

India

Insolvency

Are there any insolvency laws applicable to companies or businesses established in India?

Sole proprietorship

The owner of a sole proprietorship is not a separate legal entity from the business of the sole proprietorship. So the laws governing bankrupt individuals also govern insolvent sole proprietorships. Individuals may file a petition for their own bankruptcy or a court may declare them bankrupt if they are unable to pay their debts.

Insolvency proceedings against individuals are governed by the Presidency Towns Insolvency Act, 1909 in case of insolvency proceedings before the High Courts of Mumbai, Calcutta and Chennai and the Provincial Insolvency Act, 1920 in other cases. These Acts apply in respect of both a sole proprietorship and partnership.

Partnership

Each of the partners is jointly and severally liable for the debts of the partnership. The concept of a limited partnership is not recognised under Indian law. On dissolution of a partnership, the assets of the partnership have to be first applied towards the repayment of debts of the partnership to third parties. If the assets are not sufficient to repay the debts, the creditors may take proceedings against the partners. A partnership will also be dissolved if all but one of the partners become insolvent.

Company

The Companies Act sets out the circumstances under which the court can order a company to be wound up. A company will be wound up if it is unable to pay its debts, or if it has less than 2 shareholders or if the court believes that it is just and equitable to do so. On a winding-up order being issued, the court will appoint an official liquidator to manage the affairs of the company. In winding-up proceedings, financial institutions and other creditors of the company have preferential rights to recover the debts due to them on a sale of the assets of the company. Secured creditors will be repaid by the sale of assets taken as security for the loan granted. The claims of the employees of the company are equal to those of secured creditors. However, control of the winding-up proceedings vests solely in the liquidator with the supervision of the court.

ACTYEAR_NO: 190903

Section Text:

25. Protection order.- (1) Any insolvent who shall have submitted his schedule as aforesaid may apply to the Court for protection, and the Court may, on such application, make an order for the protection of the insolvent from arrest or detention.

(2) A protection order may apply either to all the debts mentioned in the schedule or to any of them as the Court may think proper, and

1. The words "in the Gazette of India and" rep. by the A. O. 1937.

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may commence and take effect at and for such time as the Court may direct, and may be revoked or renewed as the Court may think fit.

(3) A protection order shall protect the insolvent from being arrested or detained in prison for any debt to which such order shall apply, and any insolvent arrested or detained contrary to the terms of such order shall be entitled to his release:

Provided that no such order shall operate to prejudice the right of any creditor in the event of such order being revoked or the adjudication annulled.

(4) Any creditor shall be entitled to appear and oppose the grant of a protection order, but the insolvent shall be prima facie entitled to such order on production of a certificate signed by the official assignee that he has so far conformed to the provisions of this Act.

(5) The Court may make a protection order before an insolvent has submitted his schedule if it thinks it necessary to do so in the interests of the creditors.

ACTYEAR_NO: 190903

Section Text:

12. Conditions on which creditor may petition.--(1) A creditor shall not be entitled to present an insolvency petition against a debtor unless--

- (a) the debt owing by the debtor to the creditor, or, if two or more creditors join in the petition, the aggregate amount of debts owing to such creditors, amounts to five hundred rupees, and
- (b) the debt is a liquidated sum payable either immediately or at some certain future time, and
- (c) the act of insolvency on which the petition is grounded has occurred within three months before the presentation of the petition:

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1*[Provided that where the said period of three months referred to in clause (c) expires on a day when the Court is closed, the insolvency petition may be presented on the day on which the Court reopens].

(2) If the petitioning creditor is a secured creditor, he shall in his petition either state that he is willing to relinquish his security for the benefit of the creditors in the event of the debtor being adjudged insolvent or give an estimate of the value of the security. In the latter case he may be admitted as a petitioning creditor to the extent of the balance of the debt due to him after deducting the value so estimated in the same way as if he were an unsecured creditor.

ACTYEAR_NO: 190903

Section Text:

14. Conditions on which debtor may petition.--1*[(1)] A debtor shall not be entitled to present an insolvency petition unless--

- (a) his debts amount to five hundred rupees, or
- (b) he has been arrested and imprisoned in execution of the

decree of any Court for the payment of money, or

- (c) an order of attachment in execution of such a decree has been made and is subsisting against his property.

2*[(2) A debtor in respect of whom an order of adjudication, whether made under this Act or under the Provincial Insolvency Act, 1920 (5 of 1920), has been annulled owing to his failure to apply or to prosecute an application for his discharge shall not be entitled to present an insolvency petition without the leave of the Court by which the order of adjudication was annulled. Such Court shall not grant leave unless it is satisfied either that the debtor was prevented by any reasonable cause from presenting or prosecuting his application, as the case may be, or that petition is founded on facts substantially different from those contained in the petition on which the order of adjudication was made.]

ACTYEAR_NO: 190903

Section Text:

9. Acts of insolvency.-1*[(1)] A debtor commits an act of insolvency in each of the following cases, namely;--

- (a) if, in the States or elsewhere, he makes a transfer of all or substantially all his property to a third person for the benefit of his creditors generally;
- (b) if, in the States or elsewhere, he makes a transfer of his property or of any part thereof with intent to defeat or delay his creditors;
- (c) if, in the States or elsewhere, he makes any transfer of his property or of any part thereof, which would, under this or any other enactment for the time being in force, be void as a fraudulent preference if he were adjudged an insolvent;
- (d) if, with intent to defeat or delay his creditors,--
 - (i) he departs or remains out of the States,
 - (ii) he departs from his dwelling-house or usual place of business or otherwise absents himself,
 - (iii) he secludes himself so as to deprive his creditors of the means of communicating with him;
- (e) if any of his property has been sold or attached for a period of not less than twenty-one days in execution of the decree of any Court for the payment of money;
- (f) if he petitions to be adjudged an insolvent;
- (g) if he gives notice to any of his creditors that he has suspended, or that he is about to suspend, payment of his debts;

(h) if he is imprisoned in execution of the decree of any Court for the payment of money. 2*

3*[(2) Without prejudice to the provisions of sub-section (1), a debtor commits an act of insolvency if a creditor, who has obtained a decree or order against him for the payment of money (being a decree or order which has become final and the execution whereof has not been stayed), has served on him a notice (hereafter in this section referred to as the insolvency notice)

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1. S. 9 re-numbered as sub-section (1) thereof by Act 28 of 1978, s. 2 (w.e.f. 1-9-1979).
 2. For cl. (i) and the proviso, applicable to Bombay only, see the Presidency-towns Insolvency and the Provincial Insolvency (Bombay Amendment) Act, 1939 (Bom. 15 of 1939), s. 2.
 3. Ins. by Act 28 of 1978, s. 2 (w.e.f. 1-9-1979).
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as provided in sub-section (3) and the debtor does not comply with that notice within the period specified therein:

Provided that where a debtor makes an application under sub-section (5) for setting aside an insolvency notice--

- (a) in a case where such application is allowed by the Court, he shall not be deemed to have committed an act of insolvency under this sub-section; and
- (b) in a case where such application is rejected by the Court, he shall be deemed to have committed an act of insolvency under this sub-section on the date of rejection of the application or the expiry of the period specified in the insolvency notice for its compliance, whichever is later:

Provided further that no insolvency notice shall be served on a debtor residing, whether permanently or temporarily, outside India, unless the creditor obtains the leave of the Court therefor.

(3) An insolvency notice under sub-section (2) shall--

- (a) be in the prescribed form;
- (b) be served in the prescribed manner;
- (c) specify the amount due under the decree or order and require the debtor to pay the same or to furnish security for the payment of such amount to the satisfaction of the creditor or his agent;
- (d) specify for its compliance a period of not less than one month after its service on the debtor or, if it is to be served on a debtor residing, whether permanently or temporarily, outside India, such period (being not less than one month) as may be specified by the order of the Court granting leave for the service of such notice;
- (e) state the consequences of non-compliance with the

notice.

(4) No insolvency notice shall be deemed to be invalid by reason only that the sum specified therein as the amount due under the decree or order exceeds the amount actually due, unless the debtor, within the period specified in the insolvency notice for its compliance, gives notice to the creditor that the sum specified in the insolvency notice does not correctly represent the amount due under the decree or order:

Provided that if the debtor does not give any such notice as aforesaid, he shall be deemed to have complied with the insolvency notice if, within the period specified therein for its compliance, he takes such steps as would have constituted a compliance with the insolvency notice had the actual amount due been correctly specified therein.

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(5) Any person served with an insolvency notice may, within the period specified therein for its compliance, apply to the Court to set aside the insolvency notice on any of the following grounds, namely:--

(a) that he has a counter-claim or set off against the creditor which is equal to or is in excess of the amount due under the decree or order and which he could not, under any law for the time being in force, prefer in the suit or proceeding in which the decree or order was passed;

(b) that he is entitled to have the decree or order set aside under any law providing for the relief of indebtedness and that--

(i) he has made an application before the competent authority under such law for the setting aside of the decree or order; or

(ii) the time allowed for the making of such application has not expired;

(c) that the decree or order is not executable under the provisions of any law referred to in clause (b) on the date of the application.]

Explanation.--For the purposes of this section, the act of an agent may be the act of the principal, even though the agent have no specific authority to commit the act. 1*

1. For s. 9A, applicable to Bombay only, see the Presidency-towns Insolvency and the Provincial Insolvency (Bombay Amendment) Act, 1939 (Bom. 15 of 1939), s. 2.

Section Text:

24. Insolvent's schedule.--(1) Where an order of adjudication is made against a debtor, he shall prepare and submit to the Court a schedule verified by affidavit, in such form and containing such particulars of and in relation to his affairs as may be prescribed.

(2) The schedule shall be so submitted within the following

times, namely:--

- (a) if the order is made on the petition of the debtor, within thirty days from the date of the order,
- (b) if the order is made on the petition of a creditor, within thirty days from the date of service of the order.

(3) If the insolvent fails, without reasonable excuse, to comply with the requirements of this section, the Court may, on the application of the official assignee or of any creditor, make an order for his committal to the civil prison.

(4) If the insolvent fails to prepare and submit any such schedule as aforesaid, the official assignee may, at the expense of the estate, cause such a schedule to be prepared in manner prescribed.

A NEW INSOLVENCY LAW IN OFFING

New Delhi ~ June 21 2001

The Government has decided to introduce a Bill further to amend the Companies Act 1956 to provide for a new Insolvency Law intended to expedite winding up of sick companies. The Bill which is before the Cabinet will be based on the recommendations of Justice V. Balakrishna Eradi Committee Report. It will also take into consideration the views of the Group of Ministers (GOMs). The proposed Insolvency Law will provide for a time bound expeditious and efficient winding up procedure for sick companies in tune with modern global standards under the WTO regimen so that workers promoters and other investors do not have to suffer for a longer period. The existing procedure delays the liquidation of companies. Some of the important reasons for delay are elaborate procedural requirements non-cooperation by ex-directors of the companies, non-filing of statement of affairs by ex-directors to enable Official Liquidators to proceed further and non-service of the notices of complaints filed by the Official Liquidators in courts for filing statement of affairs by ex-directors non-service of notices on debtors even after getting ex-parte decree difficulties facing in tracing the debtors and execution of decree by attachment. Besides considerable time is taken in realisation of dues and settlement of claims including claims of tax authorities workmen and others.

The high level committee on law relating to insolvency and winding up of companies has recommended setting up of a national company law tribunal with power and jurisdiction presently exercised by Company Law Board (CLB)/BIFR/AAIFR/High Courts repeal of the Sick Industrial Companies (Special Provisions) Act 1985 (SICA) enunciation of principles under Orderly and Effective Procedures proposed by International Monetary Fund (IMF) application of UNCITRAL Model Law as adopted by the United Nations to cases of cross border insolvency encouraging voluntary winding up of companies companies with a minimum capital of rupees ten lakh only to be eligible for submitting winding up petitions basis of voluntary winding up and for revival of companies to the national company law tribunal with a debt default to creditors exceeding rupees one lakh and erosion of 50 per cent of net worth pari-pasu ranking of claims of employees and secured creditors of company strengthening and modernization of offices of the Official Liquidators creation of a fund for revival rehabilitation of companies, preservation and protection of the assets of companies under the control of Central Government completion of winding up steps within a

maximum time frame of two years adoption of administrative order procedure prevalent in the United Kingdom to expedite winding up and appointment of professionals as liquidators through a panel of such professionals to be prepared by the Government.

Cabinet clears insolvency kitty with corporate funds

BS Bureaus

The Union Cabinet on Thursday cleared the Companies (Amendment) Bill, 2001, which seeks to establish an insolvency fund where companies, with a paid-up capital of over Rs 1 million, would contribute 0.1 per cent of their turnover for rehabilitation of sick companies and protection of assets.

Initially, companies would be required to chip in with only 0.05 per cent of their turnover towards the fund. Along with the insolvency provisions, the government would also move a bill to repeal Sick Industrial (Special Provisions) Act or Sica in the current session of Parliament.

Officials said that the initial corpus of the fund, the modalities of which would be worked out by the department of company affairs, would be around Rs 750 million.

However, a quick estimate by the *Business Standard Research Bureau* shows that the corpus could swell to around Rs 4 billion based on a 0.05 per cent provision on the turnover for 2000-2001.

The top 10 corporates will account for nearly 40 per cent of aggregates. Indeed, India's largest corporate, the public sector giant Indian Oil Corporation will have to provide over Rs 479 million based on its turnover of Rs 958.50 billion as on March 31, 2001.

HPCL, BPCL and Reliance Petroleum will make provision of over Rs 1.60 billion each, while Reliance Industries will have to provide Rs 140 million. ONGC (Rs 100 million), SAIL (Rs 82 million), National Thermal Power (Rs 81 million) and Hindustan Lever (Rs 57 million) are the other major corporates with substantial contribution to the fund.

The study shows that 2,658 companies with aggregate sales of Rs 7955.65 billion, would have to set aside Rs 8 billion, when the provision is doubled to 0.1 per cent of the turnover.

The amendments to the Companies Act would result in the setting up of a National Company Law Tribunal with the powers and jurisdiction of Board for Industrial and Financial Reconstruction, Appellate Authority for Industrial and Financial Reconstruction, Company Law Board and High Courts.

Once the Bill is cleared by Parliament, reference to NCLT would become voluntary on erosion of 50 per cent of net worth or default on payment of loans exceeding Rs 100,000 unlike the present system of mandatory reference to BIFR.

While encouraging voluntary reference for winding up of companies with minimum paid up equity of Rs 1 million by NCLT, a parallel corporate debt restructuring mechanism would also be put in place.

The claim settlement of secured creditors and employees of companies would be treated at par.

The government also proposes to make the revival plan submitted by financial institutions binding on them and a financial penalty would be imposed in case FIs fail to adhere to the plan submitted to the NCLT.

The aim of the Bill is to reduce the funds locked up in BIFR cases and the government intends that the process should be completed in two years.
