grounds of *fraudulent preference* and the *consequences stipulating cancellation of such fraudulent preferential treatment* is a serious matter that the

law must address. Of course, the Trustee being the administrator such type of happening may be restricted.

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<sup>1</sup> The Committee comprising Dr.Y.V.Reddy, Deputy Governor, Reserve Bank of India as the Chairman; Dr.E.A.S.Sarma, Secretary, Department of Economic Affairs, Government of India as the Alternate Chairman and member; Dr. Aravind Virmani, Sr. Economic Advisor, Department of Economic Affairs, Government of India and Dr. A.Vasudevan, Executive Director, Reserve Bank of India as members. Mr. K Kanagasabhapathy, Adviser-in-Charge, MPD, Reserve Bank of India and Dr.R Kannan, Adviser DEAP, Reserve Bank of India as member secretaries vice office Memo of the Governor, Reserve Bank of India dated December 8, 1999. The Advisory Group in its meeting held in Delhi on January 13, 2000, ten advisory groups to study and advise on International Financial Standards and Codes; Payment and settlement system; Corporate Governance; Data Dissemination; Bankruptcy laws; Insurance regulation; Banking supervision; Securities market regulation ; Fiscal Transparency and Accounting and Auditing.

<sup>2</sup> As for example, sick industrial company is defined as an industrial company (being a company registered for not less than five years) which has at the end of any financial year accumulated losses equal to or exceeding its entire net worth (Sec 3(o) of the Sick Industrial Companies (Special provisions) Act, 1985. Here sickness is defined in such a position that the Company is to be put into coramin.

<sup>3</sup> Section 391 to 395 of the Companies Act

<sup>4</sup> Webb v. Stenton [(1883)11QBD 518 CA]

<sup>5</sup> Registrar of Companies v. Kavita Benefit Pvt. Ltd, 48 Comp. CAS.231

<sup>6</sup> British India Banking Corporation v. Sylhet Commercial Bank, AIR 1949 Ass. 45

<sup>7</sup> P. Satyarazu v. Guntur Cotton Mills, AIR 1925 Mad. 199

<sup>8</sup> Ray,J. In M. Gordhandas & Co. v. Madhu Woolen Industries(P) Ltd.,AIR 1971 SC 2600.

<sup>9</sup> In re Europe Life Insurance Society, 1869, 9 Equity 122.

<sup>10</sup> Seethai Mills Ltd. v. M.perumalsamy, (1980) Comp.Cas.422(Mad..).

<sup>11</sup> Clause(d) of Section 439.

<sup>12</sup> H.H.Manabendra Shah v. Official Liquidator, (1977) 47 Comp Cas 356(Del)].

<sup>13</sup> In re Sonardih Coal Co. Ltd., AIR 1930 All 617

<sup>14</sup> Pokhar Mal v. Flour and Oil Mills Co. Ltd. [AIR 1934 Lah 10 1 5]

<sup>15</sup> Avtar Singh, Company Law, (9th Edition, Lucknow: EBC) at 506-508.

<sup>16</sup> Official Liquidator v. Laxmikutty, (1981)3 SCC 321.

<sup>17</sup> Globe Motors Ltd. v. Globe United Engg. and Foundry Co. Ltd., (1975)45 Comp Cas 429 (Del)

<sup>18</sup> In Official Liquidator v. Venkatratnam [(1966)1 Comp LJ 243 (Andh), one of the creditors of a motor transport company sued the Company for debt and attachment of its buses before delivery of judgement. A compromise decree was passed by the Court, under which three of the Company buses were given to the creditor. A few days later the Company went into liquidation. The Liquidator claimed the buses back on the ground that it was a fraudulent preference of creditors and hence the transfer was invalid. Rejecting the claim the Court said: "If a debtor prefers one creditor to another on account of pressure that is put upon him, the payment cannot be regarded as a fraudulent preference .... Persons in charge of the management thought that it is profitable to discharge the debts by allotting some of the buses to the creditors".

<sup>19</sup> The effect of this section was seen in *Rajratna Naranbhal Mills v. New quality Bobbin Works* [(1973)43 Comp Cas 131 (Guj) where a suit for recovery of debt was filed against the Company by a creditor who also got some shares of the Company attached on the same day. Later, a winding up petition was presented against the Company. After this, but before passing of a final order, a consent decree was passed in execution of which these attached shares were sold and a winding up order was passed later, and the Liquidator sought an order declaring the sale of shares as void and the consequential relief of recovery of the sale proceeds. Under section 537(1) any attachment or sale of a Company property without sanction of Court after commencement of winding up is void. and under Sec. 441(2), the commencement of winding up is from the time of presentation of petition. In view of these provisions, the Court had no option but to declare the sale void (as it had taken place after commencement of winding up) and the Liquidator entitled to the sale proceeds.

<sup>20</sup> Section 17 of the SICA stipulating power of the Board to make suitable order on the completion of the enquiry into the question of sickness.

<sup>21</sup> The Report of the High Level Committee on Law Relating to Insolvency and Winding Up of Companies 2000, (Eradi Committee Report).

<sup>22</sup> Article 323A provides for administrative tribunals to decide on the disputes relating to service of government employees which may exclude jurisdiction of all courts excluding only of the Supreme Court. Under Article 323B tribunalisation is allowed in matters of dispute relating to taxation, foreign exchange, import and export across custom frontiers, industrial and labour disputes, land reform, ceiling of urban properties, procurement rent control and tenancy issues.

<sup>23</sup> (1997)3 SCC,261

<sup>24</sup> An insolvency law will need to provide for an institutional framework for its implementation. Since the adjudication of disputes is a judicial function, insolvency proceedings should be conducted under the authority of a court of law where judges will, at a minimum, be required to adjudicate disputes between the parties on factual issues and, on occasion, render interpretations of the law. the judiciary will only be able to fulfil this function if it is made up of independent judges with particularly high ethical and professional standards. See, *Orderly and Effective Insolvency Procedures: Key Issues*, IMF 1999 at 8.

<sup>25</sup> Section 529A of the Companies Act.

<sup>26</sup> Section 530 of the Companies Act.

<sup>27</sup> Section 520 of the Companies Act.

<sup>28</sup> Section 2(26) of the Income-tax Act, 1961.

<sup>29</sup> Private international law recognises that the fact that majority of shareholders of a company are Indians will not make it an Indian domicile company, even if it is incorporated elsewhere. See, *Paras Diwan, Private International Law* ( New Delhi: Deep & Deep Publications, 1993) at 382. In *Re Travancore National etc. Bank Ltd.*, (1939) Mad. 318, Rao, J., said that the domicile of a company is the place considered by the law to be the centre of its affairs which in the case of (1) a trading company is its principal place of business, i.e., the place where the administrative business of the corporation is carried, and (2) in the case of other corporations, it is the place where its functions are discharged. In short, the test of domicile of a company is the same under the Indian law as it is under the English law. It should be kept in mind that the domicile of the company is entirely distinct and independent from the domicile of its members or shareholders.

<sup>30</sup> Part X of the Indian Companies Act.

<sup>31</sup> Rajah of Vizianagaram v. Official Receiver and Liquidator, 1962 S.C. 500.

<sup>32</sup> Section 582 of the Companies Act defines an unregistered company thus: " For the purposes of this part, the expression "unregistered company" -

1. shall not include -

- i. a railway company incorporated by any Act of Parliament or other Indian law or any Act of Parliament of the United Kingdom;
- ii. a company registered under this Act; or
- iii. a company registered under any previous companies law and not being a company the registered office whereof was in Burma, Aden or Pakistan immediately before the separation of that country from India; and

2. save as aforesaid, shall include any partnership, association or company consisting of more than seven members at the time when the petition for winding up the partnership, association or company, as the case may be, is presented before the Court.

<sup>33</sup> Section 584 runs thus: " Where a body corporate incorporated outside India ceases to carry on business in India, it may be wound up as an unregistered company under this Part, notwithstanding that the body corporate has been dissolved or otherwise ceased to exist as such under or by virtue of the law of the country under which it was incorporated."

<sup>34</sup> Re Travancore National Bank Ltd., 1939 Mad. 318; Raghubardayal v. The Sarafa Chambers, 1954 All. 555.

<sup>35</sup> 1949 All. 778.

<sup>36</sup> Re Travancore National Bank Ltd., 1939 Mad. 318; In re Frontier Bank Ltd., 1951 Punj, 145; In the matter of Indian Companies Act, 1913, 1949 Lah. 48.

<sup>37</sup> Re Travancore National Bank Ltd., 1939 Mad. 318.

<sup>38</sup> These are: (1) if the company is dissolved, or has ceased to carry on business, or is carrying on business only for the purpose of winding up its affairs; (2) if the company is unable to pay its debts; (3) if the court is of the opinion that it is just and equitable that the company should be wound up.

<sup>39</sup> Section 583(2) of the Companies Act.

<sup>40</sup> State of Madras v. Madras Electric Tram. Co., 1956 Mad. 131; Rajah of vizianagaram v. Official Receiver, 1962 SC 500.

<sup>41</sup> Re Travancore National Bank Ltd., 1939 Mad. 318.

<sup>42</sup> Section 588(1) of the Companies Act.

<sup>43</sup> AIR 1962 SC 500

<sup>44</sup> The Supreme Court of India held, "The Courts of a country dealing with the winding-up of a company can ordinarily deal with the assets within their jurisdiction It is, therefore, necessary that if a company carries on business in countries other than the country in which it is incorporated, the courts of those countries too should be able to conduct winding-up proceedings of its business in their respective countries. Such winding-up of the business in a country other than the country in which the company was incorporated is really an ancillary winding-up of the main company whose winding-up may have already been taken up in that country or may be taken up at the proper time.... ordinarily the winding-up of the company will be proceeded simultaneously in the various countries where it carried on business whenever the business of the company has ceased to be profitable and the company is reduced to a position in which it is not expected to make good its liabilities. It is the company incorporated outside India which is really wound up as an unregistered company in this country. In fact, there is no separate unregistered company which is being wound up here".

<sup>45</sup> Section 2(6) defines "foreign judgment" as the judgment of a foreign court. The same section defines a judgment as the statement given by the judge of the grounds of a decree

or order. This definition is restrictive and excludes proceedings on insolvency like reorganisation.

<sup>46</sup> Annex I of the Report of the 30th session of UNCITRAL (A/52/17)

<sup>47</sup> Section 584 deals with the power to wind up foreign companies, already dissolved. The section reads, “where a body corporate incorporated outside India which has been wound up as an unregistered company under this Part, notwithstanding that the body corporate has been dissolved or otherwise ceased to exist as such under or by virtue of the laws of the country under which it was incorporated.”

<sup>48</sup> Section 583 of the Companies Act enumerates the circumstances in which an unregistered company may be wound up.

<sup>49</sup> Section 426 (4) of the Insolvency Act states that the courts having jurisdiction in relation to insolvency law in any part of the United Kingdom shall assist the courts having the corresponding jurisdiction in any other part of the United Kingdom or any relevant country or territory.

<sup>50</sup> See, Charles D. Booth, Recognition of Foreign Bankruptcies: An Analysis and Critique of the Inconsistent Approaches of United States Courts, 66 Am. Bankr. L.J. 135 (1992). The English court refused to discharge Mareva injunctions freezing the company’s UK assets brought by UK creditors, on the basis that as the US organisation procedure envisaged only the continuation of the business in the US (and the discontinuation of business in Europe) then there could be no possible benefit to English creditors in seeing the UK assets repatriated to the US. This case has been criticised for not applying the principle of comity in recognising the US restraining order as an overriding or paramount consideration binding on the English court.

<sup>51</sup> Section 426 of the Insolvency Act, 1986.