

LATECOMERS IN LIQUIDATION – ENTITLEMENTS AND PENALTIES

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Editor's Note: 'Proof of claim' is a technical requirement in resolution/liquidation proceedings. A creditor claiming to be so, has to file a proof stating requisite details of the claim and the same has to be filed within a stipulated time. What happens to a creditor who arrives late? Is it possible for a late creditor to participate in the proceedings? Will the creditor receive a share in the funds already distributed, or will he lose it for all time to come?

The article seeks to answer these questions, with the help of illustrations.

The Code provides for resolution of corporate debtors and then liquidation, where the insolvency proceedings fail. Liquidation of a company entails settlement of claims of creditors in the staking order of their priorities. Hence, the task of collection, collation, verification, admission and rejection of claims by the liquidator constitutes a major function in the liquidation process. The function becomes all the more crucial when the company under liquidation is an insolvent entity. The competing stakeholders put their claims against insufficient assets. The laws regulating liquidation generally mandate the stakeholders to furnish their claims within a specified time limit. However, it might be possible in several cases that a creditor fails to furnish his proof of debt within the time so stipulated. Issues generally do not arise when there had been no distributions before the filing of proof by the creditor. Concerns would be there when an interim distribution had already been made. Also, the issue does not come up during resolution process, since the proofs are invited for the purpose of determining eligibility as a member of the committee of creditors and voting in meetings thereof⁵⁵.

In this context, questions which may come up are –

1. Is it possible for a creditor to submit claims after the maximum time period allowed for submission of claims?
2. If the creditor is allowed to submit belated claim, and an interim distribution had been made before receipt of his claim, will the creditor get his share which he would have received from the distribution so made?
3. If answer to the above is yes, what would be the impact on the distributions already made?

⁵⁵ According to regulation 12 of the CIRP Regulations, 2016, a creditor, who failed to submit proof of claim within the time stipulated in the public announcement, may submit such proof to the interim resolution professional or the resolution professional, as the case may be, till the approval of a resolution plan by the committee. Where the creditor is a financial creditor, it shall be included in the committee from the date of admission of such claim.

The article below attempts to study the questions in the context of the Code read with the regulations framed thereunder, viz. the CIRP Regulations and the Liquidation Process Regulations

What the Code says

Sections 33 to 54 of the Code deal with the liquidation of the corporate debtor arising out of a failed attempt to resolve the insolvency of the corporate debtor. The liquidator is appointed to conduct the process of liquidation and is thus required under the law to receive and collate the claims of the creditors and distribute the realizations in accordance with the priority laid down under section 53. Section 38 of the Code provides that the liquidator shall receive or collect the claims of creditors within a period of 30 days from the date of the commencement of the liquidation process. Also, according to regulation 12 of the Liquidation Regulations, 2016, the last date for submission of claims shall be 30 days from the liquidation commencement date. The Liquidation Regulations, 2016 do not dwell upon the consequences of delayed filing of proofs by creditors.

Certain provisions are contained in the CIRP Regulations, 2016 – as required under regulation 12 (2), a creditor shall submit proof of claim on or before the time stipulated in the public announcement. However, a creditor who failed to submit proof of claim within the time so stipulated, may furnish such proof till the approval of a resolution plan by the committee of creditors. The provision is not of much help in the liquidation scenario.

Noteworthy is section 177 of the Code which provides for entitlements and penalties of and for the creditor who does not prove his debt before the declaration of dividend. It states

“(1) A creditor who has not proved his debt *before the declaration of any dividend* is not entitled to disturb, by reason that he has not participated in it, the distribution of that dividend or any other dividend declared before his debt was proved, but—

(a) when he has proved the debt, he shall be entitled to be paid any dividend or dividends which he has failed to receive, out of any money for the time being available for the payment of any further dividend; and

(b) any dividend or dividends payable to him shall be paid before that money is applied to the payment of any such further dividend.”

The provision contained in section 177 as stated above has been traditionally present in laws like the Presidency Towns Insolvency Act, 1909 and the Provincial Insolvency Act, 1920 and then in the Companies Act, 1956 – see the discussion that follows.

Here, note that the word “dividend” is being used so as to refer to a share of the distributable proceeds of the assets of the bankrupt/insolvent corporate debtor. The view is evident from a reading of various provisions of the Code – see sections 171 (7) whereunder a creditor may receive dividends in manner prescribed; and section 174 which states that the bankruptcy trustee may declare and distribute interim dividend *among the creditors*.

A point which should be noted as evident from the provisions above is that there is nothing in the Code or the regulations made thereunder which altogether exclude a creditor from submitting claims post the last date for submission. However, the entitlement of a creditor, who comes late, to

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distributions already made shall be determined taking into consideration principles settled over time.

The Insolvency Act, 1986 and the Bankruptcy Act (Chapter 20), Singapore

According to section 153 of the Insolvency Act, 1986 of UK, the court may fix a time or times within which creditors are to prove their debts or claims or to be excluded from the benefit of any distribution made before those debts are proved. However, rule 14.40 of the UK Insolvency Rules 2016 also provides for entitlement of creditors delaying proofs. It may be reproduced as –

“14.40.—(1) A creditor is not entitled to disturb the payment of any dividend or making of any distribution because—

(a) the amount claimed in the creditor’s proof is increased after payment of the dividend;

(b) in an administration, a creditors’ voluntary winding up or a winding up by the court the creditor did not prove for a debt before the declaration of the dividend; or

(c) in a members’ voluntary winding up, the creditor did not prove for a debt before the last date for proving or increases the claim in proof after that date.

(2) However *the creditor is entitled to be paid a dividend or receive a distribution which the creditor has failed to receive out of any money for the time being available for the payment of a further dividend or making a further distribution.*

(3) *Such a dividend must be paid or distribution made before that money is applied to the payment of any further dividend or making of any further distribution.*

(4) If, after a creditor’s proof has been admitted, the proof is withdrawn or excluded, or the amount of it is reduced, the creditor is liable to repay to the office-holder, for the credit of the insolvency proceedings, any amount overpaid by way of dividend.”

As regards “dividend” and “distribution”, section 65 of the UK Insolvency Act allows the administrator to make a distribution to a creditor of the company. Rule 14.27 of the UK Insolvency Rules provide for declaration and distribution of dividends among the creditors in respect of the debts which they have proved. “Dividend”, in relation to a members’ voluntary winding up, includes a distribution.

Section 118 of the Bankruptcy Act of Singapore too has the same provisions as regards claims of unsatisfied creditors.

Erstwhile & Contemporary Laws

The Presidency Towns Insolvency Act, 1909 & the Provincial Insolvency Act, 1920 – These were the longest living insolvency laws in the country and survived till the advent of the Code. Section 72 of the PTIA, 1909 and section 63 of the PIA, 1920 contain provisions similar to Rule 178 of the Companies (Court) Rules, 1959 – see below.

The Companies Act, 1956 read with the Companies (Court) Rules, 1959 – Section 474 of the Companies Act, 1956 provided that the court may fix a time or times within which creditors are to

prove their debts or claims, or to be excluded from the benefit of any distribution made before those debts or claims are proved.

Rules 177 and 178 of the Companies (Court) Rules, 1959 are relevant. Rule 177 says,

“R.177. Procedure on failure to prove the debt within the time fixed - If any creditor fails to file proof of his debt with the Liquidator within the time specified in the advertisement referred to in Rule 148, such creditor may apply to the Court for relief, and the Court may, thereupon, adjudicate upon the debt or direct the Liquidator to do so.”

Further, rule 178 says,

“R.178. Right of creditor who has not proved debt before declaration of dividend - Any creditor who has not proved his debt before the declaration of any dividend or dividends shall be entitled to be paid *out of any money for the time being in the hands of the Liquidator available for distribution of dividend, any dividend or dividends which he may have failed to receive before that money is applied to the payment of any future dividend or dividends, but he shall not be entitled to disturb the distribution of any dividend declared before his debt was proved by reason that he has not participated therein.*”

Judicial Precedents

The provisions as enunciated in the Companies Act, 1956 were comprehensively discussed in [Ganeshilal Gupta v. Bharatpur Oil Mills through Official Liquidator](#) [1972 WLN 68]. The court observed that

“there has been a long delay in filing the proof, but the claim is within the period of limitation prescribed by the Limitation Act, the only consequence of the delay will be that prescribed by Section 474 of the Companies Act according to which a creditor, who does not prove his debt or claim within the time fixed by the court, *has to be excluded from the benefit of any distribution made before his debt or claim is proved.*”

However, in view of rules 177 and 178 of the Court Rules, 1959, it is also clear that the creditor is “. . . entitled to be paid *out of any money for the time being in the hands of the Liquidator available for distribution of dividend. The scheme of the law therefore does not prescribe any other penalty in the case of a belated claim.*”

The court relied on the decision made in *In re General Rolling Stock Company 1871 (7) Ch. Appeal 646*, wherein the court held,

“. . . the rule is that everybody who had a subsisting claim at the time of the adjudication, the insolvency, the creation of the trust for creditors, or the administration decree, as the case may be, is entitled to participate in the assets, and that the Statute of Limitations does not run against this claim, but, as long as assets remain unadministered he is at liberty to come in and prove his claim, not disturbing any former dividend. ***Therefore so long as justice can be done to a creditor without disturbing the dividend already declared or paid, there is no reason why he should be prevented from getting his dividend.*** . . . I therefore direct the Official Liquidator to admit the applicant's claim without further proof and *pay her the*

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dividend due to her if he can do so without disturbing the previous dividend and if he has funds enough in his hands."

The court also relied on *In re Metcalfe* 1879 (13) Ch. D. 236, where it was held that that a creditor may come in as long as there are undistributed assets still available, and he is entitled to prove, not disturbing the previous dividends. The view has also been followed in *In re Kit Hill Tunnel* 1880 (16) Ch. D. 590.

In *Buckley on Companies Act*, 13th edition, it has been stated,

"A creditor may come in and prove at any time before the company is dissolved; the penalty of not coming in before the day fixed by the Court is not exclusion altogether, but exclusion from the *benefit of any distribution* made before proof."

Reference was also made to the decisions in *Isack Jesudasen Pillai v. Divan Bahadur Ramsamy Chhetty* ILR 1904 Mad. 496 which appears to have been based on the decision in *General Rolling Stock Company (supra)*, and to *T.R. Rajakumari v. Motion Picture Producers Combine Ltd.* AIR 1942 Mad. 349. Same view has been expressed in Palmer's Winding up, Part II at p. 483:

"As by the Act the assets are impressed with a trust in favour of all the creditors, the Court will make no difficulty in admitting proofs after the expiration of the time fixed. No mischief can be done to other creditors by reason of the delay or laches of any creditor, since, if he delays beyond the proper time, **he must take his chance of what assets he can find for payment of his debt, not disturbing any former dividend.**"

It is thus a well settled proposition of the law, a creditor may come in and prove his debt at any time before the final distribution of the assets, however, within the time prescribed under the limitation law, but he cannot disturb any dividend which has already been paid.

The rules that emerge

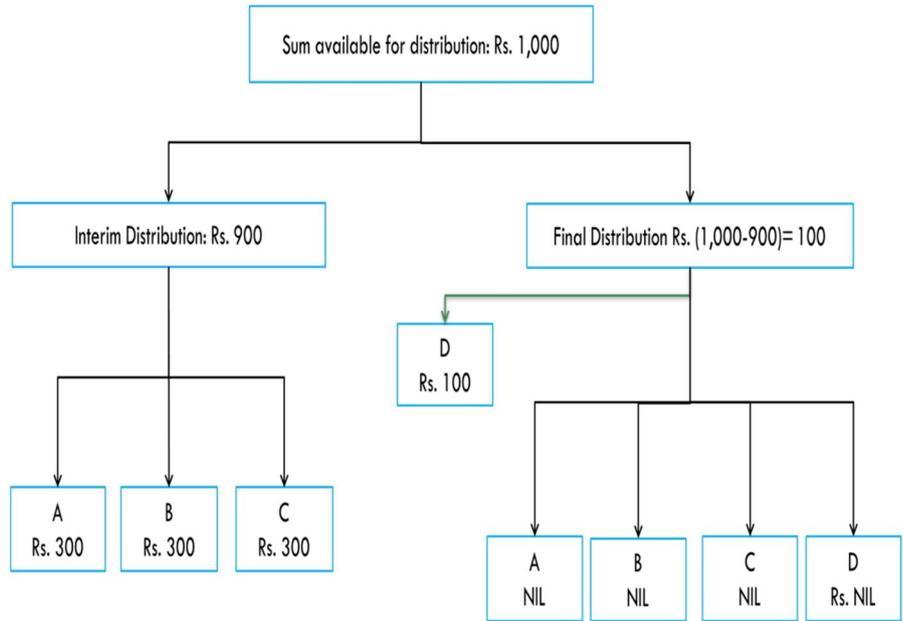
The foregoing discussion makes the following clear –

- (i) A creditor who delays filing of proof of debt is not barred from proving altogether.
- (ii) The creditor may come in any time before the final distribution of dividend.
- (iii) The debt must not be time-barred; i.e. the proof must be lodged within the time allowed under the limitation law.
- (iv) Where a distribution had been made prior to the creditor lodging delayed proof, he is *not entitled to disturb such distribution*, because he had not participated in it.
- (v) However, the creditor *is entitled to the sums he has failed to receive*.
- (vi) Such sum shall be paid to the creditor out of the money, for the time being in the hands of the liquidator, available for distribution as dividend.
- (vii) The money in the hands of the liquidator shall *first be applied to pay the creditor and then applied to the payment of any future dividend or dividends*.

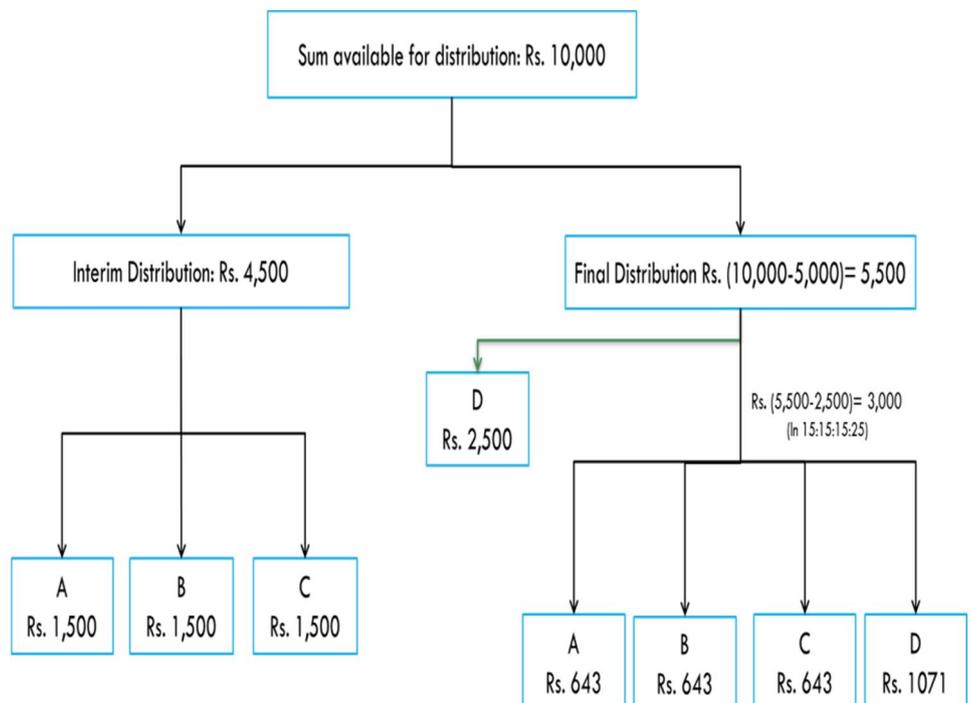
Illustrations

Let us take some illustrations to clarify the rules above.

Example 1: A, B, C (assuming that they share the same priority level) lodge claims of Rs. 3000 each before the liquidator. The liquidator has Rs. 10000 (Ten Thousand) in hand available for distribution. He makes an interim distribution at the rate of 50% of creditors' claims. Therefore, A, B, C will receive Rs. 1500 each. The money left in the hands of the liquidator is Rs. (10000-1500*3), i.e. Rs. 5,500. The liquidator, after some time, proposes to make another distribution for full and final settlement of the creditors. Now, D, another creditor comes in and claims Rs. 5000 as due from the company. During the interim distribution, he failed to receive Rs. 2500 (i.e. 50% of Rs. 2500). The money in the hands of the liquidator is Rs. 5,500 for the time being. Therefore, D shall be paid Rs. 2500, and then the liquidator shall make the final distribution to A, B, C, D from Rs. (5500-2500), i.e. Rs. 3,000. Money amounting to Rs. 3000 payable to A, B, C, D would be in the ratio 1500:1500:1500:2500. Therefore, A, B, C will receive Rs. 643 each and D will receive Rs. 1071. From calculations, it will be noted that each of these four creditors has received 71% of their claims. The creditor D did not disturb the distributions made to A, B, C; however, he got equivalent proportion of his dues from the liquidation estate.



Example 2: A, B, C (assuming that they share the same priority level) lodge claims of Rs. 3000 each before the liquidator. The liquidator has Rs. 1000 (One Thousand only) in hand available for distribution. He makes an interim distribution at the rate of 10% of creditors' claims. Therefore, A, B, C will receive Rs. 300 each. The money left in the hands of the liquidator is Rs. (1000-300*3), i.e. Rs. 100. The



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liquidator, after some time, proposes to make another distribution for full and final settlement of the creditors. Now, D, another creditor comes in and claims Rs. 4000 as due from the company. During the interim distribution, he failed to receive Rs. 400 (i.e. 10% of Rs. 4000). The money in the hands of the liquidator is only Rs. 100 for the time being. Therefore, D shall be paid Rs. 100, and no money is left to be paid to A, B, and C. In total, A, B, C has received Rs. 300 each and D has received Rs. 100. From calculations, it will be noted that A, B, C has received 10% of their claims, while D has received merely 2.5% of his claim. The creditor D cannot claim for the deficiency since he was late in participating in the distributions.

Conclusion

The provision contained in rule 178 of the Court Rules, 1959 or section 177 of the Code shall not be read so as to deprive the creditor of his share in the distribution already made. He is entitled to the same, subject to the condition that he does not disturb the distribution made. The creditors who filed their proofs in time will not suffer at the hands of the creditor who came late. Therefore, the creditor who comes late will have to contend himself with the money available after the distribution – he cannot seek re-inclusion of the moneys distributed in the liquidation estate. However, at the same time, it must be accepted that a creditor's delay cannot promote other creditors' entitlements just because a creditor was late in filing his proof must not let other creditors receive more than what they ought to have received had all the creditors filed their claims in time. Therefore, there is no prejudice against the creditors including the one who comes late.

As such, the latecomer creditor will get the dividend which he failed to receive, subject to availability of funds in the hands of the liquidator. His penalty for coming late, in effect, is that he will be running with the risk of insufficient assets which may get distributed totally if the delay is prolonged. Also, the creditor will be losing on the time value of money which he could have received at the time the distribution was made.