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Law for Directors & Managers

Lecture 9

Dissolution and Winding up

-

Part 1

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— ADVOCATES —



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Objectives of Insolvency Law



1. Realising its assets;
2. Distributing the proceeds; and
3. Distributing any surplus

Why create an insolvency and winding up regime?

The main purpose of any winding-up and dissolution procedure is to achieve the following three objectives:

1. To create a fair and equitable method of distributing the assets of the company among its creditors, and where possible creating a complementary defined hierarchy of payment, such as a ranking of creditors;
2. To give a lifeline to the company by allowing it to have a respite from the burdens of its debts and obligations as in instances where moratoriums are given to the company; and
3. To create a system which protects the creditors and the public at large, by investigating the conduct of companies that cannot pay their creditors, and by creating a legal safety net against fraud and other misconduct.

EXIT

The modes of winding up of companies



The modes of winding up of companies

SOLVENT
DISSOLUTION

INSOLVENT
DISSOLUTION

Solvent Dissolution → the Company is able to pay its debts, as it has sufficient assets to settle liabilities.

Insolvent Dissolution → the Company is unable to pay its debts, as it has insufficient assets to settle liabilities.

The modes of winding up of companies

Voluntary winding-up

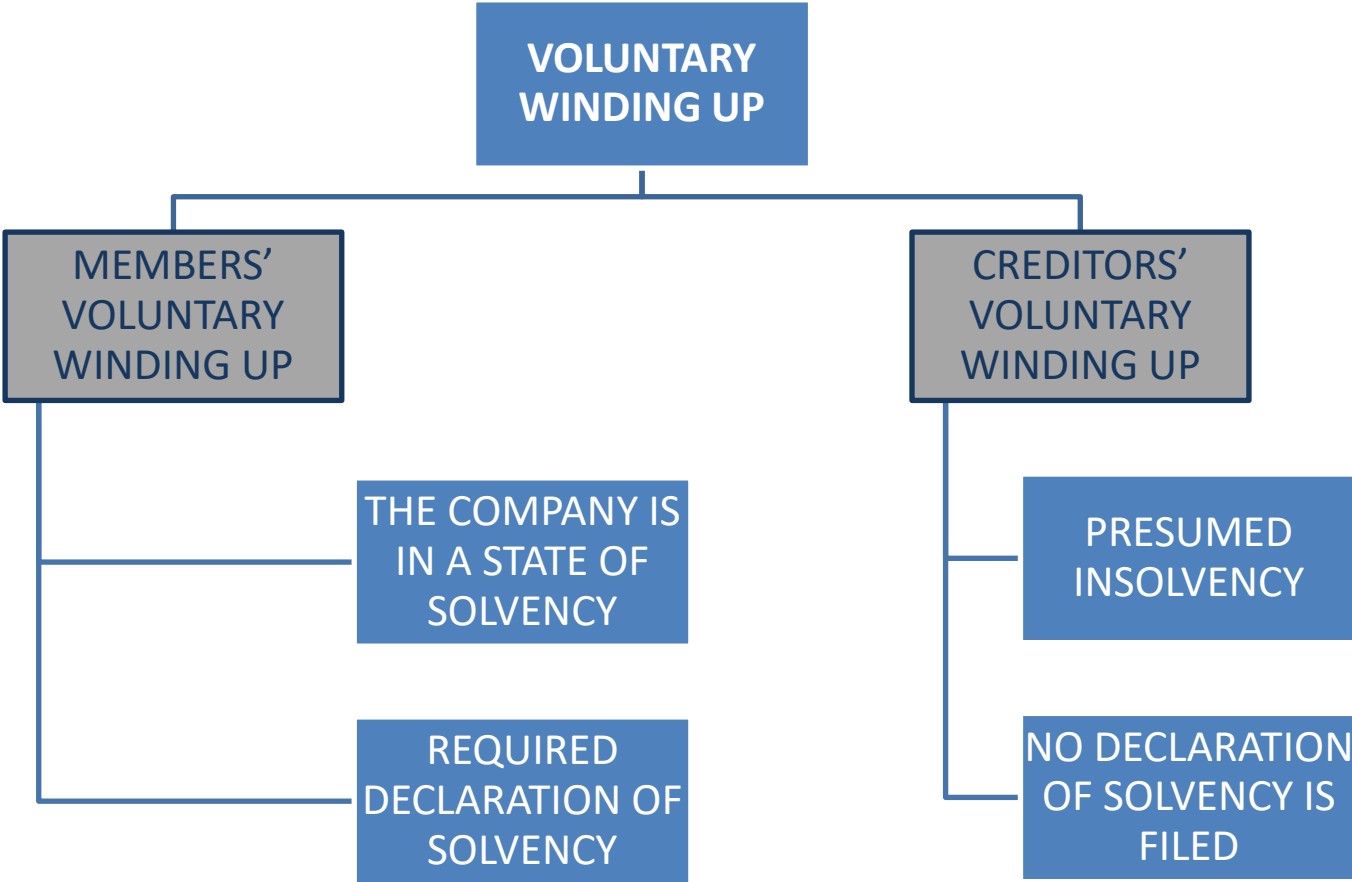
- a. *Members*
- b. *Creditors*

Court winding-up

Voluntary Winding Up



Voluntary Winding Up



Voluntary Winding Up

This may be a **members'** or **creditors'** voluntary winding up.

The fundamental distinction between a members' and a creditors' voluntary winding-up is in the former, a state of solvency is essential and must be accompanied by a declaration of solvency; whereas a creditors' winding-up presumes insolvency.

Members' Voluntary Winding Up

The process of a members' voluntary winding up:

STEP 1

THE DIRECTORS MAKE A SWORN DECLARATION OF SOLVENCY

STEP 2

AN EXTRAORDINARY RESOLUTION IS THEN PASSED. THE DATE OF DISSOLUTION IS THE DATE OF THE RESOLUTION OR SUCH LATER DATE AS SPECIFIED IN THE RESOLUTION ITSELF.

STEP 3

FOLLOWING WHICH, A LIQUIDATOR IS APPOINTED. ON THE APPOINTMENT OF A LIQUIDATOR, THE POWERS OF THE DIRECTORS CEASE & THE COMPANY MUST THEN ALSO CEASE TO CARRY ON ITS BUSINESS .



Members' Voluntary Winding Up

STEP 4

THE LIQUIDATOR MUST DRAW UP A SCHEME OF DISTRIBUTION + INDICATE THE AMOUNT DUE IN RESPECT OF EACH SHARE FROM THE ASSETS OF THE COMPANY

STEP 5

WHERE WINDING-UP CONTINUES FOR MORE THAN 12 MONTHS, LIQUIDATOR CONVENES A MEETING TO REPORT ON STATUS OF WINDING-UP PROCESS

STEP 6

UPON COMPLETION OF THE LIQUIDATION A FINAL MEETING IS CALLED TO LAY THE SCHEME OF DISTRIBUTION BEFORE THE ACCOUNT, SCHEME OF DISTRIBUTION AND THE AUDITOR'S REPORT THEREON. THE DOCUMENTS ARE FILED WITH THE MBR FOR REGISTRATION.

STEP 7

THE REGISTRAR PUBLISHES A NOTICE THAT THE SCHEME HAS BEEN REGISTERED AND THE NAME OF THE COMPANY IS STRUCK OFF THE REGISTER WITHIN 3 MONTHS FROM THE PUBLICATION



Declaration of solvency

This is essentially a declaration made by the directors indicating that they have made a full inquiry into the affairs of the company and formed the opinion that the company will be able to pay its debts in full.

Such debts will be paid in a period not exceeding 12 months from the date of dissolution.

- The declaration is made within the month immediately preceding the date of the passing of the extraordinary resolution for dissolution
- The declaration contains a statement of the company's assets and liabilities

Creditors' Voluntary Winding Up

The process of a creditors' voluntary winding up:

STEP 1

EXTRAORDINARY RESOLUTION PASSED COMMENCING PROCESS (NO DECLARATION OF SOLVENCY IS REQUIRED)

STEP 2

A LIQUIDATOR IS APPOINTED

STEP 3

CREDITOR'S MEETING IS CALLED (14 DAYS FROM THE EXTRAORDINARY RESOLUTION)

STEP 4

DIRECTORS MUST CAUSE A FULL STATEMENT OF THE POSITION OF THE COMPANY'S AFFAIRS + LIST OF CREDITORS + ESTIMATED AMOUNTS OF THEIR CLAIMS



Creditors' Voluntary Winding Up

STEP 5

WHERE WINDING UP CONTINUES FOR MORE THAN 12 MONTHS, THE LIQUIDATOR MUST COVENE A MEETING OF THE MEMBERS AND THE CREDITORS TO REPORT ON THE STATUS OF THE WINDING UP PROCESS

STEP 6

FINAL MEETING IS CALLED UPON COMPLETION OF LIQUIDATION WHEREBY THE LIQUIDATOR'S FINAL ACCOUNTS ARE LAID BEFORE THE GENERAL MEETING OF THE COMPANY + CREDITOR'S MEETING

STEP 7

COMPANY'S ASSETS DISTRIBUTED TO CREDITORS

STEP 8

THE REGISTRAR WILL FOLLOWING RECEIPT OF THE ACCOUNT + SCHEME OF DISTRIBUTION + AUDITOR'S REPORT (IF ANY), REGISTER THEM. ON THE EXPIRATION OF 3 MONTHS FROM PUBLICATION OF A NOTICE IN A GOVERNMENT GAZZETTE, THE COMPANY WILL BE STRUCK OFF



Provisions applicable to every voluntary Winding Up

- *Distribution of Assets (Art.287)*
- *Powers and Duties of the Liquidator (Art.288)*
- *Powers of the court to remove the liquidator (Art.289)*
- *Notice of appointment (Art.290)*
- *Binding arrangement (Art.291)*
- *Questions to the court (Art.292)*
- *Costs of voluntary winding up (Art.293)*

PROVISIONS APPLICABLE TO EVERY VOLUNTARY WINDING UP

DISTRIBUTION OF ASSETS

Upon the winding up of the company, the property of the company will be applied in satisfaction of its liabilities as follows:

STEP 1 – First applied in respect of preferential (secured) debts

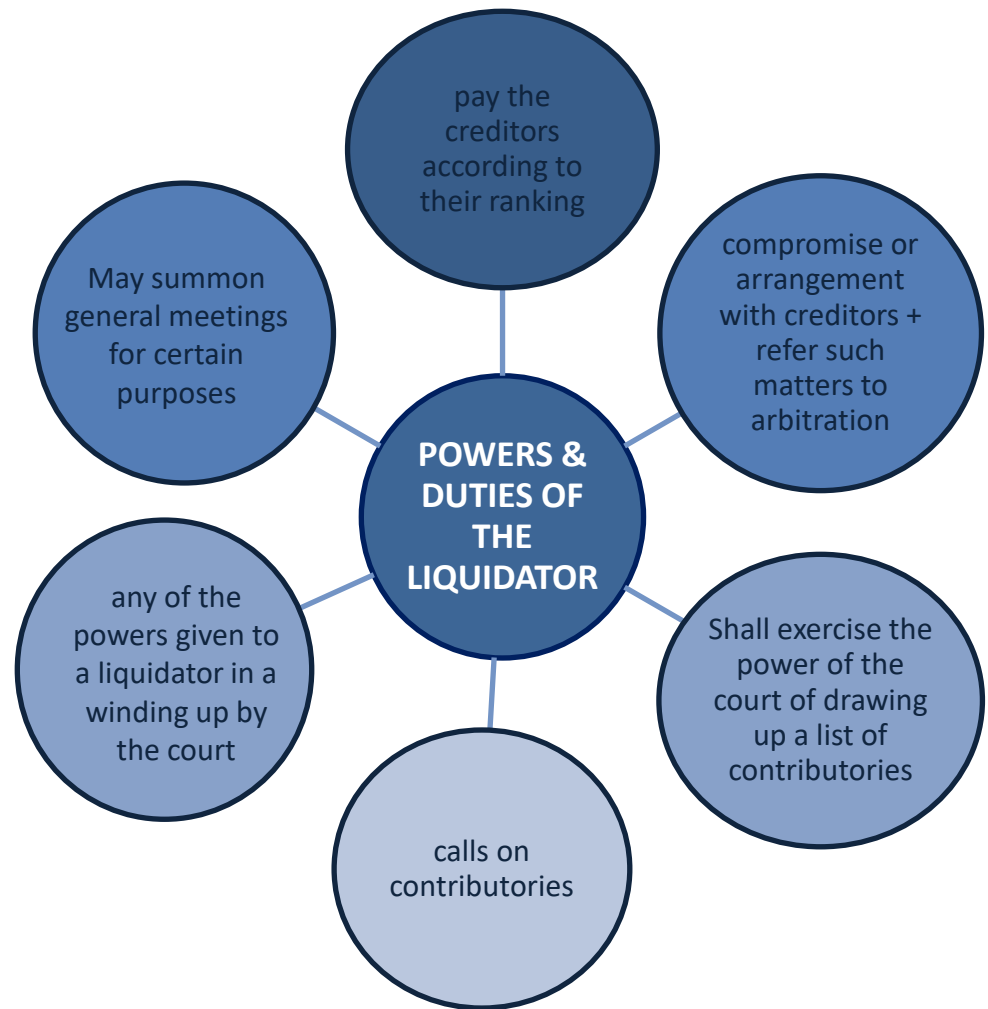
STEP 2 – Secondly applied in satisfaction of its liabilities *pari passu*

STEP 3 – Thirdly, surplus distributed to members according to rights and interests in the company, unless the M&As otherwise provide

PROVISIONS APPLICABLE TO EVERY VOLUNTARY WINDING UP

NOTICE OF APPOINTMENT:

Within 14 days of appointment, the liquidator shall deliver notice of his appointment to the Malta Business Registry



PROVISIONS APPLICABLE TO EVERY VOLUNTARY WINDING UP

POWERS OF THE COURT TO REMOVE THE LIQUIDATOR:

On the application of any member, creditor or contributory, a liquidator may be removed if the court is satisfied that there exist sufficient grounds to warrant his removal and appoint another liquidator

QUESTIONS TO THE COURT:

The liquidator may apply to the court to fix a time within which creditors are to prove their debts/claims
The court, if satisfied that the determination of the question or the exercise of the above powers will be just and beneficial, may accede wholly/ partially on such terms and conditions as it thinks fit, and make such order as it thinks fit

COSTS OF VOLUNTARY WINDING UP:

All costs/charges/expenses properly incurred in the winding up, including the remuneration of the liquidator, shall be payable out of the assets of the company in priority to all other claims

POWER TO REQUEST WINDING UP BY THE COURT:

A voluntary winding up shall not bar the right of any creditor/contributory to have it wound by the court

Court Winding Up



Court Winding Up

- _ A request to the court for the winding-up of the company may be made means of an application which may be made either by the company following a decision of the general meeting or by its board of directors, or by any debenture holder, creditor or creditors, or by any contributory or contributories
- _ The application may also be made by any shareholder or director (where the application is not made following a decision to wind up by the company by way of an extraordinary resolution of the company)
- _ The Registrar of Companies may also file an application in certain instances

Causes of dissolution (1)

The application may be preceded by an extraordinary resolution to dissolve the company and be consequently wound up by the court.

Causes of dissolution (2)

A company **may** be dissolved and wound up by the court in the following cases:

- i. If the business of the company is **suspended for an uninterrupted period of 24 months**; or
- ii. The company is **unable to pay its debts**, i.e. a debt due by the company has remained unsatisfied in whole or in part after 24 weeks from the enforcement of an executive title against the company, or it is proved to the satisfaction of the court that the company is unable to pay its debts, account being taken also of contingent and prospective liabilities of the company.

These are alternative tests: only one needs to be failed. Even though they are determining factors of insolvency, it does not necessarily mean that if one is failed then there shall be dissolution and winding-up: other directives/orders, including a company recovery order (upon the court's discretion).

Nurton et. vs. PMN International Ltd (2011) → the Court held that the company was deemed to be insolvent when it had seized to pay its debts. It was not necessary to show that it did not have funds or assets to pay its debts.

Causes of dissolution (3)

A company **shall** be dissolved in the following cases:

- i. The number of members of the company is reduced to below 2, and remains so for more than 6 months (other than in the case of a single member company);
- ii. The number of directors is reduced to below the minimum and remains so reduced for more than 6 months (**the court may allow a “cure period” not exceeding 30 days, on good cause being shown**);
- iii. The court is of the opinion that there are **grounds of sufficient gravity** to warrant the dissolution and consequential winding up of the company; and
- iv. When the period, if any, fixed for the duration of the company by the memorandum or articles expires, or a particular event occurs, as contemplated by the memorandum or articles, and the company has not passed a resolution to be wound up voluntarily (**the court may allow a “cure period” not exceeding 30 days, on good cause being shown**).

The provisional administrator

THE PROVISIONAL ADMINISTRATOR

PERIOD: May be appointed by the court at any time after the presentation of a winding up application and before the making of a winding up order. The provisional administrator holds office until such time as the winding up order is made or the winding up application is dismissed (unless he resigns/is removed before that time).

ROLE: Shall carry out such functions and powers in relation to the administration of the estate or business of the company as the court may specify in the order appointing him.

The official receiver

THE OFFICIAL RECEIVER

PERIOD: The below functions kick in once a winding up order is made.

ROLE: Upon notification by the Court, the official receiver becomes the liquidator of the company and continues in office until another person becomes liquidator, and shall, upon notification by the Court, be the liquidator during any vacancy.

The liquidator

THE LIQUIDATOR

PERIOD: Following the official receiver becoming liquidator of the company, another person shall become liquidator, and the official receiver shall no longer be the liquidator of the company.

The liquidation committee

The committee is responsible to assist and overview the acts of the liquidator. It may direct the liquidator on how to administer the assets of the company.

The creditors decide whether or not to appoint a liquidation committee, and who sits on the committee.

If a liquidation committee is not appointed, the liquidator may ask the Official Receiver to carry out the functions of the committee.

Procedure in a court winding-up

STEP 1

- Request for court dissolution and winding up, upon application of any shareholders/director/registrar of companies; **OR**
- Request for court dissolution and winding up, upon a decision taken by general meeting/ board of directors/ any debenture holder/ any creditors/contributories

STEP 2

- Appointment of the provisional administrator after the presentation of a winding up application but **BEFORE** the issue of a winding up order.
- the directors, the company secretary, and every contributory and creditor of the company shall be entitled to make submissions on the hearing of a winding up application

STEP 3

- Court may dismiss application;
- If the court accepts, a court winding up order is made, and the creditors of the company may appoint a liquidation committee. The winding-up order is filed with the Malta Business Registry for registration.
- When a company is being wound up by the court , any act or warrant, whether precautionary or executive, issued against the company would be void.

Procedure in a court winding-up

STEP 4

- Upon the winding up order, the official receiver automatically becomes liquidator until another person so appointed;
- The official receiver then carries out investigations as he deems appropriate and submits preliminary report on the state and prospects of the company;
- The liquidator then takes into custody all property and rights of the company + realizes property + makes final payments
- The liquidator would then draw up a liquidation report

STEP 5

- A court order would further be made for the company name to be struck off the Malta business register.

STEP 6

- The company name would then be struck of the Malta business register

1. Disappearance of the substratum - German Date Coffee Co. (1882)

Facts:

- The company's memorandum stated that it was formed for working a German patent that was to be granted for manufacturing coffee from dates. The memorandum also stated that the company could acquire or produce any other inventions for similar purposes and to import all descriptions of produce for the manufacture of food.
- The German patent was not granted, but the company acquired a Swedish patent and established works in Germany where it made and sold coffee produced from dates without a patent.
- Some shareholders disposed of their interest in the company when they learned that the German patent could not be obtained, but the majority desired to continue with the company. Two shareholders filed for the winding up of the company.

Decision:

- The Court of Appeal held that the main object of the company was that relating to the German patent and that once it was impossible for the company to carry out the main object for which it had been formed it was just and equitable that it be wound up.



2. Deadlock – Ivan Calleja vs M.I.M.S Supplies Limited (2014)

Facts:

- The plaintiff was a 50% shareholder in the company. The other half of the shares in the company were held by a company owned by MB.
- The plaintiff and MB were the defendant company's two directors. As a result of financial difficulties and disputes between the directors, the company stopped operations in 2006. The last audited accounts were of 2004.
- Draft accounts had been prepared in the meantime but were not approved. MD had declared that he saw no future for the company.

Decision:

- The court noted that the dispute between the directors was clear from the evidence.
- The court also found that the many issues and problems that divided the two equal shareholding groups led to a total lack of trust between both sides leading to a point of no return and bringing the company to its knees.
- The court concluded by saying that one thing was certain: there was a breakdown of mutual confidence and trust that the defendant company could no longer continue with its existence.



3. Exclusion – Ebrahimi vs Westbourne Galleries Limited (1973)

Facts:

- In 1945 Ebrahimi and Nazar set up a business, which thrived for many years. In 1958, it was then incorporated as a company and again things went well.
- Subsequently, Nazar wanted to bring in his son as a shareholder/director and did so. Nazar and his son now held the majority of shares and the relationship between the 2 and the 1 other shareholder turned sour – they wanted to remove Ebrahimi from director and excluded him from the management of the business.
- Ebrahimi instituted an action asking for one of two remedies:
 1. Dissolution and winding up of the company; or
 2. The unfair prejudice remedy.

Decision:

- The court concluded that it was just and equitable to wind-up the company: the House of Lords held that based on the close relationship between the parties involved, it would be inequitable to allow Nazar and his son to use their rights to force Ebrahimi out of the company.
- The House of Lords held that even though the company is a separate juridical person, in companies that are small and based on the partnership concept, there is room to lift the corporate veil and see who lies behind the veil of incorporation.



CLAW-BACK MECHANISMS

(i) ACTIO PAULIANA

(where a transaction is made in fraud of a creditors' claims)

(ii) FRAUDULENT PREFERENCE

(refers to those transactions entered into 6 months prior to the dissolution of the company if such transaction is given at an undervalue or gives a preference)

Conclusion





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