

## **Winding up of NBFCs — A Live Example of Catch-22**

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### **Hue and cry**

The hue and cry raised by the depositors of NBFCs whose deposits were not repaid on maturity is understandable. The major brunt of such defaults by NBFCs is borne by uninformed depositors. Many pensioners have claimed that they have lost their life savings. Attempts are made to organise morchas<sup>1</sup> to draw public attention. One of the causes for the failure of NBFCs was siphoning of funds to the companies in their own group. The loans, advances or other investments within the group became bad and doubtful of recovery and the NBFCs in question did not show much interest in recovering from those companies.

2. The Joint Parliamentary Committee, which enquired into the irregularities in securities and banking transactions, had recommended that the Govt. should examine whether the legislative framework for regulating NBFCs is sufficiently wide<sup>2</sup>. The working group on financial companies appointed by the Bank under the Chairmanship of Dr. A.C. Shah had suggested regulatory and control measures to ensure the healthy growth and operations of these companies<sup>3</sup>.

### **Need for Winding Up**

3. Prior to 1997, the Bank could prohibit<sup>4</sup> a Non-Banking Institution from accepting deposits if it failed to comply with the directions issued by the Bank. Even though the failure to comply with the directions issued by the Bank was an offence punishable<sup>5</sup> under the Act, there was no provision for eliminating such companies which were prohibited from accepting public deposits. The companies prohibited by the Bank from accepting deposits continued to carry on the business of a Non-Banking Financial Institution. It is possible that some such companies could have accepted deposits also in violation of the prohibitory order issued by the Bank. In view of the huge number of NBFCs carrying on the business and operating in remote corners of the country, many such violations would have escaped the notice of the Bank also. That situation appears to have been further misused by some unscrupulous NBFCs. It was necessary to ensure that such companies were wound up. Further, prosecution does not help in the recovery as it is meant for punishing the guilty. Recovery for the benefit of depositors, is possible in winding up proceedings where the properties belonging to the company may be sold and the proceeds, distributed to the creditors of the company including the depositors.

### **Locus Standi**

4. NBFCs being companies under the Companies Act 1956 are governed by the provisions of Companies Act in respect of formation, management, winding up etc. Under the Companies Act<sup>6</sup>, an application for winding up of a company can be made by

the company itself, creditors, shareholders, the Registrar of Companies or the person authorised by Central Govt. The Bank has no *locus standi* under the Companies Act to file a winding up petition even against an NBFC which according to the Bank is not fit for accepting public deposits or for carrying on the business of NBFC. In this background, it was expected that if the Bank is empowered to file a winding up petition against an erring NBFC, it would be possible for the Bank to weed out the unhealthy NBFCs, paving the way for a healthy growth of the others. In an ideal situation, such a result could have helped building up the public confidence in the NBFC sectors, facilitating an orderly growth of the sector.

5. One of the new provisions<sup>7</sup> introduced by the 1997 amendment in the Reserve Bank of India Act 1934 (Act) was to confer upon the Bank, the power to file a winding up petition against NBFCs. During the last three years, in exercise of the powers conferred by Sec. 45 MC, the Bank has filed winding up petitions in various High Courts. The question is whether the amendment has been successful in weeding out unhealthy NBFCs and in securing repayment, even in part, to the depositors. It is also necessary to see what can be done to strengthen the machinery for achieving the desired object.

### **Provisional Liquidator**

6. The Courts<sup>8</sup> have appointed the official liquidator attached to them as the provisional liquidator in respect of many companies against which the Bank has filed winding up petitions. The properties of the company have been vested with the provisional liquidator. The bank accounts of the companies and their associate institutions have been frozen by the Courts<sup>9</sup>. Allahabad High court<sup>10</sup> has issued injunction against the company<sup>11</sup> prohibiting it from alienating its assets and has ordered issue of advertisement in respect of the winding up petition in the press and the official gazette. In the winding up petition<sup>12</sup> filed by the Bank against Asia Pacific Investment Trust Ltd., the Court<sup>13</sup> appointed a Provisional Liquidator. However, the final order<sup>14</sup> of winding up was passed by the Court in the winding up petition filed by a creditor.

### **Delay in Winding Up Proceedings**

7. The inordinate delay which is built into the winding up procedure under the Companies Act is discouraging the Courts to pass the final order or winding up. In some Courts like the Delhi High Court, the official liquidator is stated to be having hundreds of companies in liquidation. The office of the Official Liquidator is not equipped to deal with such huge number of liquidation proceedings. The financial activities carried on by NBFCs being of a technical nature, the office of the official liquidator is in a very disadvantageous position to tackle the issues<sup>15</sup>. It is stated that the technical support is also not available to the office of the official liquidator making it difficult to track the records maintained in electronic medium by some of the NBFCs under provisional liquidation. This perhaps calls for strengthening the office of official liquidator with adequate manpower having technical and professional expertise. Amendments to Companies Act may also be necessary for making it possible to appoint professional private liquidators.

## Secured Creditors

8. Apart from the difficulties faced by the office of the official liquidator in handling the numerous liquidation proceedings, the advantageous position held by secured creditors against the unsecured creditors has also been weighing very heavily in the minds of the Courts. There is genuinely a general feeling that the depositors who rank as unsecured creditors may not see the colour of the money if the company is wound up in accordance with law. As the secured creditors would have taken as security, almost everything belonging to the company, they will receive whatever is realised from the sale of assets of company, leaving nothing for the depositors. **Thus a problematic situation has arisen where there are inherent problems in what is supposed to be a solution.**

## Schemes

9. The Courts therefore are tending to find out some alternative measures for protecting the interest of the depositors. Therefore, any NBFC which says that it would repay all the depositors if some concessions are given or if some alternate schemes are allowed to be framed, or is given a chance to formulate its own scheme for repaying the depositors<sup>16</sup>. The schemes so far submitted by the companies are either unrealistic or seek unduly long time for repaying the depositors. In other words, no company has so far come forward with a scheme, which is more beneficial to the depositors than the statutory scheme of winding up provided under Companies Act.

## Commissioners, Agents and Special Officers

10. The Courts have also explored the possibilities of appointing Court Commissioners for realising the assets and distributing the proceeds with the help of the officials of the company, by believing the tall promises made by the company<sup>17</sup>. In *Tange & Ors. v. the Bank and Ors*<sup>18</sup>, a public interest litigation for a direction to the Bank to file a winding up petition against Sanjeevani Savings & Investments (India) Ltd., the Bombay High court explored the possibilities of getting the properties of the company and its officials attached and seized, by issuing direction to the Bank, the police etc. Ultimately, on a creditor's winding petition, the Nagpur Bench of Bombay High Court has ordered winding up of the company. Delhi High Court<sup>19</sup> appointed agents to assist the provisional liquidator to examine the accounts and books of the company<sup>20</sup>. A committee headed by a retired judge<sup>21</sup> of the Delhi High Court was also appointed, as the said agents could not get sufficient information. But no substantial gain could be achieved.

11. The Madras High Court<sup>22</sup> appointed an administrator to assist the provisional liquidator while passing an order on the winding up petition filed by the Bank against MCC Finance Ltd. The said administrator is stated to have resigned. There is thus a need to statutorily provide for appointment of professional liquidators who can undertake the task of liquidation instead of the Courts trying to work out other means such as appointing agents, administrators etc. It is not out of place to mention that the Bank does not file winding up petitions as a matter of routine. In some cases, the Bank has appointed special officers to oversee the functioning of the company and to ensure compliance with the directions issued by the Bank. Even though special officer was appointed, filing of

winding up petition could not be avoided<sup>23</sup>.

### **Local Law**

12. In yet another public interest litigation filed in the Bombay High Court, the Court has directed<sup>24</sup> the authorities under the Maharashtra Protection of Interest of Depositors (In Financial Establishments) Ordinance 1999 to consider taking action regarding seizing the properties of the company and protecting the interest of depositors. While disposing of a batch of Writ Petitions<sup>25</sup> filed as public interest litigation, the Lucknow Bench of the Allahabad High Court has examined various issues arising out of the defaults committed by NBFCs and has suggested footnote No. 26 to the State of Uttar Pradesh that it may consider passing a legislation on the lines of Tamil Nadu Protection of Interests of Depositors (In Financial Establishments) Act 1997.

13. The experience gained in the above cases clearly indicates that there is no alternative to the winding up of the companies in question or taking steps under the local legislation for attaching and seizing properties. It is very difficult even for the High Courts to evolve any procedure to deal with the assets and liabilities of NBFCs which are spread throughout the length and breadth of the country. Any arrangement approved of by the High Court could face difficulties while enforcing in different part of the country. But, the winding up procedure has its own drawbacks. The Committee<sup>27</sup> appointed by Govt. of India for suggesting *inter alia* the changes in the existing law relating to winding up of companies to avoid delays in the final liquidation of companies has submitted its report to the Government sometime in late August 2000. The legislative changes suggested by the said Committee may take some time for being implemented.

### **An Inevitable Evil?**

14. A very complicated situation has arisen. The companies in question are not able to come out with a viable scheme for repaying the depositors. The Bank has filed winding up petitions as the last resort. Winding up is not viewed by many Courts as a solution to the problems of the depositors. The experience shows that not resorting to winding up does not solve their problems either. Prosecution has its own limitations. The grievance of the depositors remains to be redressed in any case. Till the recommendations of Justice Eradi Committee see the light of the day, one wonders whether the winding up process with all its shortcomings and delays should be given a chance to see how effective it is, in protecting the interest of depositors. More so because, not resorting to winding up could result in further diversion of funds causing more damage.

1. The Hindu, dated 14/11/2000 Daily published from Chennai.
2. Paragraph 2 of Statement of Objects and Reasons dated 20/2/1997 accompanying the Reserve Bank of India (Amendment) Bill, 1997.
3. *Ibid.*
4. Sec. 45K(4), RBI Act, 1934.
5. Sec. 58B(6), RBI Act, 1934.
6. Sec. 439.
7. Sec. 45MC.
8. Delhi, Patna, Ahmedabad and Andhra Pradesh High Courts have appointed Provisional Liquidators in the winding up petitions filed against many companies.

9. Order dated 13/6/1997 of Delhi High Court in CP No. 191 of 1997 filed against CRB Capital Markets Ltd. In a public interest litigation being WP No. 1893 of 1998 (D.S. Tange v. The Bank & ors), by order dated 24/6/1998, Division Bench of the Bombay High Court directed freezing of bank accounts of Sanjeevani and Investments (India) Ltd.
10. In CP No. 88 of 2000, by order dated 16/10/2000.
11. Krishi Exports Commercial Corporation Ltd.
12. CP No. 134 of 1998.
13. Andhra Pradesh High Court.
14. Order dated 19/8/1998, CP No. 64 of 1997.
15. Delhi High Court, CP No. 191 of 1997, order dated 16/ 6/1997.
16. e.g. CRB and JVG cases before the Delhi High Court.
17. The Chairman of Midwest India Industries Limited and the company had filed Writ petition No. 32498 of 1998 before A.P. High Court at Hyderabad seeking police protection etc. The Court appointed advocate commissioners and explored the possibilities of repaying depositors. After the efforts failed, the Court directed in its judgement and order dated 13/12/1999, filing of winding up petition.
18. WP No. 1893 of 1997.
19. In CP No. 191 of 1997, order dated 16/6/1997.
20. CRB Capital Markets Ltd.
21. Justice Shri Anand. 22. In CP No. 496 of 2000. 23. e.g. MCC Finance Ltd.
24. Para 9 of the order dated 20/8/1999 of Division Bench in S.D. Penha & ors. v. Dealwell Investments Pvt. Ltd. and ors., WP No. 2568 of 1998.
25. WP No. 3418 (MB) of 1998, 1078 and 1983 (MB) of 1999, Agents of Kuber Group of Companies & Ors v. State of UP and Ors.
26. Order dated 28/7/2000 of the Division Bench.
27. The Committee on law relating to insolvency of companies headed by Justice Shri V. Balakrishna Eradi retd. Judge of Supreme Court.