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**CORPORATE AND PROFESSIONAL RESPONSIBILITY
IN INSOLVENCY - THE POSITION IN INDIA**

By

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INTRODUCTION

In India, insolvency proceedings can get triggered under two statutes: The Companies Act, 1956 (1956 Act) and Sick Industrial Companies (Special Provisions) Act, 1985 (SICA).

Under SICA, it is mandatory for the company whose net worth is completely eroded, to make a reference to Board for Industrial and Financial Reconstruction (BIFR) for determination of appropriate measures to be adopted. If on an inquiry into such reference, BIFR formulates the opinion that it is not possible for the company to make its net worth exceed its accumulated losses within a reasonable time, and that it is just and equitable that the company be wound up, it records such opinion and forwards it to the High Court under whose jurisdiction the company is registered for initiation of winding up proceedings. Under the 1956 Act, a proceeding for winding up of a company can be initiated against a company on the grounds mentioned therein, before the High Court under whose jurisdiction the registered office of the company is situated.

As such, the corporate and professional responsibility has to be understood in the context of the 1956 Act and SICA.

RESPONSIBILITY OF DIRECTORS AND OTHER PROFESSIONS

Who are these "Other Professionals"?

Before proceeding to discuss the responsibilities and obligations of professionals and other professionals in the company in liquidation, it is desirable to discuss as to who are the 'other professionals' apart from directors who carry certain obligations and attract liabilities, civil and criminal. Following persons may be considered as "Other Professionals":

"Manger" - A manager of a company i.e. an individual (not being the managing agent) who, subject to the superintendence, control and direction of the Board of directors, has the management of the whole, or substantially the whole, of the affairs of a company and includes a director or any other person occupying the position of a manger, by whatever name called, and whether under a contract of service or not.

"Managing Agent" - Any individual, firm or body corporate entitled, to the management of the whole, or substantially the whole of the affairs of a company by virtue of an agreement with the company, or by virtue of its memorandum or articles of association and includes any individual, firm or body corporate occupying the position of a managing agent, by whatever name called.

"Officer" - Any director, managing agent, secretaries and treasurers, manager or secretary; where the managing agent or the secretaries and treasurers are a firm, also includes any partner in the firm; and where the managing agent or the secretaries and treasurers are a body corporate, also includes any director, managing agent, secretaries and treasurers or manager of the body corporate.

"Secretaries and Treasurers" - Any firm or body corporate (not being the managing agent) which, subject to the superintendence, control and direction of the Board of directors, has the management of the whole or substantially the whole, of the affairs of a company; and includes any firm or body corporate occupying the position of securities and treasurers, by whatever name called, and whether under a contract of service or not. "Secretary" means the person, if any, who is appointed to perform the duty, which may be performed by a secretary.

"Contributory" - Every person liable to contribute to the assets of a company in the event of its being wound up and includes the holder of any shares which are fully paid up; and for the purposes of all proceedings for determining, and all proceedings prior to the final determination of, the persons who are to be deemed contributories, includes any person alleged to be a contributory.

The directors and the other persons have various obligations and duties during the insolvency proceedings.

Obligation to Co-operate

Under the 1956 Act and SICA there is no specific provision, which exclusively makes certain people duty bound to cooperate with investigation into Company's affairs. However, such duty is implicit in various other provisions, which makes it obligatory to co-operate. Under SICA, the BIFR is empowered to seek information. Under 1956 Act, the Liquidator can call for information. The duty is to give such information concerning the company and its promotion, formation, business dealings, affairs or property as may at any time after the effective date reasonably require; and to attend on the BIFR/ Official Liquidator at such times as they may reasonably require. It applies in the case of a company where:

- ☒☒ Proceedings are pending before BIFR under SICA.
- ☒☒ A winding up petition has been presented.
- ☒☒ A Provisional or an Official Liquidator has been appointed; or
- ☒☒ The company goes into liquidation; or
- ☒☒ The court has made a winding-up order.

The duty is imposed on the following persons:

- Those who are or have at any time been officers of the company - this will include a director, manager or secretary of a company;
- Those who have taken part in the formation of the company at any time within one year before the effective date;
- Those who are in the employment of the company, or have been in its employment (including employment under a contract for services - which includes those who have provided professional services to the company, for example, accountants) within that year, and are in the official Liquidators opinion capable of giving information which he requires;
- Those who are, or have within that year been, officers of, or in the employment (including employment under a contract for services) of, another company which is, or within that year was, an officer of the company in question; and

- In the case of a company being wound up by the court, any person who has acted as official Liquidator or provisional Liquidator of the company.

If a person without reasonable excuse fails to comply with any obligation imposed he is liable to a fine or even contempt of court or guilty of offence under Section 33 of SICA.

Obligation to Assist in getting the Company's Property

This obligation is caused in the case of a company where a winding up order has been made; or a Provisional Liquidator or Official Liquidator has been appointed; or the company goes into liquidation. The court has the power to summon persons suspected of having property of the company and the court may require the person(s) to produce any books and papers in his custody relating to the company. Failure to appear before the court may lead to his apprehension and be brought before the court for further examination.

Obligation to provide information

The court may summon to appear before it: any officer of the company; any person known or suspected to have in his possession any property of the company or supposed to be indebted to the company; or any person whom the court thinks capable of giving information concerning the promotion, formation, business, dealings, affairs or property of the company.

Such person may be required (a) to submit an affidavit to the court containing an account of his dealings with the company; or (b) to produce any books and papers in his custody or under his control relating to the company but where he claims any lien on books or papers produced by him, the production shall be without prejudice to that lien and the court shall have jurisdiction in the winding up to determine all questions relating to that lien.

If any officer or person so summoned, after being paid or tendered a reasonable sum for his expenses, fails to appear before the court at the appointed time, not having a lawful impediment, the court may cause him to be apprehended and brought before the court for examination.

Company's Statement of Affairs

Where the court has made a winding-up order or appointed a provisional Liquidator, the official Liquidator or the provisional Liquidator may require certain persons to make out and submit to him a statement of the affairs of the company.

The persons who may be required to provide such a statement are as follows:

- ✍ Those who are or have been officers of the company;
- ✍ Those who have taken part in the formation of the company at any time within one year before the relevant date;

- ✍✍ Those who are in the company's employment, or have been in its employment within that year, and are in the official Liquidators opinion capable of giving the information required; or
- ✍✍ Those who are or have been within that year officers of, or in the employment of, a company, which is, or within that year was, an officer of the company.
- ✍✍ Past or present officers of the company may commit an offence if they make material omissions from the statement of affairs.

Public Examination of Officers

Where a company is being wound up by the court, and the official Liquidator has made a report to the court stating that in his opinion a fraud has been committed by any person (a) in the promotion or formation of the company or (b) by any officer of the company. Since its formation, the court may direct that the person or officer may appear before the Court and be publicly examined.

The court may on proof of probable cause for believing that a contributory is about to quit India or abscond, or avoid examination respecting affairs of the company have the contributory to be arrested and his books and papers and movable property to be seized and safely kept until such time as the court may order.

Common law duties owed to the company

It is one of the duties of directors to see that the corporate capital is used only for the legitimate business of the company. If any part of it has been diverted to purposes foreign to the company's memorandum, the directors will be personally liable to replace it.

Directorships are always susceptible to abuse. The law therefore seeks to reduce the chances of abuse by making them liable for the acts committed.

Liability for breach of trust- the directors are in a fiduciary position, thus to act with honest is asked for and therefore an undeserved gain would make the director personally liable.

Directors' personal profits- Such profits are to accounted for if there is a slight doubt as to the credibility of the profits gained.

Business opportunities- A director should not exploit to his own use the corporate opportunities. When a director is instructed to purchase some property for the company, and he purchases for the same himself and then sells it to the company at a profit, he is clearly liable to account for the profit so made.

Director making personal use of company's opportunities- In certain cases a director may profit by a corporate opportunity without incurring the liability to account for it.

Directorship when ceases to exist- Fiduciary obligation does not cease with resignation, but on the company exercising its right on full information to accept the resignation or to terminate his services if it so wishes.

Competition by directors- Accountability chases a director if he happens to use the company's assets for the benefit of a rival concern, which is inclusive of business connections, goodwill, trade assets and the list of customers.

Trading in corporate control- Directors other than the chairman are in a fiduciary relationship to the company and liable to repay to it the profit they make on the shares.

Statutory provisions relating to sale of controlling shares- There are legal provisions designed to catch any extra payment that may be received by directors in connection with transfer of the undertaking or property or shares of a company. The right to control the management of a company is a valuable asset and it is desirable that if any price is obtained for the sale of this right, the members in accordance with their rights should share the same.

Misuse of corporate information-Using and exploiting unpublished and confidential information belonging to the company is a breach of duty and the company can ask the director in question to make good its loss, if any.

LIABILITIES OF DIRECTORS & OFFICER PERSONS & OFFENCES IN INSOLVENCY

The directors and other persons attract numerous liabilities under the 1956 Act. Following acts of omission and commission constitute an offence in an insolvency proceeding.

Misconduct by Officers of Companies in Liquidation

A past or present officer of a company commits an offence of misconduct if

- ✎ he does not, to the best of his knowledge and belief, fully and truly discover to the Liquidator all the property, movable and immovable, of the company, and how and to whom and for what consideration and when the company disposed of any part thereof, except such part as has been disposed of in the ordinary course of the business of the company;
- ✎ does not deliver up to the Liquidator, or as he directs, all such part of the movable and immovable property of the company as is in his custody or under his control, and which he is required by law to deliver up;
- ✎ does not deliver up to the Liquidator, or as he directs, all such books and papers of the company as are in his custody or under his control and which he is required by law to deliver up;
- ✎ within the twelve months next before the commencement of the winding up or at any time thereafter, conceals any part of the property of the company to the value of one hundred rupees or upwards, or conceals any debt due to or from the company;

- ✎✎ within the twelve months next before the commencement of the winding up or at any time thereafter, fraudulently removes any part of the property of the company to the value of one hundred rupees or upwards;
- ✎✎ makes any material omission in any statement relating to the affairs of the company;
- ✎✎ knowing or believing that a false debt has been proved by any person under the winding up, fails for a period of one month to inform the Liquidator thereof; after the commencement of the winding up, prevents the production of any book or paper affecting or relating to the property or affairs of the company;
- ✎✎ within the twelve months next before the commencement of the winding up or at any time thereafter, conceals, destroys, mutilates or falsifies, or is privy to the concealment, destruction, mutilation or falsification of, any book or paper affecting or relating to, the property or affairs of the company;
- ✎✎ within the twelve months next before the commencement of the winding up or at any time thereafter makes, or is privy to the making of, any false entry in any book or paper " affecting or relating to the property or affairs of the company;
- ✎✎ within the twelve months next before commencement of the winding up or at any time thereafter, fraudulently parts with, alters or makes any omission in, or is privy to the fraudulent parting with, altering or making of any omission in, any book or paper affecting or relating to the property or affairs of the company;
- ✎✎ after the commencement of the winding up or at any meeting of the creditors of the company within the twelve months next before the commencement of the winding up, attempts to account for any part of the property of the company by fictitious losses or expenses;
- ✎✎ within twelve months next before the commencement of the winding up or at any time thereafter, by any false representation or other fraud, obtains on credit, for or on behalf of the company, any property which the company does not subsequently pay for;
- ✎✎ within the twelve months next before the commencement of the winding up or at any time thereafter, under the false pretence that the company is carrying on its business, obtains on credit, for or on behalf of the company, any property which the company does not subsequently pay for;
- ✎✎ within the twelve months next before the commencement of the winding up or at any time thereafter, pawns, pledges or disposes of any property of the company which has been obtained on credit and has not been paid for, unless such pawning, pledging or disposing is in the ordinary course of the business of the company; or
- ✎✎ is guilty of any false representation or other fraud for the purpose of obtaining the consent of the creditors of the company or any of them, to an agreement with reference to the affairs of the company or to the winding up;

The liability is criminal. A person guilty of this offence is liable to imprisonment or a fine or both. The gravity of the misconduct is demonstrable from the term of imprisonment or the extent of the fine that is imposed. In exercising its punitive jurisdiction, the court(s) do not seek to compensate the company concerned. The officer shall be punishable, in the case of some of the offences with imprisonment for a term which may extend to five years, or with fine, or with both, and, in the case of any other offence, with imprisonment for a term which may extend to two years, or with fine, or with both. It shall however, be a good defence if the accused proves that he had no intent to defraud and if he proves that he had no intent to conceal the true state of affairs of the company or to defeat the law.

Defrauding of Creditors

Defrauding of creditors by directors and other persons constitutes an offence if they, by false pretences or by means of any other fraud, induced any person to give credit to the company; or with intent to defraud creditors of the company, have made or caused to be made any gift or transfer of or charge on, or have caused or connived at the levying of any execution against, the property of the company; or with intent to defraud creditors of the company, have concealed or removed any part of the property of the company since the date of any unsatisfied judgement or order for payment of money obtained against the company, or within two months before that date.

The guilty liable to be punished with imprisonment for a term which may extend to two years and shall also be liable to fine. There is no hard and fast rule as to maximum gap between the impugned transaction and the order of winding up by the Court or passage of a resolution for voluntary winding up. It all depends on the evidence to be adduced so as to prove that when the transaction took place, it was within the knowledge of the officer that the company was bound or likely to go in for liquidation. Absence of intention to defraud is a defence.

Maintenance of Improper Accounts & Liability for Falsification

The directors and professions are required to maintain proper accounts. If, in the course of winding up of a company, if it is shown that proper books of account were not kept by the company, every officer of the company who is in default shall guilty of the offence under this provision. It shall be deemed that proper books of account have not been kept in the case of any company, if there have not been kept such books or accounts as are necessary to exhibit and explain the transactions and financial position of the business of the company, including books containing entries made from day to day in sufficient detail of all cash received and all cash paid. The offence must have been committed throughout the period of two years immediately preceding the commencement of the winding up, or the period between the incorporation of the company and the commencement of the winding up, whichever is shorter.

The liability under this provision is criminal and the guilty liable to be punished with imprisonment for a term, which may extend to one year.

If any officer or contributory of a company, which is being wound up, with intent to defraud or deceive any person destroys, mutilates, alters, falsifies or secretes, or is privy to the destruction, mutilation, alteration, falsification or secreting of, any books, papers or securities; or makes, or is privy to the making of, any false or fraudulent entry in any register, book of account or document belonging to the company, he shall be punishable with imprisonment for a term, which may extend to seven years and shall also be liable to fine.

Fraudulent Conduct of Company's Business

This is a very significant provision under the 1956 Act. If in the course of the winding up of a company, it is found that any business of the company has been carried on, with intent to defraud creditors of the company or any other persons, or for any fraudulent purpose, the persons engaged in the conduct of business shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company.

The court enjoys a wide discretion to compensate for the loss caused to the company by the director's conduct but it may also include a punitive element in the award of damages made. There is no specified period.

In practice, the party may be able to admit to incompetence, imprudence or even folly as long as he honestly believed that, for example, any new credit incurred would ultimately be repaid in full.

It is worth noting that it was rare and remains rare for persons to be found liable for fraudulent trading. Historically, this resulted from the difficulty of proving dishonesty and, now, wrongful trading will in most sets of facts be easier to prove.

Delinquency, Breach of Trust & Misfeasance

Any person who has taken part in the promotion or formation of the company, or any past or present director, manager, Liquidator or officer of the company shall be guilty of delinquency, if he has misapplied, or retained, or become liable or accountable for, any money or property of the company; or has been guilty of any misfeasance or breach of trust in relation to the company;

The liability under this provision is civil. A person guilty of this offence can be compelled by the Court to repay or restore the money or property or any part thereof respectively, with interest at such rate as the Court thinks just, or to contribute such sum to the assets of the company by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust, as the Court thinks just.

The court has wide discretion with respect to the orders it may make under this provision. It is able to apportion the order made against individual directors in proportion to their involvement and culpability.

The proceeding can be instituted under this provision within five years from the date of the order for winding up, or of the first appointment of the Liquidator in the winding up, or

of the misapplication, retainer, misfeasance or breach of trust, as the case may be, whichever is longer.

Misfeasance Proceedings

If in the course of scrutiny or implementation of any revival/rehabilitation scheme or proposal, it appears to BIFR that any person who has taken part in the promotion, formation or management of the sick industrial company or its undertaking, including any past or present director, manager or officer or employee of the sick industrial company has misapplied or retained, or become liable or accountable for, any money or property of the sick industrial company; or has been guilty of any misfeasance, malfeasance or non-feasance or breach of trust in relation to the sick industrial company,

The guilty person can be directed to repay or restore the money or property or any part thereof, with or without interest, as it thinks just, or to contribute such sum to the assets of the sick industrial company or the other person, entitled thereto by way of compensation in respect of the misapplication, retainer, misfeasance or breach of trust, as the BIFR thinks just and also report the matter to the Central Government for any other action which that Government may deem fit. Further, If the BIFR is satisfied on the basis of the information and evidence in its possession with respect to any person who is or was a director or an officer or other employee of the sick industrial company, that such person by himself or along with others had diverted the funds or other property of such company for any purpose other than a bona fide purpose of the company or had managed the affairs of the company in a manner highly detrimental to the interests of the company, the BIFR shall, by order, direct the public financial institutions, scheduled banks and State level institutions not to provide, during a period of ten years from the date of the order, any financial assistance to such person or any firm of which such person is a partner or any company or other body corporate of which such person is a director (by whatever name called).

Directors and Managers with unlimited liability

In the winding up of a limited company, any director, or manager, whether past or present, whose liability is, under the provisions of the 1956 Act, unlimited, shall, in addition to his liability, if any, to contribute as an ordinary member, be liable to make a further contribution as if he were, at the commencement of the winding up, a member of an unlimited company.

A past director or manager shall not be liable to make such further contribution, if he has ceased to hold office for a year or upwards before the commencement of the winding up; and if debt or liability of the company was contracted after he ceased to hold office; and subject to the articles of the company, a director, or manager shall not be liable to make such further contribution, unless the Court deems it necessary to require the contribution in order to satisfy the debts and liabilities of the company, and the costs, charges and expenses of the winding up. Hence, even other persons are liable in addition to the directors.

Liability as Contributories of present and past Members

In the event of a company being wound up, every present and past member is liable to contribute to the assets of the company to an amount sufficient for payment of its debts and liabilities and the costs, charges and expenses of the winding up, and for the adjustment of the rights of the contributories among themselves. A past member shall however, not be liable to contribute -

- ✍✍if he has ceased to be a member for one year or upwards before the commencement of the winding up.
- ✍✍If any debt or liability of the company is contracted after he ceased to be a member.
- ✍✍No past member shall be liable to contribute unless it appears to the Court that the present members are unable to satisfy the contributions required to be made by them.
- ✍✍In the case of a company limited by shares, no contribution shall be required from any past or present member exceeding the amount, if any, unpaid on the shares in respect of which he is liable as such member.
- ✍✍In the case of a company limited by guarantee, no contribution shall be required from any past or present member exceeding the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up. In the winding up of a company limited by guarantee which has a share capital, every member of the company shall be liable, in addition to the amount undertaken to be contributed by him to the assets of the company in the event of its being wound up, to contribute to the extent of any sums unpaid on any shares held by him as if the company were a company limited by shares.

CONTRACTS AND TRANSACTIONS

Fraudulent Preference

Any transfer of property, movable or immovable, delivery of goods, payment, execution or other act relating to property made, taken or done by or against a company within six months before the commencement of its winding up which, had it been made, taken or done by or against an individual within three months before the presentation on any insolvency petition on which he is adjudged insolvent, would be deemed in his insolvency a fraudulent preference, shall in the event of the company being wound up, be deemed fraudulent preference of its creditors and be invalid accordingly.

For the purpose of above provision, the presentation of a petition for winding up in the case of a winding up by or subject to the supervision of the Court, and the passing of a resolution for winding up in the case of a voluntary winding up, shall be deemed to correspond to the act insolvency in the case of an individual.

Where, in the case of a company which is being wound up, anything made, taken or done is invalid as a fraudulent preference of a person interested in property mortgaged or charged to secure the company's debt, the person preferred is subjected to the same liabilities, and have the same rights, as if he had undertaken to be personally liable as surety for the debt, to the extent of the mortgage or charge on the property or the value

of his interest, whichever is less. The value of the said person's interest is determined as the date of the transaction constituting the fraudulent preference, and is determined as if the interest were free of all encumbrances other than those to which the mortgage or charge for the company's debt was then subject.

On any application made to the Court with respect to any payment on the ground that the payment was a fraudulent preference of a surety or guarantor, the courts have jurisdiction to determine any questions with respect to the payment arising between the person to whom the payment was made and the surety or guarantor and to grant relief in respect thereof, notwithstanding that it is not necessary so to do for the purpose of the winding up, and for that purpose may give leave to bring in the surety or guarantor as a third party as in the case of a suit for the recovery of the sum paid.

This provision applies, with the necessary modifications, in relation to transactions other than the payment of money as it applies in relation to payments of money.

Avoidance of voluntary transfer

Any transfer of property, movable or immovable, or any delivery of goods, made by a company, not being a transfer or delivery made in the ordinary course of its business or in favour of a purchaser or encumbrance in good faith and for valuable consideration, if made within a period of one year before the presentation of a petition for winding up by or subject to the supervision of the Court or the passing of a resolution for voluntary winding up of the company, shall be void against the Liquidator.

Transfer for benefit of all creditors to be void.

Any transfer or assignment by a company of all its property to trustee for the benefit of all its creditors is void.

Effect of floating charge.

Where a company is being wound up, a floating charge on the undertaking or property of the company created within the twelve months immediately preceding the commencement of the winding up, is unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, except to the; amount of any cash paid to the company at the time of, or subsequently to the creation of, and in consideration for, the charge, together with interest on that amount at the rate of five per cent per annum or such other rates may for the time being be fortified by the Central Government in the Official Gazette.

Avoidance of transfers, etc., after commencement of voluntary winding up.

In the case of a voluntary winding up, any transfer of shares in the company, not being a transfer made to or with the sanction of the Liquidator, and any alteration in the status of the members of the company, made after the commencement of the winding up, shall, unless the Court otherwise orders, be void.

Transactions at an undervalue

An undervalued transaction is not defined anywhere. In ordinary parlance, it could be stated to be one that is entered into at a time when the company is insolvent at an apparently lesser price than it could have attracted otherwise. There is no direct provision dealing with this aspect though it could be stated to fall under Fraudulent Preference. There are no conditions for setting aside a transaction at undervalue in the 1956 Act. Of course, the sale should have been made during the period immediately preceding one year. The court may not set aside an undervalued transaction if it is satisfied that the company which entered into the transaction did so in good faith and for the purpose of carrying out its business; and that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company and that all possible efforts were made to get the best possible price. The court may not make an order which would prejudice certain purchasers in good faith and for value.

Preferences

A preference transaction is also not defined. It is an act of putting a creditor in a better position than he would have been if the company had instead just gone into liquidation. If it is questioned, the court has a range of options to restore the position. The court can only make an order for restoration of the status quo by way of relief under this provision if the following conditions are satisfied:

There are very few reported examples of such transactions. However, it can be reasonably stated that the court shall not make an order under this provision in respect of a preference given to any person unless the company which gave the preference was influenced in deciding to give it by a desire to have the effect of giving a preference to that person as is the case under English law. This is a question of fact and requires to be established by leading evidence.

Transactions defrauding creditors

If an asset charged to a creditor or from which a creditor could later recover its dues is sold with intent to put the assets beyond the reach of a person who is making or may at some time make a claim against the company or of otherwise prejudicing the interests of such person in relation to the claim he is making or may make, the court can restore and protect the interests of the persons who are affected by the transaction.

Extortionate credit transactions

The court can set aside or vary a transaction for, or involving, the provision of credit to the company. It is a matter of fact and evidence.

Avoidance of floating charges for past value

Where a company is being wound up, a floating charge on the undertaking or property of the company created within the twelve months immediately preceding the commencement of the winding up, shall, unless it is proved that the company

immediately after the creation of the charge was solvent, be invalid, except to the amount of any cash paid to the company at the time of, or subsequently to the creation of, and in consideration for the charge together with interest on that amount at the rate of five percent per annum or such other rate as may for the time being be notified by the central Government in this behalf in the official Gazette. Provided that in relation to a charge created more than three months before the commencement of this Act, this section shall have effect with the substitution for references to twelve months of references to three months.

In the application of the provisions mentioned above, Section 530 shall be construed as if the provision for payment of accrued holiday remuneration becoming payable on the termination of employment before or by the effect of the winding up order or resolution were a provision for payment of such remuneration becoming payable on the termination of employment before or by the effect of the appointment of the receiver or possession being taken as aforesaid.

The periods of time mentioned in the said provisions shall be taken from the date of appointment of the receiver or of possession being taken as aforesaid, as the case maybe.

THIRD PARTY RIGHTS

As is the situation in most of the legal systems all over the world, in India too, the period preceding the commencement of insolvency proceedings is vulnerable. Under Indian Law, every transaction preceding one year of the presentation of insolvency proceedings is questionable as per the provisions of the Companies Act, 1956.

Under SICA, the creditors can question transactions of the company while its accounts and financial affairs are being scrutinised for determining whether it has become insolvent. While the High Court has the power to set aside such transactions after following the principles of natural justice, BIFR can only make observations and consider reverse entries by taking into account the loss that may have occurred due to under value sale or under invoicing etc. The creditors and shareholders can always challenge a transaction of the company or an act of breach of duty by a Director.

There are no means whereby a potential buyer wishing to buy assets from a Company facing insolvency would know that a Liquidator would not try and seek to get the transaction aside. While scrutinising the accounts, if the Liquidator feels that a particular transaction was glaringly undervalued and thus, questionable, it could become subject matter of setting aside proceedings. Obviously, once it is definitely concluded that the sale was not bonafide and that it highly undervalued to compromise with company's interest, it would be set aside. The property would be put to resale. But the buyer or person in possession having bought from original buyer from the company would be given the first preference if he were able to meet the market value.

It is advisable to obtain proper professional advice before entering into any transaction. The solution could be obtaining an Indemnity Bond indemnifying against future loss owing to setting aside of sale for above reasons.

Sometimes a creditor also uses its position to coerce the company to enter into a transaction with it to sell a property at a much lower price than the market value thereof. In such cases, the other creditors find themselves in a dilemma particularly if the creditor, which has entered into a transaction, has very high stakes and has charge over the assets of the company and has first preference in terms of repayment of debt. Thus, the third parties are always at risk. Even those assets, which are sold as court sale, become subject matter of litigation for years together.

WHO CAN BRING AN ACTION?

When a company goes into liquidation, the authority and powers of the directors are taken over by the Official Liquidator or the Provisional Liquidator. They review actions taken by the directors and other personnel during the twilight period and if there has been any loss to the company, they try to initiate proceedings for the benefit of creditors. The Official Liquidator in essence is empowered to bring actions against the directors and others where there has been a breach of either legal or fiduciary duties owed to the company subject to the authority of the Court without the sanction of which these proceedings would have no effect.

Criminal Proceedings

The following acts are criminal offences which the Official Liquidator is duty bound to bring to the Court's notice

- ✂✂ Fraudulent removal or concealment of property to prevent distribution among creditors
- ✂✂ Falsification of accounts- these are punishable under the Indian Penal Code and hence for implicating the offenders, the offences have to be brought to notice of the Court in order to take appropriate legal action.
- ✂✂ Falsification of company's books
- ✂✂ Fraud by officers
- ✂✂ Offences by officers
- ✂✂ Fraudulent conduct of business
- ✂✂ Wrongful withholding of property
- ✂✂ False representations to creditors
- ✂✂ Disqualification of a director

Civil Proceedings

In civil proceedings, the official Liquidator has the power to initiate action against Directors and other personnel. When certain actions cause loss to the company and its creditors, a provision thereby providing access of a range of people to bring action to recover funds for the benefit of the company's creditors. The overall recovery so made is distributed evenly amongst the creditors in accordance to the rules relating to priority. The table below sets out those people who may bring an action against the directors and others in connection with certain transactions, which the company has entered into.

Activity/transaction	Person able to bring proceedings
Misfeasance	Liquidator, a creditor or a contributory
Fraudulent trading	Liquidator only
Transaction at undervalue	Liquidator/Creditors
Performance	Liquidator
Extortionate transactions	credit Liquidator
Transactions defrauding creditors	Liquidator/Creditor

FOREIGN CORPORATIONS

The position outlined above do not as such or en-block applies to the foreign companies but these apply with certain riders. These riders are part of those provisions, which are discussed, below, which apply to the foreign companies. The foreign companies can be treated as 'unregistered companies' in India. However, needless to mention that a wholly owned subsidiary in India of a foreign company is not a foreign company but a domestic company to which all the provisions discussed in the preceding chapters shall apply.

Before any discussion it is essential to know as to which foreign companies could be exposed to the provisions stated hereunder. These are those companies incorporated outside India, which establish a place of business within India.

Unregistered Company includes a Foreign Company

Unregistered company shall include any company including any partnership, association or company consisting of more than seven members except a railway company incorporated by any Act of Parliament or other India law or any Act of Parliament of the United Kingdom; a company incorporated in India; or 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 the country from India or in the State of Jammu and Kashmir immediately before the 26th January, 1950;

Winding up of Unregistered Companies

Any unregistered company may be wound up and all the provisions as discussed in the preceding chapter with respect to winding up shall apply to an unregistered company.

For the purpose of determining the Court having jurisdiction in the matter of the winding up, an unregistered company shall be deemed to be registered in that State of India where its principal place of business is situate or, if it has a principal place of business situate in more than one State, then, in each State where it has a principal place of business; and the principal place of business situate in that State in which proceedings are being instituted shall for all the purposes of the winding up, be deemed to be the registered office of the company.

No unregistered company shall be wound up voluntarily or subject to the supervision of the Court.

Where a body corporate incorporated outside India which has been carrying on business in India, ceases to carry on business in India, it may be wound up as an unregistered company 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.

Criteria of Winding Up

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; If the company is unable to pay its debts; and/or if the Court is of opinion that it is just and equitable that the company should be wound up.

Contributories in Winding up of Unregistered Company

In case of winding up as aforesaid, every person shall be deemed to be a contributory, who is liable to pay, or contribute to the payment of any debt or liability of the company; or any sum for the adjustment of the rights of the members among themselves; or the costs, charges and expenses of winding up the company.

Every contributory shall be liable to contribute to the assets of the company all sums due from him in respect of any liability to pay or contribute as aforesaid.

In the event of the death or insolvency of any contributor, the provisions hereof with respect to the legal representatives of deceased contributors, or with respect to the assignees of insolvent contributories, as the case may be, shall apply.

Court's Power

Where an order has been made for winding up an unregistered company, no suit or other legal proceeding shall be proceeded with or commenced against any contributory of the company in respect of any debt of the co, except by leave of the Court and except on such terms as the Court may impose.

If an unregistered company has no power to sue and be sued in a common name, or if for any reason it appears expedient, the Court may, by the winding up order or by any subsequent order, direct that all or any part of the property, movable or immovable

(including actionable claims), belonging to the company or held by trustee on its behalf, shall vest in the Official Liquidator by his official name; and thereupon the property or the part thereof specified in the order shall vest accordingly. The Official Liquidator may, after giving such indemnity, if any, as the Court may direct, bring or defend in his official name any suit or legal proceeding relating to that property, or which it is necessary to bring or defend for the purposes of effectually winding up the company and recovering its property.

INCURRING FURTHER CREDIT

In India, when a rehabilitation scheme for revival of an insolvent company is under consideration, it may contemplate fresh financial assistance and/or additional financial burden by way of interest on deferred/re-scheduled payments. The earlier credits also continue but with the difference that now they are part of the rehabilitation scheme.

Under the provisions of SICA, every scheme for rehabilitation is monitored by an agency appointed by the BIFR. The responsibility of Directors is much higher during this period in respect of further credit as there is direct supervision of BIFR and the liabilities are much more serious. Although there are very few instances where the Directors have been penalised by directing them to restore the property or money or make good the loss, but there have been cases where observations have been made against the Directors by BIFR which have had the consequences of informal blacklisting of these Directors and the companies in which they are Directors, from further financial assistance in future.

The Court is empowered to injunct the Directors from dealing with and/or disposing of the assets during the insolvency proceedings except in the ordinary course of business. Normally Courts issue such directions at instance of creditors. However, during the period when a rehabilitation scheme is under implementation, such a direction may not be given. In such cases, Directors, ought to watch the interests of the creditors of their company as but for their consent, rehabilitation scheme would not have been approved and further because, serious Misfeasance, mal-feasance and non-feasance proceedings are attracted.

While the relevant legislations in India are drafted in such a manner that they strike a balance between the two, the company's rehabilitation and recovery of creditors money and safeguarding of its interest but in practice, the experience has been that the creditor has largely been put to disadvantage. Directors not only render the company insolvent by mismanagement and misfeasance, they escape the consequences by seeking protection under SICA and further get away without paying dues of creditors for number of years and continue to enjoy possession and use of the assets.

THE PERIOD THROUGH WHICH THE RESPONSIBILITY RUNS

Under SICA, there is an obligation caused on the Board of Directors to intimate to BIFR, when fifty percent of its net worth is eroded at the end of a financial year. If this provision is not complied with, all the Directors and other officers are liable to be punished with imprisonment not to be less than six months and which may extend upto two years and with fine.

Once intimation of erosion of fifty percent of net worth is made, the BIFR has the authority to call for periodic information from such company and thus the actions of Directors get to be monitored. If such erosion of fifty percent has occurred repeatedly, on every such erosion, intimation has to be made to BIFR. Thus, Directors and other officers continue to be under some kind of supervision of BIFR as long as the erosion does not get reduced to less than fifty percent. The BIFR holds an inquiry and if it forms an opinion that it is not possible for the company to regain its net worth and that it is just and equitable that the company be wound up, recommendations are made to the concerned High Court.

On a reference made by a company on erosion of its complete net worth, a detailed inquiry is held by BIFR into the financial affairs of the company to find out if the said company is genuinely sick or that it has manipulated its accounts to render itself sick to avail the protections under SICA. The secured creditors of the company are also heard.

The investigation by BIFR is not limited to the immediately preceding financial year at the end of which the erosion has occurred. A comprehensive inquiry can be held into the financial affairs of the company. Special Investigative Audit is also directed if the accounts are large and doubts too many. If at the end of such inquiry, it is found that the company has diverted monies, manipulated its accounts, sold assets at under valued prices or interest of company compromised by Directors and/or any of its officers, BIFR can direct that such a company is not sick and can not avail benefits of SICA and such Directors/Officers should not be granted financial assistance by Banks in future. The BIFR can inform the Central Government if any offence under the 1956 Act or any other Act is suspected to have been committed, for taking suitable action, if necessary.

If BIFR finds that the company has attempted to deal with the assets of the company in a manner detrimental or prejudicial to its interest, it can initiate action against its Directors and/or responsible officials.

The liability of Directors and other officers is also much more stringent if a scheme for rehabilitation is approved and sanctioned. If during the course of the implementation of a scheme, it is found that any Director or an officer has misapplied, or retained, or become liable or accountable for any property of the company or has been guilty of misfeasance, malfeasance or nonfeasance or breach of trust, BIFR can direct repayment or restoration of money or property as the case may be or to contribute such sum as may be ordered by way of compensation. This supervision by BIFR continues till such time the company is declared to have regained its net worth and is out of purview of SICA.

The jurisdiction of BIFR ceases if the company is revived or when BIFR formulates the opinion for winding up of the company and forwards it to the High Court.

In case of winding up of a company in proceedings initiated under the 1956 Act (excluding those which are taken up on recommendations of BIFR under SICA) including those for voluntary winding, the period through which the corporate and professional liability and responsibility runs starts much ahead of the passing of the order of winding up and runs till the company is removed from the register of companies.