

DIRECTORS' LIABILITIES FOR DECLARATION OF SOLVENCY



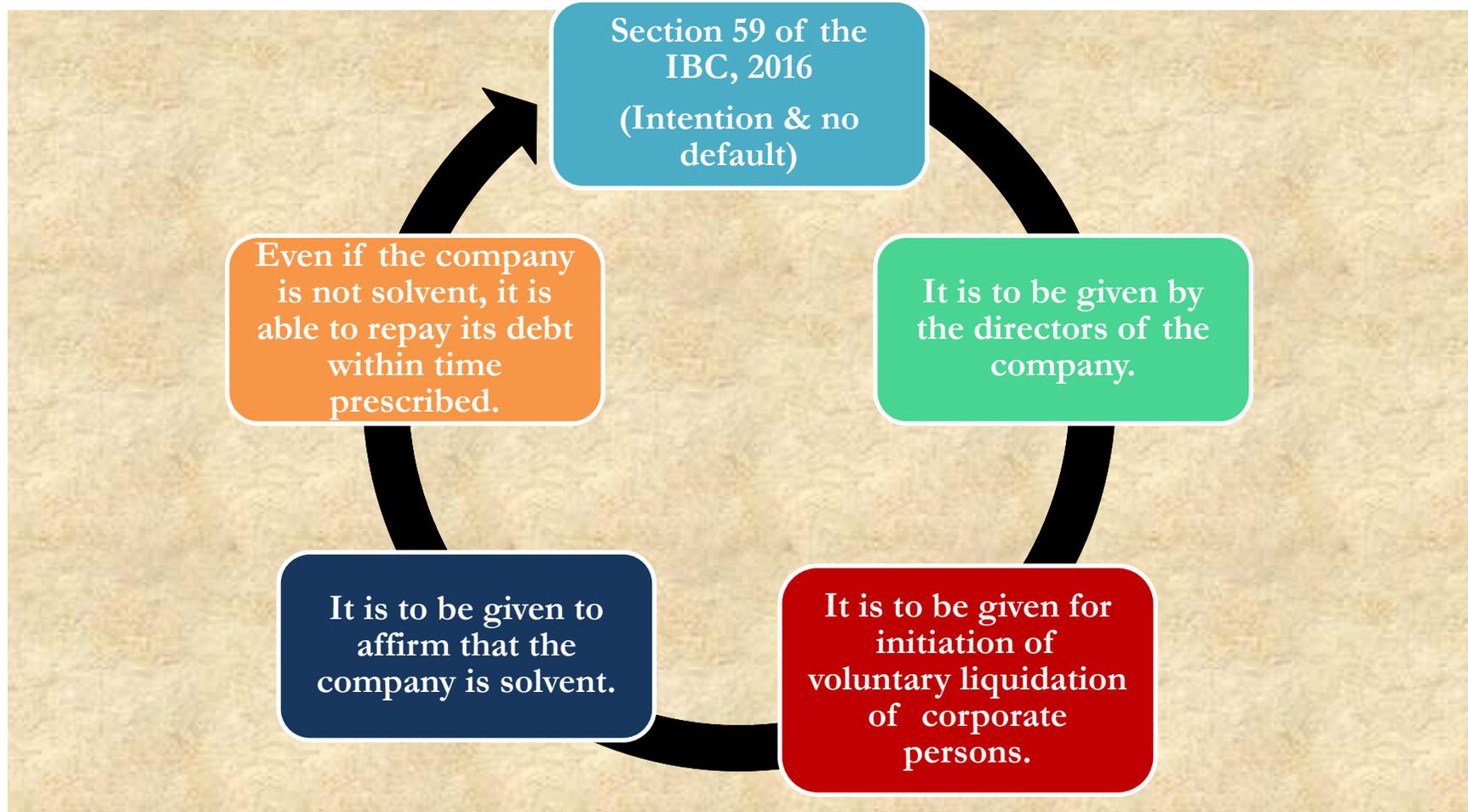
-Neelam Meshram

What is declaration of solvency (‘DoS’)?

DoS is a statutory declaration made by the directors, that the **company is solvent and will be able to pay its debts in full**, within the time prescribed in DoS.



In the context of voluntary liquidation



Directors have to make a full inquiry into the affairs of the company and they have to make an opinion

Company has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the voluntary liquidation.

A declaration from majority of the directors, verified by an affidavit.

The company is not being liquidated to defraud any person.

Section 59

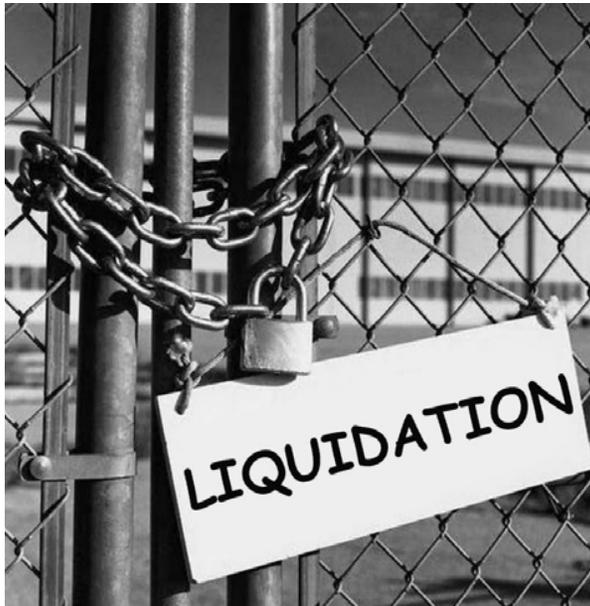
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graph TD; A[Company has no debt or that it will be able to pay its debts in full from the proceeds of assets to be sold in the voluntary liquidation.] --> D{Section 59}; B[A declaration from majority of the directors, verified by an affidavit.] --> D; C[The company is not being liquidated to defraud any person.] --> D;
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Special resolution of members of the Company

for voluntary liquidation and appointment IP to act as a liquidator, or

voluntary liquidation is a result of expiry of duration or occurrence of any event

Need of DoS



Because the law says so...

- Statutory requirement to initiate voluntary liquidation proceedings.
- Section 59 of the Insolvency & Bankruptcy Code mandates directors to submit DoS.
- Purpose is to safeguard the interest of persons/entities associated with the Company.

Why only directors?



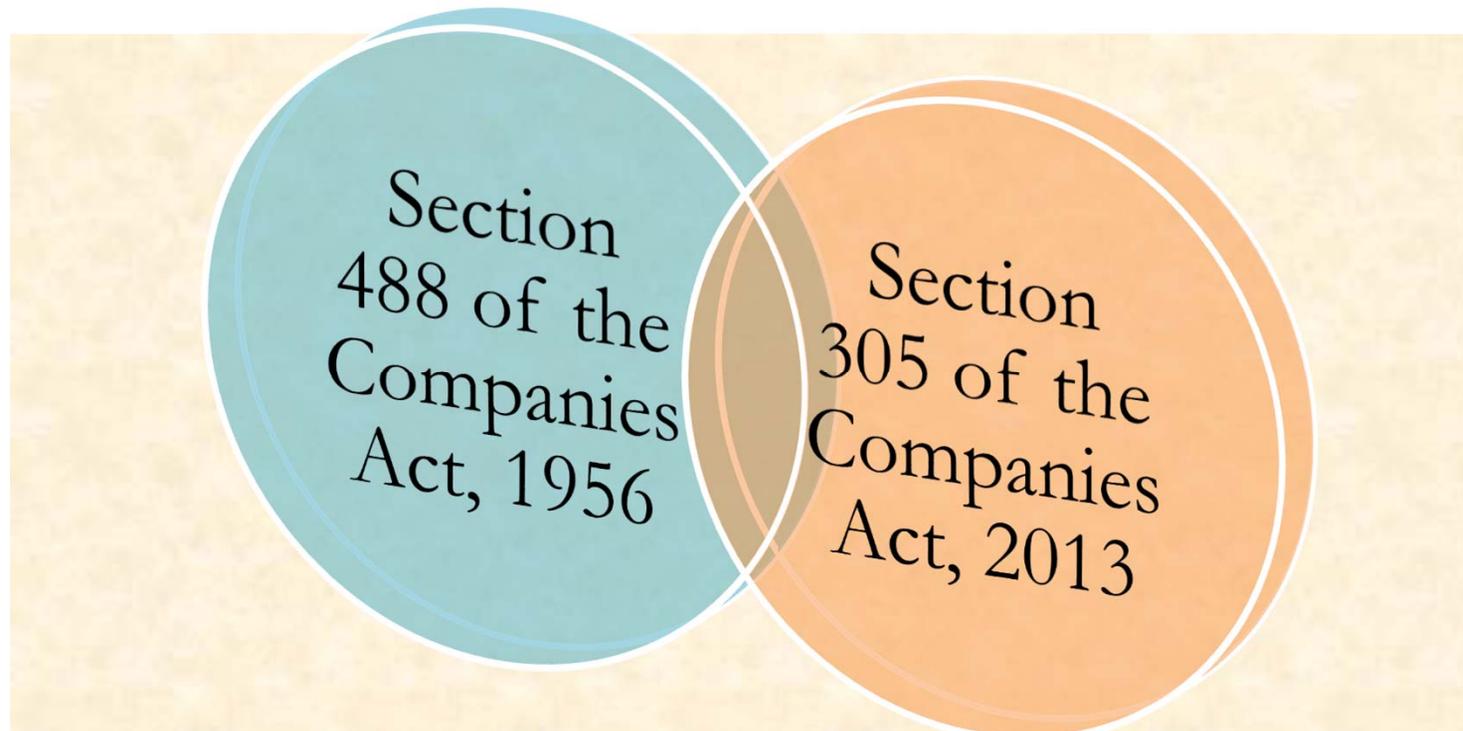
Manages the Company;
Agent of the Company;
Takes operational decisions of the
Company;
Directing mind and will of the Company



Own shares in the Company;
Only majority shareholders can be the
owner of the Company;
Not interested in management of the
Company;
Organs of the Company

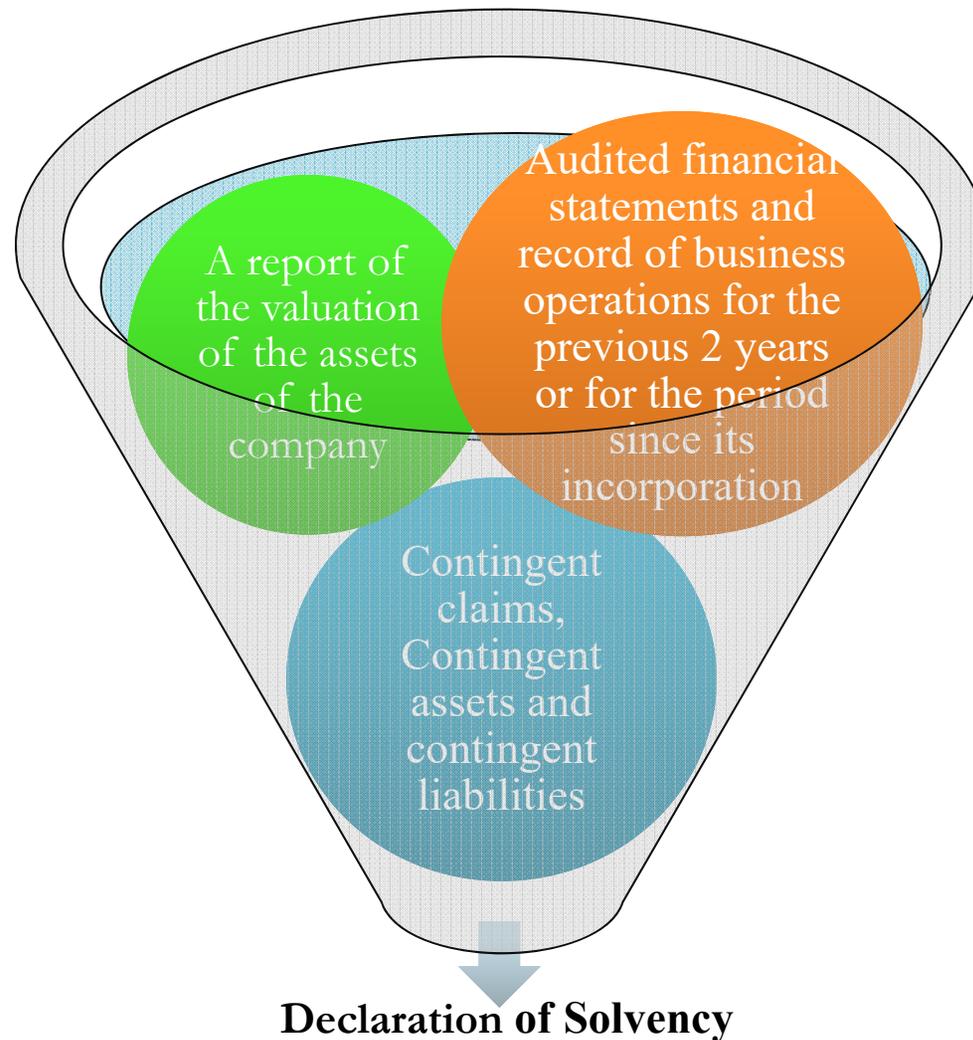


Pre-IBC Scenario



Rebuttable provision that if the company was not able to pay or provide for its debts in full within the time given in the DoS, the DoS was negligently made.

Factors to be considered while making a DoS



Requirement of 'no default'

Section 3(12) of the IBC, 2016

- Default means **non-payment of debt** when whole or any part or installment of the amount of debt has become **due and payable and is not paid** by the debtor or the corporate debtor, as the case may be.

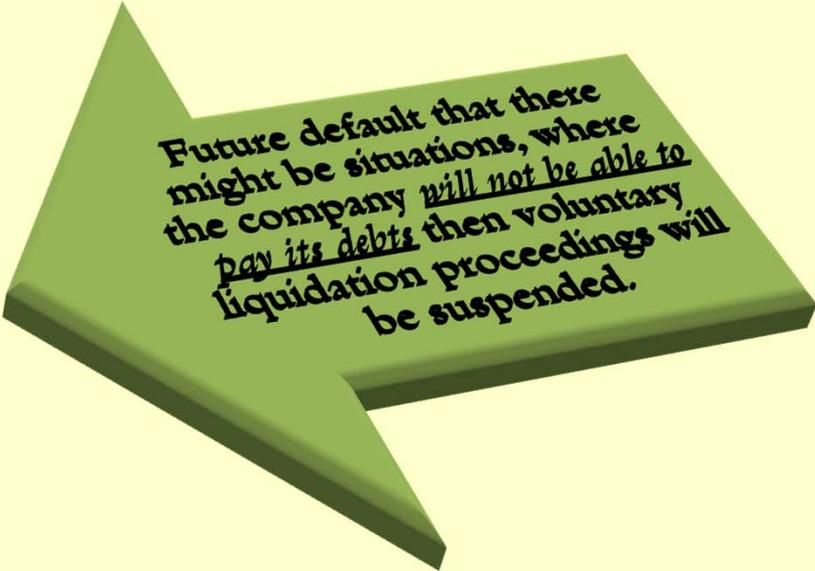
Regulation 40 (2) of the IBBI (Voluntary Liquidation Process) Regulations, 2017

- Where the liquidator is of the opinion that the **corporate person will not be able to pay its debts** in full from the proceeds of assets to be sold in the voluntary liquidation, he shall make an application to the Adjudicating Authority to suspend the process of voluntary liquidation and pass any such orders as it deems fit.

Requirement of 'no default'

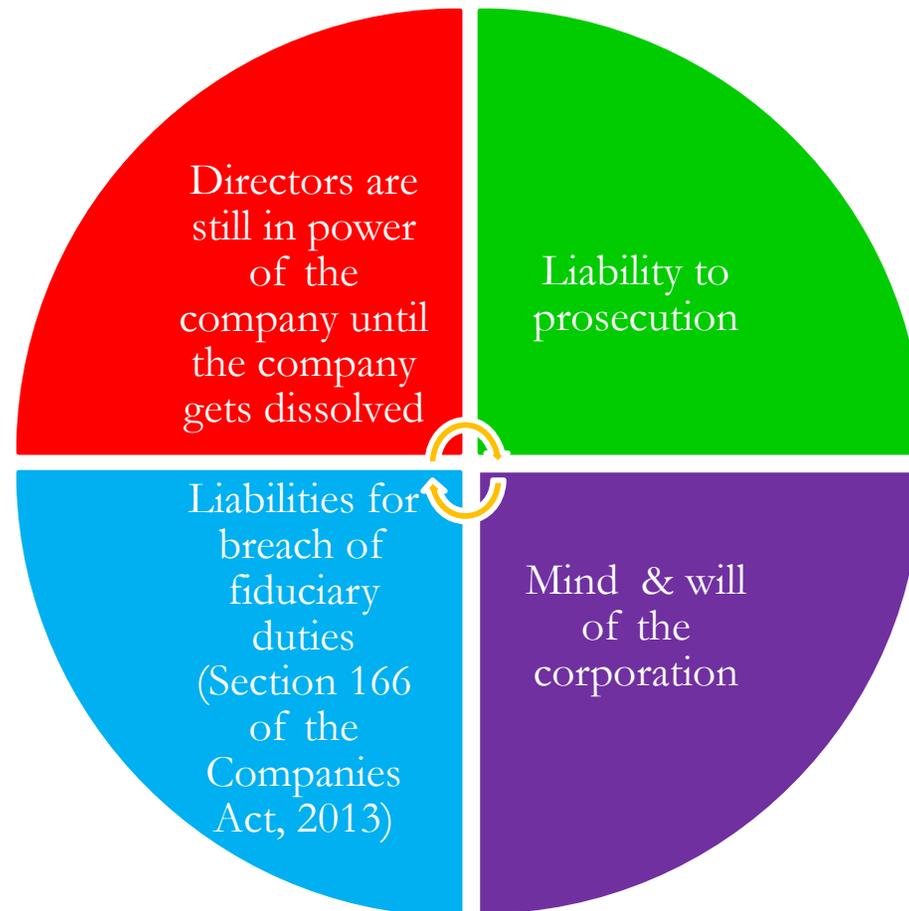


If a company had committed any default in past but the same had been repaid.



Future default that there might be situations, where the company will not be able to pay its debts then voluntary liquidation proceedings will be suspended.

Directors' liabilities for DoS



Possible scenarios pertaining to a DoS

The company was insolvent on the date of the DoS; the directors either negligently or knowingly declared it solvent.

The company was insolvent on the date of the DoS; much as the directors tried to assess the situation, they were not able to see that the Company was actually insolvent.

The company was solvent on the date of the DoS; however, assets failed to fetch expected values, and liabilities swelled, the company turned out to be insolvent.

Scenario 1- The company was insolvent on the date of the DoS; the directors either negligently or knowingly declared it solvent

Liability to prosecution for wrong DoS

- Section 72- Imprisonment for 3-5 years or fine of not less than 1 lakhs- 1 crore rupees or both.
- Section 235A- Fine 1 lakhs – 2 crore rupees.

Liabilities for breach of fiduciary duties

- The concerned directors will be asked to compensate the creditors/company on account of breach of fiduciary duty, because while exercising functions of solvent company, the director acts as a trustee and could be made personally liable.

Scenario 2- The company was insolvent on the date of the DoS; much as the directors tried to assess the situation, they were not able to see that the Company was actually insolvent.

Section 106 of the Evidence Act, 1872 provides that burden of proving a fact, which is specially within the knowledge of the person, lies in that person. If such onus is successfully discharged by directors then no question of liability arises.

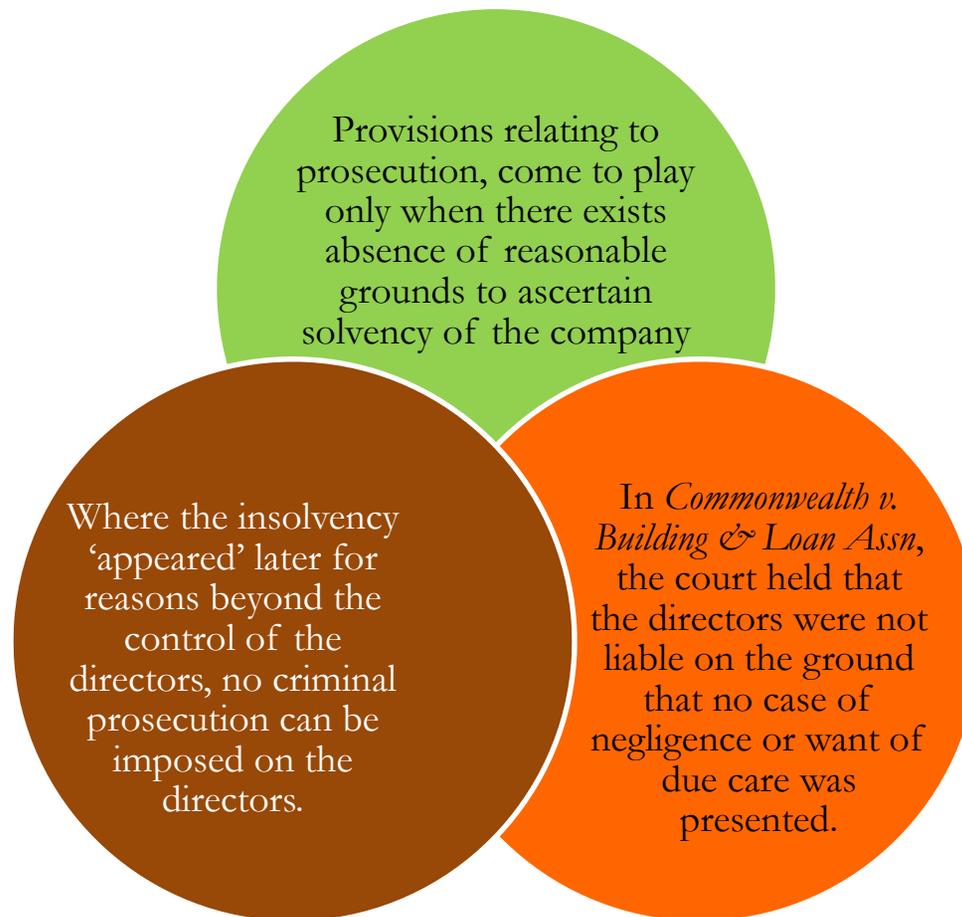
Liability to prosecution will be same as Scenario 1, if the onus has not successfully discharged by the directors.

subject to discharge of burden by directors will be held responsible for breach of fiduciary duty.

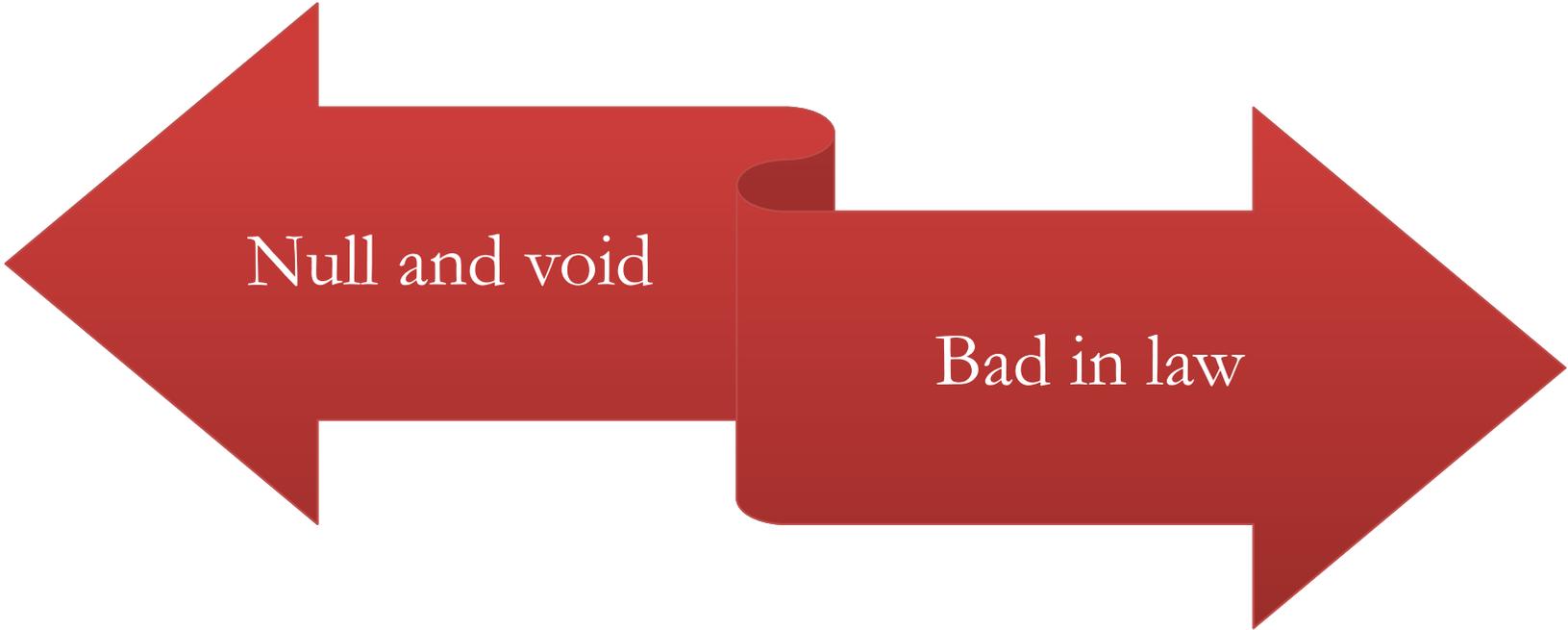
LRH Services Ltd. v. Trew and Ors

- DoS was made on the believe that the company will be able to pay its debts by way of loan proposed to be given to it by its subsidiary company.
- However, loan was not given to the company and DoS made was declared to be invalid.
- It was held that on account of invalid solvency statement, the director has committed a breach of duty and liable to the company.

Scenario 3- The company was solvent on the date of the DoS; however, as assets failed to fetch expected values, and liabilities swelled, the company turned out to be insolvent



Effect of false DoS on subsequent voluntary liquidation proceedings



Null and void

Bad in law

Summary

Directors have to exercise reasonable due diligence, if not, then they may be held personally liable.

Fiduciary liability is always present there as far as the company is in control of directors or the company is solvent.

The directors are expected to take bona fide, well-reasoned and objective decisions considering the beneficial interests of the company, SH, creditors.

Thank You