

**CLUSTER 7**

1. **M/s. Sagar Retail Mega Mart Ltd. applied for winding up on 1<sup>st</sup> April, 2018 before the Honourable Tribunal by passing a special resolution as per the provision of Section 271(1)(a) of the Companies Act, 2013 on account of fall in business and continued losses but not due to inability to pay debts. The company was in the business of ordinary retail trade of multiple branded goods. A few shareholders of the company have alleged before the Honourable Tribunal that the company had failed to maintain proper books of accounts for over a period of more than three years immediately prior to the date of winding up application and the sole reason cited by them in support of their allegation is that no proper statements of all goods sold and purchased by the company have been kept as such every officer in default must be punished as per the provisions of the Companies Act, 2013. Mr. Ravi, the CFO and officer in default does not refute the allegation of non-maintenance but is of the opinion that this act as per the provision of the Companies Act, 2013 is not punishable. Decide whether the opinion of the CFO is correct. Would your answer be different had the business of the company be wholesale trade instead of ordinary retail trade? (CA (Final) May 2018)**

**Ans**

1. Section 338 applies where a company is being wound up, and if it is shown that the proper books of account were not kept by the company —

(a) Throughout the period of 2 years immediately preceding the commencement of the winding up; or

(b) The period between the incorporation of the company and the commencement of the winding up.

Whichever is shorter.

2. Where the business of the company involves dealings in goods, it shall be deemed that the proper books of account have not been kept if the following details have not been kept.

(a) Statements of the annual stock takings

(b) The details with respect to goods sold and goods purchased

(c) Such sufficient details of the buyers and sellers of such goods as are required to enable such buyers and sellers to be identified.

The details with respect to buyers and sellers is not required to be maintained in case of such transactions of ordinary retail trade.

3. Here, the business of M/s Sagar Retail Mega Mart Ltd. involves ordinary retail trade and hence not required to maintain the details with respect to buyers and sellers. However, the company is required to maintain the details with respect to goods purchased, goods sold and statements of annual stock takings.

4. M/s Sagar Retail Mega Mart Ltd. has failed to maintain the details with respect to goods purchased and goods sold. This amounts to non-compliance of Section 338.

5. The opinion of the CFO that non-maintenance of details with respect to goods purchased and goods sold is not punishable, is incorrect.

6. If the business at company was wholesale trade instead of ordinary retail trade, the answer would have remained same, even since details with respect to goods purchased and goods sold are required to be maintained by every company dealings in goods, whether such dealings are by way of wholesale trade or ordinary retail trade.

2. **Winding-up proceedings were commended against Lucky Limited, a non-government company. Even after completion of one year from the date of commencement of winding up proceedings, it has not been possible to conclude the same. The liquidator is of the opinion that the statement with respect to pending liquidation is to be filed only with the Tribunal and the Registrar.**

**Ans.** As per Section 348, where the winding up proceeding are not concluded within 1 year,

the liquidator is required to file a statement with respect to position of pending liquidation, as follows:

- (a) In case of a non-government company, the statement is to be filed with —
- (i) the Tribunal; and
  - (ii) the Registrar.
- (b) In case of a government company, the statement is to be filed with —
- (i) the Tribunal;
  - (ii) the Registrar;
  - (iii) the Central Government, where the Central Government is a member,
  - (iv) the State Government, where the State Government is a member;
  - (v) the Central Government and the State Government, if both the Governments are members of the Government company.

If the Liquidator fails to file the statement as required under Section 348, he shall be punishable with fine which may extend to Rs. 5,000 for every day during which the default continues.

#### Analysis and conclusion

- (i) In case Lucky Limited is a non-government company, the liquidator has not contravened the provisions of Section 348.
- (ii) In case Lucky Limited is a government company, the liquidator has contravened the provisions of Section 348, as he has not filed the statement with the Central Government or the State Government or both, as the case may be.
- (iii) For non-filing of the statement, the liquidator shall be punishable with fine which may extend to Rs. 5,000 for every day during which the default continues.

**3. LED Bulb Ltd. has made default in filing financial statements and annual returns for a continuous period of 4 financial years ending on 31st March, 2017. The Registrar of Companies having jurisdiction approached the Central Government to accord sanction to present a petition to Tribunal (NCLT) for the winding up of the company on the above ground under Section 272 of the Companies Act, 2013. Examine the validity of the RoC move, explaining the relevant provisions of the Companies Act, 2013. State the time limit for passing an order by the Tribunal under Section 273 of the Companies Act, 2013? (CA (Final) May 2018)**

#### Ans.

1. As per Section 270, a company may be ordered To be wound up by The Tribunal on any of The 5 grounds of which one is -  
Where a company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding 5 consecutive financial years.
2. As per Section 272, the Registrar is empowered to make a petition for winding up on the ground that the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding 5 consecutive financial years. However, before making the petition for winding up, the Registrar shall obtain the previous approval of the Central Government and the Central Government shall not grant the approval to the Registrar unless the company has been given a reasonable opportunity of making representations.
3. As per Section 273, where a petition for winding up of a company has been made to the Tribunal, the Tribunal shall pass its order within 90 days from the date of presentation of the petition.

#### Analysis and conclusion

The default by LED Bulbs Ltd, has been in existence only for 4 financial years, and so the condition mentioned in Section 272 that the default has to be for immediately preceding 5 consecutive years is not satisfied. Since none of the grounds mentioned in Section 270 is attracted to LED Bulbs Ltd., the application made to The Central Government by the Registrar

is not valid.

**Time limit for passing order by The Tribunal under Section 273**

As per Section 273, The Tribunal shall pass its order within 90 days from the date of presentation of the petition.

**4. Explain the provisions of the Companies Act, 2013 relating to preparation and filing of Statement of Affairs (SA) in case of winding of a company by the Tribunal, with regard to the following aspects:**

(i) Who is required to prepare and file SA and whether cost and expenses incurred in preparing SA are recoverable?

(ii) Contents of SA and the period within which the same is required to be submitted and to whom? Also state about delay in filing SA and up to what period the same is allowed. Some applicants consented to become shareholders of a company on the condition that their suggestions should be included in the memorandum and articles of association. Their suggestions, however, were not carried out by the promoters but the applicants signed usual applications for shares allotted to them and thereby become shareholders of the company. The company went into liquidation. What shall be the fate of the applicants who had consented to become shareholders on certain conditions? (CA (Final) May 2017 (Modified))

**Ans.** As per Section 285, a person who is a member of the company shall be included in the list of contributories, and he shall be liable to pay the unpaid calls on the shares held by him. As per Section 9, the subscribers to memorandum of association become members by the fact of subscription (i.e. signing on the memorandum). A subscriber cannot deny his obligation to take shares or to pay the money on the shares allotted to him on the ground that he was induced to sign the memorandum by fraud or misrepresentation.

In **Re, East Bengal Sugar Mills Ltd.** the names of two persons had been included in the list of contributories by the liquidator. These two persons were the subscribers to the memorandum and articles. The question before the Court was whether these two subscribers were liable to pay calls as contributories or not.

Following two issues were raised before the Court:

**Issue No.1:** The two subscribers alleged that prior to the incorporation of the company, draft memorandum and articles were shown to them, to which they had objected and had made certain suggestions. They had consented to become subscribers on the condition that their suggestions would be incorporated in the draft memorandum and articles. However, the promoters filed the memorandum and articles without incorporating their suggestions.

**Issue No. 2:** It was submitted before the Court that prior to winding up of the company, calls had been made on these two subscribers-members which remained unpaid, and the liability to pay calls had become barred by limitation, and accordingly, these two subscribers-members were not liable for the payment of these calls.

**Decision of the Court:** The Court held that it was the duty of the subscribers to satisfy themselves that their suggestions had been incorporated in the memorandum and articles. It was a failure on their part to check that their suggestions were incorporated or not, and so, this cannot be a reason for these two subscribers to escape from their liability to pay calls. The Court further held that when winding up of a company commences, then, as per Section 285 a new liability is created irrespective of the fact that previously calls had been made by the company and had become time barred. Accordingly, it was held that inclusion of the names of two subscribers in the list of contributors was valid, and these two subscribers were liable for the payment of the calls.

**Conclusion-** Applying the provisions contained in Section 285 and the decision in **Re, East Bengal Sugar Mills Ltd.**, the applicants in the given case are liable for the payment of the calls remaining unpaid on the shares held by them.

5. M/s LJK Limited was wound up with effect from 15th March 2018 by an order of the Court. Mr. A, who ceased to be a member of the company from 1st June 2017, has received a notice from the liquidator that he should deposit a sum of Rs. 5,000 as his contribution towards the liability on the shares previously held by him. In this context explain whether Mr. A can be called as a contributory, whether he can be made liable and whether there is any limitation on his liability. (CA (Final) Nov. 2018)

OR

M/s. XYZ Limited was wound up with effect from 15.3.2000 by an order of the Tribunal. Mr. A, who ceased to be a member of the company from 1.6.1999, has received a notice from the liquidator that he should deposit a sum of Rs. 5,000 as his contribution towards the liability on the shares previously held by him. In this context explain whether Mr. A can be called a contributory and whether he can be made liable and whether there is any limitation on his liability. (CA (Final) May 2000)

OR

By an order of the Tribunal M/s ABC Limited was wound up with effect from 15.3.2002. Mr. Gupta, who ceased to be a member of the company from 1.6.2001 received a notice from the liquidator to deposit a sum of Rs. 15,000 as his contribution towards the liability on the shares previously held by him. Mr. Gupta seeks your opinion about his liability. (CA (Final) Nov. 2002)

Ans.

### The legal position

1. The term 'contributory' has been defined under clause (26) of Section 2, as follows: 'Contributory' means a person liable to contribute towards the assets of the company in the event of its being wound up.

A person holding fully paid-up shares in a company shall be considered as a contributory but shall have no liabilities of a contributory under the Act whilst retaining rights of such a contributory.

2. As per Section 285, a person, who is not a member, but has been a member in the past shall also be liable to contribute to the assets of the company, subject to the following conditions:

(a) A past member shall not be liable to contribute if he has ceased to be a member for 1 year or more before the commencement of the winding up.

(b) A past member shall not be liable to contribute in respect of any debt or liability of the company contracted after he ceased to be a member.

(c) A past member shall not be liable to contribute unless it appears to the Tribunal that the present members are unable to satisfy the contributions required to be made by them. Thus, the liability of a past member is secondary.

(d) In the case of a company limited by shares, the past member shall not be liable to contribute any amount exceeding the amount, if any, unpaid on the shares in respect of which he is liable as such member.

### Analysis and Conclusion

1. Mr. A ceased to be a member of IJK Limited with effect from 1<sup>st</sup> June, 2017.

2. The winding up of IJK commenced on 15<sup>th</sup> March, 2018.

3. As on the date of commencement of winding up, one year has not elapsed since Mr. A ceased to be a member, and therefore, he shall be liable as a past member.

4. As per clause (26) of Section 2, Mr. A shall be termed as a contributory, since a sum of Rs. 5,000 is due and remains unpaid on the shares previously held by him and so he is liable to contribute to the assets of the company in the event of winding up of the company.

5. Mr. A is liable in the capacity of a past member.

6. As per Section 285, Mr. A shall not be liable to contribute-

(a) in respect of any debt or liability of the company contracted after he ceased to be a

member;

(b) unless it appears to the Tribunal that the present members are unable to satisfy the contributions required to be made by them;

(c) anything more than the amount remaining unpaid on the shares held by him, i.e. Rs. 5,000, being the unpaid calls on shares previously held by him.

**6. Info-tech Overtrading Ltd. was ordered to be compulsory wound up by an order dated 10<sup>th</sup> March, 2019 by the Tribunal. The official liquidator who has taken control of the assets and other records of the company has noticed that:**

**(i) One of the contributories whose calls are pending to be paid is about to leave India for evading payment of calls and;**

**(ii) A person having books of accounts of the company in his possession may abscond to avoid examination of books of accounts in respect of the affairs of the company.**

**Apprehending such possibilities, Tribunal detained such contributory for next 6 months disallowing him to leave India as well as arrest & seize books of accounts from the person who may possibly abscond to avoid examination of the affairs of the company.**

**Referring to the provisions of Companies Act, 2013, answer the following in current scenario:**

**(iii) What is the validity of Tribunal's order for detention of contributory disallowing him to leave India?**

**(iv) Is it correct on Tribunal's part to arrest and seize books of accounts from the person planning to abscond to avoid examination of books of accounts in respect of the affairs of the company? (CA (Final) May 2019)**

**Ans.** As per Section 301, the Tribunal to make an order for—

(a) Detention of a contributory where the Tribunal is satisfied that such contributory is about to leave India or otherwise to abscond for the purpose of evading payment of calls;

(b) seizure of books and papers and movable property of a person where The Tribunal is satisfied that such person has property, accounts, or papers of the company in his possession, and he is about to leave India or otherwise to abscond, or is about to remove or conceal any of his property for the purpose of avoiding examination with respect to the affairs of a company.

**Analysis and Conclusion:**

(i) The order of the Tribunal detaining the contributory from who calls are payable to the company and disallowing him to leave India is valid, assuming that there is sufficient material on record by which the tribunal is satisfied that such contributory intends to abscond for the purpose of evading payment of calls.

(ii) The order of the Tribunal directing seizure of books of a person is valid assuming that the Tribunal is satisfied that such person is planning to abscond to avoid examination with respect to the affairs of the company.

**7. M/s. LMN Limited has been running in losses and has defaulted payment to its creditors. On 1.8.2017, the company mortgaged its plant and machinery to Mr. Patel, a close friend of the managing director of the company, against payment of his dues of Rs. 10 lakhs payable by the company. The other creditors were left in lurch. In the meantime, Mr. Raman (who was not paid by the company for supply of raw material of the value of Rs. 50,000) presented a petition for winding up the company before the Tribunal on 31.12.2017. The company was ordered to be wound up by the Tribunal on 30.4.2018. Can the Tribunal declare the transaction of mortgage with Mr. Patel as invalid? (CA (Final) May 2005 (Modified))**

**Ans.** As per Section 357, in case of a winding up by the Tribunal, the winding up shall be deemed to have commenced at the time of presentation of the petition for the winding up.

Thus, where a petition is made to the Tribunal and the Tribunal orders the winding up, the order relates back to the date of the presentation of the petition.

As per Section 328, a transaction shall be deemed to be a fraudulent preference and consequently invalid if all the following conditions are satisfied:

- (a) The transaction relates to transfer of property, delivery of goods, payment of money or other act relating to the property of the company.
- (b) It took place within 6 months before the commencement of the winding up of the company.
- (c) It was an entirely voluntary act and not made under any pressure.
- (d) The dominant motive was to give a creditor a preference over other creditors.

In the given case, the winding up of M/s LMN Limited commenced on 31.12.2017, viz. the date of presentation of petition of winding up. M/s LMN Limited mortgaged its plant and machinery in favour of Mr. Patel on 1.8.2017, i.e. within 6 months before the commencement of winding up. The mortgage was made voluntarily by the company, without any consideration, and not under any pressure. Thus, the dominant motive behind the transaction was to give Mr. Patel some preference over the other creditors. Since all the requirements of Section 328 are satisfied in the given case, the mortgage of plant and machinery made in favour of Mr. Patel amounts to fraudulent preference, and therefore, the Tribunal is empowered to declare it as void.

**8. A company was in financial distress. They pledged certain immovable properties with a nationalised bank in the belief that their loan limits would be increased. However, within 3 months, some creditors filed a petition for winding up. The management was accused of fraudulent preference.**

**(i) In the above context discuss fraudulent preference.**

**(ii) Would your answer be different if the charge was created in favour of an NBFC? (CA (Final) May 2016)**

OR

**Modern Textiles Limited incurred huge losses during the last three financial years and its financial position was bad. The Company created a legal mortgage on some of its immovable properties in favour of a bank on 1<sup>st</sup> September, 2017 in the hope that by keeping good faith with the bank could get further advances from the bank and the same could be utilized to revive the Company. Some creditors filed winding up petition in the court on 15<sup>th</sup> January, 2018. The court passed an order of winding up on 1<sup>st</sup> August, 2018. Answer the following with reference to the provisions of the Companies Act, 2013:**

**(i) What is meant by 'Fraudulent Preference'? State the effect of 'Fraudulent Preference.'**

**(ii) Whether the creation of legal mortgage by the Company in favour of the bank would amount to fraudulent preference? (CA (Final) Nov. 2013)**

**Ans.** As per Section 328, a transaction shall be deemed to be a fraudulent preference and consequently invalid if all the following conditions are satisfied:

- (a) The transaction relates to transfer of property, delivery of goods, payment of money or other act relating to the property of the company.
- (b) It took place within 6 months before the commencement of the winding up of the company.
- (c) It was an entirely voluntary act and not made under any pressure.
- (d) The dominant motive was to give a creditor a preference over other creditors.

As per Section 357, in case of a winding up by the Tribunal, the winding up shall be deemed to have commenced at the time of presentation of the petition for the winding up. Thus, where a petition is made to the Tribunal and the Tribunal orders the winding up, the order relates back to the date of the presentation of the petition.

In the given case, the petition for winding up was presented to the Tribunal within 3 months

of pledge of immovable property by the company. Thus, the transaction of pledge has taken place within 6 months before the commencement of winding up of the company.

A transaction shall amount to fraudulent preference only if there is an element of dishonesty, i.e. there is a malafide intention to give preference to a creditor over others.

There is no fraudulent preference when a debtor's dominant intention is to benefit himself rather than to confer an advantage on his creditor. Thus, where a company created a legal mortgage in favour of a bank in the hope that by keeping good faith with the bank it could get further advance from the bank which could be utilised to revive the company, the mortgage was held not to be a fraudulent preference even though the mortgage was created after it was fairly clear that the company had become insolvent [**Re, F.I.E. Holdings Ltd. (1967) 3 All ER 553**].

In the given case, the immovable property was pledged by the company under a belief that the loan limit would be increased. Thus, the dominant motive was not to give to the bank any preference over other creditors, and so pledge of immovable property by the company does not amount to fraudulent preference. Therefore, the Tribunal shall not declare the pledge of immovable property as void.

Even where the charge was created in favour of NBFC, and not in favour of a bank, the answer would have remained same, since in determining as to whether a transaction is a fraudulent preference or not, it is immaterial that the creditor is a bank or NBFC or any other person.

- 9. A company created a floating charge of its current assets in favour of a bank to secure a current account, which was in debit of Rs. 5 lakhs and also to secure further working capital facilities provided by the bank. The charge created on 1<sup>st</sup> January, 2015 was duly registered with the Registrar of Companies. The bank advanced Rs. 10 lakhs subsequent to the creation of charge. The winding up of the company commenced on 1<sup>st</sup> September, 2015. Examine the validity of the floating charge in case there is not fraudulent preference. (CA (Final) May 2004 (Modified))**

**Ans.**

#### **Provisions**

As per Section 332, a floating charge created by the company within 12 months preceding the commencement of its winding up shall be invalid. However, this rule is subject to the following two exceptions:

(a) A floating charge shall not be invalid where it is proved that the company was solvent immediately after the creation of the charge.

(b) A floating charge shall be valid up to the amount of any cash paid to the company (whether at the time of creation of charge or thereafter) as a consideration for the charge. Also, interest shall be allowed on that amount at the rate of 5% per annum or such other rate as may be notified by the Central Government.

As per Section 357, in case of a winding up by the Tribunal, the winding up shall be deemed to have commenced at the time of presentation of the petition for the winding up.

#### **Analysis and Conclusion**

A company has created a floating charge on its assets in favour of a bank on 1<sup>st</sup> January, 2015. The winding up of the company commenced on 1<sup>st</sup> September, 2015. It is evident that winding up of the company has commenced within 12 months of creation of floating charge, i.e. the floating charge was created within 12 months preceding the commencement of winding up. Therefore, this case is covered under Section 332.

As on the date of creation of floating charge (viz. 1<sup>st</sup> January, 2015), the company is already indebted towards the bank for Rs. 5 lakh. The bank has advanced Rs. 10 lakhs to the company subsequent to the creation of the floating charge.

The bank would not have advanced Rs. 10 lakhs if the company had not given the security

(by way of creation of floating charge) to the bank. Therefore, the money advanced to the company by the bank was in consideration of creation of charge, and so the charge shall be held to be valid. The same decision was given on the same facts in **Re, Yeovil Glove Co.Ltd. (1962) 3 All ER 400.**

Hence,

(i) The floating charge created by the company on 1<sup>st</sup> January, 2015 shall be valid to the extent of Rs. 10 lakhs along with interest on Rs. 10 lakhs at the rate of 5% per annum or such other rate as may be notified by the Central Government.

(ii) The floating charge shall be valid for Rs. 15 lakhs (viz. Rs. 10 lakhs advanced to the company subsequent to the creation of the floating charge as well as for Rs. 5 lakhs which were already due to the bank from the company before the creation of floating charge) along with interest, if it is proved that the company was solvent immediately after the creation of the floating charge.

#### 10. Consider the following cases:

##### Case (a)

M/s. Sunset Construction Limited is being wound up by the Tribunal. The Liquidator after realization of the assets has an amount of Rs. 28,00,000 at his disposal towards payment to the creditors of the company. The list of creditors is given below:

(i) Dues to secured creditors	Rs. 20,00,000
(ii) Dues to workers	Rs. 15,00,000
(iii) Taxes, etc, payable to the government authorities	Rs. 2,00,000
(iv) Unsecured creditors	Rs. 40,00,000

Since the available amount is insufficient to meet the claims of all the creditors, explain the procedure to be followed for payment of dues as provided in the Companies Act, 2013, assuming that the company has created a charge on all the assets of the company in favour of the secured creditors. (CA (Final) May 1999 (Modified))

OR

Best Plastics Limited is being wound up by the Tribunal. The Liquidator after realization of the assets has an amount of Rs. 28 lakhs in his hand towards payment of creditors of the company. Details of creditors are as follows:-

- (i) Secured Creditors: Rs. 20 lakhs
- (ii) Workers wages: Rs. 15 lakhs
- (iii) Income Tax payable: Rs. 2 lakhs
- (iv) Unsecured Creditors: Rs. 40 lakhs

Total Creditors: Rs. 77 lakhs

Since the available amount in the hands of Liquidator is only Rs. 28 lakhs, which is insufficient to meet the claims of all the above creditors, explain the procedure you would follow for payment of the above in accordance with the provisions of the Companies Act, 2013, assuming that the company has created a charge on all the assets of the company in favour of secured creditors. (CA (Final) Nov. 2015 (Modified))

##### Case (b).

M/s XYZ limited is being wound up by the Tribunal. The Liquidator after realization of the assets has an amount of Rs. 56,00,000 at his disposal towards payment of creditors of the company. Details of creditors are as under:

(i) Dues to secured creditors	Rs. 40,00,000
(ii) Dues to workers	Rs. 30,00,000
(iii) Taxes and duties payable to Government authorities	Rs. 4,00,000
(iv) Unsecured creditors	Rs. 80,00,000

Since the available amount is insufficient to meet the claims of all the creditors, explain the procedure to be followed for payment of dues as provided in the Companies Act,



2013, assuming that the company has created a charge on all the assets of the company in favour of the secured creditors. (CA (Final) May 2003 (Modified))

Case (c)

M/s. Raman Ltd. was wound up by the Tribunal. The liquidator invited claims from its creditors which stood as under:

Income tax dues:	Rs.	11 lakhs
Sales tax dues:	Rs.	5 lakhs
Dues of Workers:	Rs.	25 lakhs
Unsecured loans payable to directors:	Rs.	25 lakhs
Trade creditors who supplied raw material:	Rs.	15 lakhs
Secured creditor being the bankers of the company:	Rs.	75 lakhs
	Rs.	156 lakhs

Liquidator could realise only Rs. 80 lakhs by sale of assets and realisations made from the company's debtors, which is not sufficient to pay to all the creditors. Please decide the order of priority for payment to creditors explaining the relevant provisions of the Companies Act, 2013. (CA (Final) Nov. 2009)

Case (d)

Mars India Limited, a company incorporated under the Companies Act, 2013 is being wound up by the Tribunal. After realization of the assets of the company, the liquidator has an amount of Rs. 70,00,000 at his disposal towards payment of creditors of the said company. The details of creditors are as follows: -

(i) Unsecured creditors	Rs.	50,00,000
(ii) Taxes and duties payable to Government	Rs.	5,00,000
(iii) Dues to workers	Rs.	30,00,000
(iv) Dues to secured creditors	Rs.	40,00,000

The available amount with the liquidator, obviously, is not sufficient to meet the claims of all the creditors. Moreover, the company had already created a charge on all the assets of the company in favor of the secured creditors. Explain the procedure to be followed by the liquidator for payment of dues as provided in the Companies Act, 2013. (CA (Final) Nov. 2008)

Case (e)

The Liquidator of the Bogus Limited (in liquidation) has realised 50 lakhs by selling the land owned by the company. The company owes Rs. 1 crore to its bankers towards a loan secured by the company's land and factory buildings. The bank has claimed that the amount realised by sale of land must be paid in full to it in preference to the 'workmen' dues' to the extent of Rs. 25 lakhs. Examine the bank's claim with reference to the relevant provisions of the Companies Act, 2013. (CA (Final) Nov. 2002)

OR

Explain the term "Overriding Preferential Payments" under the provisions of the Companies Act, 2013. ABC Limited is being wound up by the Tribunal. The liquidator has realised Rs. 100 lakh by selling the land and buildings mortgaged by the company in favour of its bankers. The company owes Rs. 200 lakh to the bank. The bank has claimed that the amount realised by sale of land and buildings must be paid in full to it in preference to the workmen's dues to the extent of Rs. 50 lakh. Examine the Bank's claim with reference to the provisions of the Companies Act, 2013. (CA (Final) Nov. 2012)

Case (f).

PQR Limited is being wound up by the Tribunal. All the assets of the company have been charged to the company's bankers to whom the company owes 1 crore. The company owes the following amounts to others:

(i) Dues to workers	Rs.	25,00,000
(ii) Taxes payable to Government	Rs.	25,00,000

**(ii) Unsecured creditors**

Rs. 5,00,000

You are required to compute with reference to the provisions of the Companies Act, 2013 the amount each kind of creditors is likely to get if the amount realized by the official liquidator from the secured assets and available for distribution among the creditors is only 80 lakhs. (CA (Final) Nov. 2010)

**Ans.** Section 326 prescribes the debts which shall be paid in priority to all other debts, i.e. overriding preferential payments.

Accordingly, the following debts shall be paid in priority to all other debts;

(a) Workmen's dues.

(b) Debts due to secured creditors to the extent such debts rank pari-passu with workmen's dues.

The debts listed under Section 326 shall be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

The order of payment of liabilities adopted by the liquidator shall be as under:

1. Overriding preferential payments under Section 326 (i.e. workers' dues and debts due to secured creditors)

2. Costs and expenses of winding up.

3. Preferential payments under Section 327.

4. Creditors secured by a floating charge.

5. Unsecured creditors.

**Case (a).**

In the present case, only Rs. 28 lakhs are available whereas the overriding preferential payments (workers' dues and secured creditors) amount to Rs. 35 lakhs. Therefore, the workers' dues and dues payable to secured creditors shall abate in equal proportions, i.e. payments to workers and secured creditors shall be made in the proportion of amount owed by the company to them (i.e. in the ratio of 20:15) Accordingly the workers shall be paid Rs. 12 lakhs and the secured creditors shall be paid Rs. 16 lakhs. No payment shall be made to the Government authorities for tax dues or to unsecured creditors.

**Case (b).**

In the present case only Rs. 56 lakhs are available whereas the overriding preferential payments (workers' dues and secured creditors) amount to Rs. 70 lakhs. Therefore, the workers' dues and dues payable to secured creditors shall abate in equal proportions i.e. payments to workers and secured creditors shall be made in the proportion of amount owed by the company to them (i.e. in the ratio of 40:30) Accordingly the workers shall be paid Rs. 24 lakhs and the secured creditors shall be paid Rs. 32 lakhs. No payment shall be made to the Government authorities for tax dues or to unsecured creditors.

**Case (c)**

In this case, Rs. 80 lakhs have been realised by the sale of all the assets of the company. The amount due to secured creditors is Rs. 75 lakhs and the workmen's dues are Rs. 25 lakhs. Overriding preferential payments (workmen's dues and secured creditors) amount to Rs. 100 lakhs.

Therefore, the workmen's dues and dues payable to secured creditors shall abate in equal proportions, i.e. payments to workmen and secured creditors shall be made in the proportion of amount owed by the company to them (i.e. in the ratio of 75:25). Accordingly, the workers shall be paid Rs. 20 lakhs and the secured creditors shall be paid Rs. 60 lakhs. No payment shall be made to the Government authorities for income tax dues, sales tax dues, unsecured loans payable to directors or to trade creditors who supplied raw material.

**Case (d)**

In this case Rs. 70 lakhs have been realised by the sale of all the assets of the company. The amount due to secured creditors is Rs. 40 lakhs and the workmen's dues are Rs. 30 lakhs. Overriding preferential payments (workmen's dues and secured creditors) amount to Rs. 70

lakhs. Since the amount realised is sufficient to pay the overriding preferential payments in full, the secured creditors will receive the full amount of Rs. 40 lakhs due to them, and similarly workers will get their entire claims of Rs. 30 lakhs. No payment shall be made to the Government authorities for tax and duties due or to unsecured creditors.

**Case (e)**

In this case Rs. 50 lakhs have been realised by the sale of land (mortgaged with the bank on account of a loan taken by the bank). The loan taken from the bank is Rs.1 crore and the workmen dues are Rs. 25 lakhs, i.e. overriding preferential payment under Section 326 amount to Rs. 125 lakhs but available cash is Rs. 50 lakhs only. Therefore, the workers dues and dues payable to bank shall abate in equal proportions, i.e. payments to workers and bank shall be made in the proportion of amount owed by the company to them (i.e. in the ratio of 4:1) Accordingly, the workers shall be paid Rs. 10 lakhs and Rs. 40 lakhs shall be paid towards the bank loan.

In view of the provisions of Section 326, the contention of the bank that whole of Rs. 50 lakhs realised from sale of land must be paid to the bank towards repayment of loan, is not tenable. Only a sum of Rs. 40 lakhs shall be paid to the bank.

**Case (f)**

In this case, Rs. 80 lakhs have been realised by the sale of all the assets of the company. The amount due to secured creditors is Rs. 1 crore and the workmen's dues are Rs. 25 lakhs. Overriding preferential payments (workmen's dues and secured creditors) amount to Rs. 1.25 crore. Since the amount realised is not sufficient to pay the overriding preferential payments in full, the workmen's dues and dues payable to secured creditors shall abate in equal proportions, i.e. payment to workmen and secured creditors shall be made in the proportion of amount owed by the company to them (i.e. in The ratio of 100:25). Accordingly, the workers shall be paid Rs. 16 lakhs and the secured creditors shall be paid Rs. 64 lakhs. No payment shall be made towards taxes payable to the Government and unsecured creditors.

**11. OGC Ltd. was a supplier of raw material to SAM Ltd., which could not make payment to OGC Ltd. owing to huge losses and financial constraints. Ultimately, SAM Ltd., went into liquidation and liquidator was appointed. OGC Ltd. filed a suit for recovery of its dues. The Court awarded a decree in favour of OGC Ltd. Armed with the Court's decree, OGC Ltd., approached the liquidator to pay the amount to it in preference over dues of the workmen. The workmen protested the demand of OGC Ltd. and contended that their dues rank pari-passu with the secured creditors and will override all other claims of other creditors even where a decree has been passed. You are required to ascertain the validity of the argument of the workmen in the light of the provisions of the Companies Act, 2013 and the decided cases on the subject. (CA (Final) May 2008, Nov. 2005)**

**Ans.** The given problem relates to Section 326 of the Companies Act, 2013.

1. The duty of the liquidator is to ensure that the property of the company is applied in satisfaction of its liabilities amongst its just and proper creditors. i.e. the persons who are justly, legally and properly creditors.

2. As per Section 326, following debts shall be paid in priority to all other debts:

(a) Workmen's dues.

(b) Debts due to secured creditors to the extent such debts rank pari-passu with workmen's dues.

The effect of Section 326 is that, in the event of liquidation, the assets of the company remain charged for the payment of workmen 's dues and such charge will be pari-passu with the claim of the secured creditors. In other words, the dues of the workmen and debts due to the secured creditors are to be treated paripassu and have to be paid in priority to all other dues. Thus, by operation of law (i.e. Section 326), The 'workmen dues' amount to over-riding preferential payments and are entitled to proportional payment along with secured creditors.

3. Where an unsecured creditor obtains a Court decree, he does not become a secured creditor [Ananta Mills Ltd. v City Deputy Collector, Ahmedabad]. Accordingly, Section 326 overrides claims of the unsecured creditors even where a decree has been passed by the Court.

4. In the given case, the Court has passed a decree in favour of OGC Ltd. to recover the price of raw materials supplied to SAM Ltd. However, such decree does not make OGC Ltd. a secured creditor. Therefore, the assets of the company shall be first applied towards payment of workmen's dues and debts due to secured creditors.

Conclusion: The contention of the workmen of SAM Ltd. is correct. The payment to OGC Ltd. cannot be made until the claims of the workmen are fully satisfied.

**12. Examine the provisions of the Companies Act and decide whether the following debts of a company under the winding up shall be preferential payments and shall be paid in priority to the claim of unsecured creditors:**

**(a) Wages amounting to Rs. 30,000/- (Rupees Thirty Thousand) only of employees for services rendered for a period of 8 months within the preceding 12 months next before the relevant date.**

**(b) Rs. 1 lakh due to an employee from Provident Fund and Rs. 50,000/- towards gratuity.**

**(c) Rs. 20,000/- payable by the company on account of expenses incurred in respect of investigation held under Section 213 of the Companies Act, 2013.**

**Ans.** As per Section 327, following debts shall be paid in priority to all other debts (termed as 'preferential payments '):

(a) All wages and salaries of any employee, due for a period not exceeding 4 months within 12 months before the relevant date. However, such amount payable to any employee shall not exceed the amount as may be notified.

Thus, the whole amount of wages of Rs. 30,000 shall not amount to preferential payments. Wages for a period of 4 months within 12 months preceding the relevant date (subject to a maximum of such amount as may be notified) shall amount to preferential payments.

(b) All sums due to any employee from a provident fund, a pension fund, a gratuity fund or any other fund for the welfare of the employees, maintained by the company.

Thus, Rs. 1 lakh due from Provident Fund and Rs. 50,000 due towards gratuity shall amount to preferential payments.

(c) The expenses of any investigation held in pursuance of Section 213 and 216, in so far as they are payable by the company.

Thus, Rs. 20,000 payable by the company on account of expenses incurred in respect of investigation held under Section 213 of the Companies Act, 2013, amounts to preferential payments.

**13. What shall be the amount to be borne by the secured creditors out of the expenses incurred by the liquidator if:**

**(a) The value of the security of secured creditors of a company is Rs. 1 lakh;**

**(b) Total amount of workmen'**

**(c) Debts due from the company to its secured creditors is Rs. 3 lakh; and**

**(d) The liquidator incurred Rs. 10,000 for the preservation of the security before it is realized by the secured creditors. (CA (Final) May 2017)**

**Ans.** Section 326 prescribes the debts which shall be paid in priority to all other debts, i.e. overriding preferential payments. Accordingly, the following debts shall be paid in priority to all other debts:

(a) Workmen's dues.

(b) Debts due to secured creditors to the extent such debts rank pari passu with workmen's dues.

The debts listed under Section 326 shall be paid in full unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

Value of the security: Rs. 1 lakh.

Amount due towards workmen's dues: Rs. 1 lakh.

Amount due to secured creditors: Rs. 3 lakh.

Overriding preferential payments (workmen's dues and secured creditors): Rs. 4 lakh.

Since the amount realised is not sufficient to pay the overriding preferential payments in full, the workmen's dues and dues payable to secured creditors shall abate in equal proportions, i.e. payments to workmen and secured creditors shall be made in the proportion of amount owed by the company to them (i.e. in the ratio of 1:3).

Accordingly, the amount payable towards workmen's dues would have been Rs. 25,000 and the amount payable to secured creditors would have been Rs. 75,000, had the liquidator not incurred any expense towards preservation of security.

Since the liquidator has incurred Rs. 10,000 towards preservation of the security, this amount of Rs. 10,000 shall have to be borne by the 'workmen dues' and secured creditors in the proportion of 1:3. Accordingly, the workmen shall have to bear Rs.2,500 and the secured creditor shall bear Rs. 7,500.

**14. Imprudent Company Limited approached Safe Finance Company Limited for loan of Rs. 20 Lakhs to finance purchase of some essential machinery. The company created a floating charge on some of its assets on 1<sup>st</sup> December, 2016 for Rs. 25 lakhs to secure Rs. 5 lakhs already due to Safe Finance Company Limited and additional amount to be advanced by the said Finance company. Safe Finance Company Limited advanced Rs. 15 lakhs on 15<sup>th</sup> December, 2016 towards purchase of certain machinery. Some of the creditors filed winding up petition in the Tribunal on 1<sup>st</sup> January, 2017 and the company was ordered to be wound up on 15<sup>th</sup> December, 2017. Examine with reference to the provisions of the Companies Act, 2013 whether the floating charge is valid. (CA (Final) May 2006 (Modified))**

**Ans.**

#### **Provisions**

As per Section 332, a floating charge created by the company within 12 months preceding the commencement of its winding up shall be invalid.

However, this rule has following 2 exceptions:

(a) A floating charge shall not be invalid where it is proved that the company was solvent immediately offer the creation of the charge.

(b) A floating charge shall be valid upto the amount of any cash paid to the company (whether at the time of creation of charge or thereafter) as a consideration for the charge. Also, interest shall be allowed on that amount at the rate of 5%per annum or such other rate as may be notified by the Central Government.

As per Section 357, in case of a winding up by the Tribunal, the winding up shall be deemed to have commenced of the time of presentation of the petition for the winding up.

#### **Analysis and Conclusion**

In the given case, the winding up petition was filed in the Tribunal on 1<sup>st</sup> January, 2017 and the company was ordered to be wound up on 15<sup>th</sup> December, 2017. As per Section 357, winding up commenced on 1<sup>st</sup> January, 2017.

On 1<sup>st</sup> December, 2016, the company created a floating charge on some of its assets in favour of Safe Finance Company Limited. The amount secured by the floating charge was Rs. 25 lakhs. Thus, the floating charge was created within 12 months preceding the commencement of winding up. Therefore, this case is covered under Section 332.

The amount of Rs. 15 lakhs advanced by Safe Finance Company Limited towards purchase of machinery falls under one of the exceptions (viz. cash paid to the company as a

consideration for the charge), and therefore, the floating charge is valid up to Rs. 15 lakhs along with interest @ 5% per annum or such other rate as may be notified by the Central Government.

Hence,

- (i) Floating charge for Rs. 5 lakhs not yet advanced by Safe Finance Company Limited is void.
- (ii) The floating charge is valid for Rs. 15 lakhs along with interest @ 5% per annum or such other rate as may be notified by the Central Government.
- (iii) The floating charge shall be valid for Rs. 20 lakhs (viz. Rs. 15 lakhs advanced to the company subsequent to the creation of the floating charge as well as for Rs. 5 lakhs which were already due from the company before the creation of floating charge) along with interest, if it is proved that the company was solvent immediately after the creation of the floating charge.

**15. M/s. Info-tech Overtrading Ltd. was ordered to be wound up by an order dated 15<sup>th</sup> October, 2017. The official liquidator who has taken control of the assets and other records of the company has noticed the following:**

- (i) The Managing Director of the company has sold certain properties belonging to the company to a private company in which his son was interested causing loss to the company to the extent of Rs. 50 lakhs. The sale took place on 10<sup>th</sup> May, 2017.**
- (ii) The company created a floating charge on 1<sup>st</sup> January, 2017 in favour of a private bank for the overdraft facility to the extent of Rs. 5 crores, by hypothecating the current assets viz. stocks and book debts.**

**Examine what action the official liquidator can take in this matter having regard to the provisions of the Companies Act, 2013. (CA (Final) Nov. 2007 (Modified))**

**Ans.**

(i) As per Section 329, any transfer of property or delivery of goods made by a company shall be void against the Company Liquidator if it was made within a period of 1 year before the presentation of a petition for winding up by the Tribunal. However, the following transactions shall remain valid:

- (a) Any transfer of property or delivery of goods made in the ordinary course of business.
- (b) Any transfer of property or delivery of goods made in favour of a purchaser or encumbrances in good faith and for valuable consideration.

In the given case, the date of order of winding up is given (viz. 15<sup>th</sup> October 2017) but the date of presentation of petition for winding up is not given.

The company has sold certain properties to a private company in which the son of the managing director is interested. Such sale has been affected at a price which is much below the market price (causing loss of Rs. 50 lakhs to the company). The sale is void since such transaction is not entered into in the ordinary course of business, and such transaction is not entered into in good faith and for valuable consideration. It has been assumed that such sale was made within preceding 1 year before the presentation of a petition for winding up.

(ii) The given problem relates to Section 332 of The Companies Act, 2013, as explained below: As per Section 332, a floating charge created by the company within 12 months preceding the commencement of its winding up shall be invalid.

**Exceptions.**

- (a) A floating charge shall not be invalid where it is proved that the company was solvent immediately after the creation of the charge.
- (b) A floating charge shall be valid up to the amount of any cash paid to the company (whether at the time of creation of charge or thereafter) as a consideration for the charge. Also, interest shall be allowed on that amount at the rate of 5% per annum or such other rate as may be notified by the Central Government.

In the given case, -

Date of commencement of winding up - Not given.  
Date of order of winding up - 15<sup>th</sup> October, 2017  
Date of creation of floating charge - 1<sup>st</sup> January, 2017

In The given case, Section 332 is attracted assuming that the floating charge was created within preceding 12 months of commencement of winding up.

Floating charge up to Rs. 5 crores along with interest @ 5% p.a. or such other rate as may be notified by the Central Government shall be valid. However, if the whole amount of overdraft facility is not utilised by the company, the floating charge shall be valid only up to such amount as is actually advanced by the bank to the company plus interest @ 5% p.a. or such other rate as may be notified by the Central Government.