



EVOLUTION OF LAW RELATING TO LIQUIDATION OF COMPANY IN NEPAL: AN OVERVIEW

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ABSTRACT

Company law deals with the matters between life and death of a company, i.e. incorporation, registration, audit, update and liquidation. Once liquidation of a company is accomplished, all the outstanding assets and liabilities are settled among its shareholders and creditors, and the firm loses its legal existence forever. The first legal provision on liquidation featured in the Nepal Company Kanoon of 1993 BS which included provisions on appointment of liquidator, his or her rights and duties and the conduction of liquidation process. Later, liquidation of solvent companies found mention in subsequent company laws also, such as the Companies Act 2007 BS, 2021 BS, 2053 BS, 2062 BS and also the incumbent Companies Act of 2063 BS.

However, the liquidation of insolvent companies or involuntary liquidation found late entry into the Nepali company landscape, with the first and only Insolvency Act being enacted in 2063 BS together with the new Companies Act. However, the insolvency of natural persons (bankruptcy) has been regulated as back as in the Muluki Ain of 1910 BS. The current Insolvency Act, 2063 BS strictly concerns itself with corporate insolvency and provides for several key arrangements in this regards such as Commercial Bench at the concerned High Court, insolvency practitioners, inquiry officer, prohibition on commencing insolvency proceedings

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without a court order, appointment of inquiry officer, creation of an Insolvency Administration Office, committee of creditors, company restructuring program, functions, duties and powers of insolvency practitioner, etc. Though the present Insolvency Act adopts a “one law, two systems” approach, including both the regimes of liquidation and restructuring, it lags behind in addressing the latest developments in insolvency affairs marking today’s world.

Key Words: Evolution, Liquidation, Insolvency, Company, Audit

INTRODUCTION

Generally, company law is enacted for smooth and speedy development of business in the country through company organization. Because of this Nepal has been enacting such type of law at different times. Company law deals with different matters, such as: incorporation, liquidation, dissolution and so on. But for some reason sometimes any sort of companies may get liquidated.

There are many methods of putting an end to the life of a company. Liquidation is also one of the methods to that effect. Liquidation proceeds dissolution. Liquidation relates with those affairs, consequence of which results dissolution. Liquidation of a company is not, in itself, dissolution of the company. It is the prior stage of dissolution. At the end of liquidation, there remains no asset or property, no liability etc. of the company. There remains only dissolution, that is, only one formality to end the legal existence as a company.

Liquidation is a process to bring about an end to the life of company. Liquidation is also termed as ‘winding up’ because these two terms are used interchangeably. Liquidation of a company refers to a process including the closing a company down and collecting its assets, distribution of its liabilities etc.

Winding up of a company as defined by the Blank’s law Dictionary,” the process of settling the accounts and liquidating the assets of partnership or corporation for the purpose of making distribution of net assets to shareholders or partners and dissolving the concern”.

Liquidation is a process of realizing upon assets and of discharging liabilities in concluding the affairs of a business/ company etc.”¹

“Liquidation of a company means a situation where the registration of a company is cancelled by fulfilling the procedures referred to in Companies Act, 2063.”²

As defined by Prof. Gower the term winding up of a company is, "the process whereby its life is ended and its property is administered for the benefit of its creditors and members. An administrator called a liquidator is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with their rights."³

Thus, liquidation or winding up of company is a process under which the management of a company, by closing its transaction, is taken all and whole assets of company are controlled by an independent official called liquidator. In other words, after the appointment of the liquidator, the directors and officers of the company relieve of their office, and the liquidator takes all properties, accounts etc. of the company under his responsibility and control. Similarly, the liquidator exercises all the managerial powers of the company and conducts the liquidation proceedings of the company. In this course, the liabilities (debts) are determined and paid out by a liquidator on the basis of priority of payment of the liabilities. Even after the payment of debts if the assets of a company remain, the liquidator distributes such assets among the members pursuant to the Company Act and articles of a company. Thus, the process of liquidation/ winding up of a company consists of the realization of the assets, payment of the liabilities and distribution of surplus, if any, amongst the members of the company.

After the completion of the liquidation proceedings, the company loses its institutional or legal existence. It may be, however, noted that the company can file a suit against anybody and anybody can do so against

¹ Shankar Kumar Shrestha, Dictionary of Law and Justice 523 (English-English-Nepali, 3rd edn., Pairvi Prakashan, 2019).

² Section 2 (d) of the *Insolvency Act, 2063*.

³ The Principles of Modern Company Law 647 (3rd edn., 969).

the company during the process of liquidation (i.e., during the time between the commencement of liquidation and completion thereof).

In conclusion, the process of liquidation consists of the realization of the assets, determination and payment of the liabilities as well as distribution of surplus assets, if any, amongst the members of the company in proportion.

PHASES OF EVOLUTION OF LAW RELATING TO LIQUIDATION OF COMPANY IN NEPAL

It can be discussed from two angles:

- Development of Law relating to Liquidation of Company (Solvent company) under Law of Company and
- Development of Law relating to Liquidation of Company (Insolvent company) under Law of Insolvency

Development of Law relating to Liquidation under Law of Company (Solvent Company)

In Nepal, generally, company law governs the provisions regarding liquidation of company which is solvent in nature. Nepal has neither a long history of law relating to company nor law relating to liquidation of company. It is deemed that, in Nepal, enactment of the company law had begun from the period of second world war.⁴ Generally, the law of company deals with almost all matters from incorporation to liquidation or dissolution of a company. The law of company itself includes the provisions concerning liquidation of the company. In this sense, the law relating to liquidation is born as soon as a company is incorporated in accordance with law. In Nepal, for the first time, it is found that the provision concerning liquidation came into existence when Nepal Company Kanoon was enacted in 1993 B.S.⁵ So, Nepal Company Kanoon (Law) is deemed to be the first law of Nepal giving birth to liquidation. The life of the law relating to liquidation, therefore, is as same as the law of company even in Nepal. The law relating to liquidation of company is necessary to be

⁴ Surendra Bhandari, *Company and Corporation Law* 5 (Athrai Pustak Bhandar, Kathmandu, 2052).

⁵ Bharat Raj Upreti, *Company Law, FREEDEAL* 65 (2nd edn., Kathmandu, 2064).

discussed under the law of company enacted in different time periods in Nepal. Mainly, the historical evolution of law relating to liquidation of company can be discussed along with the law governing it in the following three stages:

Ancient Period (1993 B.S. - 2007 B.S.)

In this stage, the Nepal Company Kanoon (Law), 1993 was promulgated to incorporate, operate and regulate a company being established by joint stock with a view to obtaining commercial purpose. This law is deemed to be the first law in the history of Nepal⁶ and promulgated during the then Prime Minister Juddha Shamsheer Rana seemed to have been influenced by the British Companies Act, 1929 A.D. For almost all provisions were similar in both Nepal Company Kanoon and British Company Law. Under this law, Biratnagar Jute Mill was formed for the first time as a joint stock company. Nepal Company Kanoon had 95 Sections. This law had set out some provisions as regards liquidation of company under sections 75-93, including provisions regarding appointment of liquidator, rights and duties of the liquidator and provision regarding concerned office regulating liquidation proceedings.

Middle Period (2007 B.S. - 2021 B.S.)

This period began from 2007 B.S. and ended in 2021 B.S. In this period, the law relating to companies was first enacted in the name of Nepal Company Act, 2007 B.S. but later on the term 'Law' was amended in the name of 'Act' in 2018 B.S. This Act was the product of the establishment of democracy in Nepal. This Act was amended three times during this period. This Act is deemed to be the modified, modernized and developed form of the Nepal Company Law, (Kanoon) 1993 B.S. But the Act had also introduced some new concepts to this regard. This Act, having 160 Sections, was enacted as a separate law but this Act did not repeal the previous law of 1993 B.S. This Act came into force on 30th Bhadra, 2007.

This Act had made different provisions concerning liquidation of companies. According to this Act, the power to liquidate the registered

⁶ *Ibid*, pp. 63-64.

company or general company remained vested in Taluk Adda (also known as Udhyog Parishad) or the court itself.⁷The Act had provided some grounds under which such company could be liquidated⁸ such as: where a company filed an application after passing resolution to liquidate the company and so forth. If any ground occurred, the Taluk Adda had to appoint an experienced and reliable person or institute or firm or company as a liquidator for the purpose of liquidation.⁹ For this, the liquidator was entitled to reasonable remuneration.¹⁰ After appointment the liquidator had to perform functions with the permission of the Taluk Adda and the Court.¹¹ The liquidator had to maintain the book about the affairs of the meeting,¹² to submit the statement of income and expenditure to the Taluk Adda twice a year until remained on his post.¹³ The liquidator had to clear payment on the priority basis.¹⁴ Moreover, the liquidator had to also discharge other duties and the Taluk Adda had to also receive the complaint and had to give its decision upon the functions done and decision given by the liquidator.¹⁵ The Act had provided some certain powers to the court too,¹⁶ which the court could enjoy when an order was issued to liquidate a company and so forth. After clearance of all accounts and transactions of the company being liquidated, the company was deemed to have liquidated from the date of furnishing notice of liquidation of the company by the Taluk Adda. Moreover, the related person who was dissatisfied with the order or decision given by the Taluk Adda or the Court to liquidate the company, could file an appeal with the office hearing the appeal in accordance with Muluki Ain.¹⁷

Modern Period (2021 B.S. - Till Now)

This period can be discussed in the following stages:

⁷ Section 120 of the *Nepal Company Act, 2007*.

⁸ Section 21 of the *Nepal Company Act, 2007*.

⁹ Section 122 (a) of the *Nepal Company Act, 2007*.

¹⁰ Section 22 (c) of the *Nepal Company Act, 2007*.

¹¹ Section 123 & 137 of the *Nepal Company Act, 2007*.

¹² Section 124 of the *Nepal Company Act, 2007*.

¹³ Section 125 (a) of the *Nepal Company Act, 2007*.

¹⁴ Section 135 (a) of the *Nepal Company Act, 2007*.

¹⁵ Section 126 of the *Nepal Company Act, 2007*.

¹⁶ Section of 27-133 of the *Nepal Company Act, 2007*.

¹⁷ Section 134 of the *Nepal Company Act, 2007*.

First Stage (2021 B.S. - 2053 B.S.)

This stage started when Company Act, 2007 was repealed and Company Act, 2021 was enforced in 2021 B.S. This Act was amended four times during this stage. The life of this Act was very long in comparison to other laws before this Act was enacted. This Act had 13 Chapters, 152 Sections and 11 Schedules. This Act came into force from 9th Mangsir 2021.

The Company Act, 2021 was enacted as per demand of times. It was said in the Preamble of Company Act, 2021 that “whereas it is expedient to make legal provisions relating to companies in keeping with the requirements of the country, the times and existing circumstances; therefore this Act was made.”

This Act had dealt with various matters including liquidation of the company under its chapter 9. This Act had recognized two types of liquidation of company¹⁸ liquidation by the concerned Department¹⁹ and voluntary liquidation. The Act had prescribed some conditions under which the concerned Department (hereinafter refer to Department) could order to liquidate a company,²⁰ such as: in case of submission of an application to the department by passing a special resolution in a general meeting to liquidate a company etc. Upon receipt of an application, the department, if deemed reasonable, could issue an order to liquidate a company and the company required to close its business except in so far as many be necessary, and all the powers of directors would, ipso facto, lapse from the date of such order.²¹ The Act had also provided a right to a person who was not happy with the order issued by the department to file an appeal with the Supreme Court.²²

As per the Act, while issuing an order to liquidate a company the department had to also appoint a government liquidator (hereinafter refer to liquidator) for the purpose of liquidation and an auditor for the purpose

¹⁸ Section 116 & 128 of the *Nepal Company Act, 2007*.

¹⁹ Concerned Department as defined in Sections 2(s) of *Company Act, 2021* means “Department of Industry or Office as designed by His Majesty’s Government.”

²⁰ Section 116 of the *Nepal Company Act, 2021*.

²¹ Section 117 of the *Nepal Company Act, 2021*.

²² Section 118 of the *Nepal Company Act, 2021*.

of auditing accounts kept by the liquidator and determining their remuneration as well²³. After appointment the liquidator had to take all the necessary documents, assets of the company under his custody²⁴, and he had to do various functions and exercise the powers during liquidation proceedings along with duties.²⁵ With respect to voluntary liquidation, the Act had also set out some provisions including conditions in which a company could be liquidated voluntarily. While passing a resolution to liquidate a company voluntarily one or more liquidators and auditors had to be appointed by the company,²⁶ and a notice thereof had to be furnished to the department and published in the leading newspapers within fifteen days of passing such resolution²⁷. After passing resolution, the company had to stop its business except in so far as it is necessary to continue such business,²⁸ The liquidator had to exercise all such powers as were exercised by government liquidator.²⁹ During liquidation proceeding the liquidator had to pay off in the debt in priority basis³⁰ and present his report before general meeting of the company.³¹ Besides, the liquidator had to submit his final report to the department and the department had to publish a notice of liquidation of company.³²

Second Stage (2053 B.S to 2062 B.S.)

This stage started as soon as the Company Act, 2053 was issued. This Act replaced the former Act of 2021 B.S. This Act came into force on 22 Falgun, 2053. After the restoration of democracy in Nepal, This Act was enacted and it is the first Act which came after introducing the free market economy in the country. No amendment was made to this Act during this stage. The Act had provisioned 14 Chapters and 144 Sections.

This Act was another law governing liquidation of companies in Nepal. This Act had dealt with the matters relating to liquidation, especially

²³ Section 119 of the *Nepal Company Act, 2021*.

²⁴ Section 120 of the *Nepal Company Act, 2021*.

²⁵ Section 121-125 of the *Nepal Company Act, 2021*.

²⁶ Section 128 of the *Nepal Company Act, 2021*.

²⁷ Section 129 of the *Nepal Company Act, 2021*.

²⁸ Section 130 of the *Nepal Company Act, 2021*.

²⁹ Section 131 of the *Nepal Company Act, 2021*.

³⁰ Section 125 and 132 of the *Nepal Company Act, 2021*.

³¹ Section 136 of the *Nepal Company Act, 2021*.

³² Section 137 of the *Nepal Company Act, 2021*.

under its Chapter 10. Unlike the Company Act, 2021, this Act had adopted 3 ways of liquidating a company³³. In case of liquidation by the office³⁴, an order was issued by the office, if felt appropriate, to liquidate a company in some conditions³⁵. This Act had provided the rules regarding procedures of liquidation of a company.³⁶ After issuance of such order, the company could not operate any business transactions unless otherwise provided for in this Act and all the powers of directors would ipso facto terminated from the date of such order.³⁷ While issuing such order the office had to appoint a liquidator for the purpose of liquidation and an auditor to audit the accounts kept by the liquidator and they were entitled to remuneration as fixed by the office.³⁸ The liquidator could enjoy some powers.³⁹ After appointment the liquidator had to take all the books, documents and assets of the company under his control,⁴⁰ to convene the creditors' meeting.⁴¹ Similarly, the Act had also provisioned some conditions under which a public company can be liquidated voluntarily.⁴² Where the company passed a resolution for liquidating such company, the general meeting had to appoint one or more liquidators and one or more auditors for the purpose of liquidation of company and for the purpose of auditing accounts kept by the liquidator respectively and had to fix their remuneration. With respect to a private company, it could be liquidated in accordance with procedures laid down in its Memorandum, Articles or Unanimous Agreement.⁴³ unless otherwise mentioned elsewhere in this Act, the company was bound to close its business transactions, after a resolution had been passed for its voluntary liquidation.⁴⁴

Besides, after appointment the liquidator had to convene general meeting of the company⁴⁵ and also had to submit the accounts to the

³³ Section 101, 111 and 131 of the *Company Act, 2053*.

³⁴ Office as defined in Section 2(s) means, "the Company Registrar Office of His Majesty's Government."

³⁵ Section 101 (1) of the *Company Act, 2053*.

³⁶ Section 102 of the *Company Act, 2053*.

³⁷ Section 101 (2) of the *Company Act, 2053*.

³⁸ Section 103 of the *Company Act, 2053*.

³⁹ Section 105 of the *Company Act, 2053*.

⁴⁰ Section 104 of the *Company Act, 2053*.

⁴¹ Section 106 (1) of the *Company Act, 2053*.

⁴² Section 101 (1-3) of the *Company Act, 2053*.

⁴³ Section 101 (4) of the *Company Act, 2053*.

⁴⁴ Section 113 of the *Company Act, 2053*.

⁴⁵ Section 106 of the *Company Act, 2053*.

office.⁴⁶ The Act had provided the rules as to settlement of debt and accordingly the payment had to be paid off on the priority basis.⁴⁷ After completion of the entire liquidation proceeding the liquidator had to send a report to the office along with the fixed audited report. Upon receipt of such report, the office, if thought appropriate, would issue an order for liquidation of company and the company was supposed to be liquidated.⁴⁸ The company Act had also empowered the court to issue an order for liquidation of company. Any shareholder of the company could make an application to the district court for a remedy if a company was engaged or likely to engage in activities contrary to his interest or if a company was not doing or going to do what it should have done. Upon receipt of such application the court could, if thought reasonable, issue an order to liquidate the company for a remedy.⁴⁹ Thus, comparatively, this Act had included some other new concepts in addition to the former, and attempted to make some provisions clear. However, in the case of liquidation by court this Act was totally silent about the procedure to be followed.

Third Stage (2053 B.S. - 2063 B.S.)

This stage begins when Companies Ordinance, 2005 (2062 B.S.) has been promulgated in 2062 B.S. The Companies Ordinance, 2062 repealed the Company Act, 2053 and came into force since Asoj 23, 2062. This Ordinance was issued to amend and consolidate forthwith the law relating to companies. After having seriously discussed upon the provisions concerning companies for sometimes, this Ordinance was replaced by enacting new Companies Act, 2063 with a view to amending and consolidating forthwith the law relating to companies. This Act has repealed some provisions of the former Companies Ordinance and has adopted some new concepts too. This Act has comprised almost all contemporary aspects of modern business.

The Companies Act, 2006 (2063 BS) came into force from 24thKartik, 2063. This Act has contained 21 Chapters and 188 Sections. It has been said in the preamble of this Act, “whereas it is expedient to

⁴⁶ Section 108 of the *Company Act, 2053*.

⁴⁷ Section 109 of the *Company Act, 2053*.

⁴⁸ Section 118 (1) of the *Company Act, 2053*.

⁴⁹ Section 131 (1) (3) and (4) of the *Company Act, 2053*.

amend and consolidate the law relating to companies in order to bring about dynamism in the economic development of the country by promoting investment in the industry, trade and business sectors through economic liberalization and make the incorporation, operation and administration of companies much easier, simpler and more transparent; therefore be it enacted by the House of Representatives.

One of the major provisions made by this Act is the provision relating to liquidation of company which is solvent in nature.

DEVELOPMENT OF LAW RELATING TO LIQUIDATION OF COMPANY (INSOLVENT COMPANY) UNDER LAW OF INSOLVENCY

This can be discussed in two folds:

Muluki Ain (1910 B.S. - 2020 B.S. & Muluki Civil Code, 2074 B.S.)

In Nepal, law of insolvency which is considered to be a part of company law deals with the provisions as to liquidation of company which is insolvent. Actually, Muluki Ain, 1853 (1910 B.S.) is deemed to be the first written law in respect of insolvency concept in the history of Nepal. Concept of insolvency had been adopted in third Part of 'Damasahi ko' under first Muluki Ain, 1910 B.S. issued under the regency of then king Surendra Bir Bikram Shah Dev, and the Act came into force since 7 Paus 1910 B.S. After a very long time, this Ain was repealed and new Muluki Ain, 1963 (2020 B.S.) came into existence. The Ain of 2020 had incorporated the rules regarding insolvency under its chapter 'Damasahiko Mahal'. With the pace of time this Ain was also replaced by Muluki Civil Code, 2017 (2071 B.S.) (formerly Muluki Civil Code Act, 2074) which came into force from 1stBhadra, 2075. This present Code has provisioned the rules as to insolvency in its Chapter 3 "Provision on Natural Person" of part 2. The rules incorporated in this Code are purely related with insolvency of natural person (also called Bankruptcy) and not legal person. i.e. company which is insolvent.

In this way, all the provisions adopted and incorporated in all MulukiAin or Code discussed above are the attempts towards development

of insolvency of natural person and such provisions, except some concepts do not fall under the area of my study.

Insolvency Ordinance/Act (2062/2063 B.S. to till Date)

The Insolvency Ordinance, 2005 (2062 BS) is the first legislation in the history of Nepal, which has dealt with the provisions relating to company which is insolvent. This Ordinance was issued on 7th Asoj, 2062. Before promulgation of this Ordinance, the process had been commenced in 2002 (2059 B.S.) with the technical assistance grant from the Asian Development Bank, the Ordinance forthwith was converted into Insolvency Act. The Act came into force from 4th Mangsir 2063 B.S. This Act has provisioned 9 Chapters and 77 Sections. It is said in its preamble that, "Whereas, it is expedient to make legal provisions immediately in relation to the administration, insolvency proceedings of companies which are insolvent or going to be insolvent being unable to pay debts to creditors or which are facing financial difficulties, and in relation to the restructuring of such companies, therefore be it enacted by the House of Representatives". Thus, one of the major objectives of the Insolvency Act is to make legal provisions governing the administration and proceedings of companies which become insolvent or likely become insolvent.

Being a separate and single law, the Insolvency Act, 2063 is concerned with insolvency of legal person, especially a company which is insolvent in nature. Hence, the Insolvency Act, 2063 is a law which governs the matters of legal/corporate insolvency and not the matter of personal insolvency or individual insolvency.

Both the Companies Act, 2063 and Insolvency Act, 2063 have made some provisions relating to liquidation of company. They are provisions on Company Registrar Office, Commercial Bench, Insolvency Administration Office, Professional Practitioners, such as inquiry officer, liquidator, auditor etc. Moreover, the Insolvency Act has adopted 'One Law Two System' including restructuring and liquidation. The provisions of this Act are applicable only to companies incorporated under Companies Act 2063 and corporate body with limited liability and so forth.

CONCLUSION

Overall, liquidation of a company is an undesirable yet essential procedure in the lives of many companies. Companies need to be liquidated for a variety of reasons. While many companies are liquidated voluntarily by its members when they are still solvent, quite a few others have to involuntarily choose the path as it becomes untenable to run the firm as its liabilities exceed its assets. Hence, it would be prudent for all the parties involved to opt for its dissolution as that would prevent extra drainage of resources and effort in a hopeless entity. That is why, all jurisdictions have provided for legal and institutional measures for conducting the liquidation proceedings in an organized and efficient fashion.

In the past and for a long time, insolvency in Nepal was associated only with natural persons who have failed to pay off their individual or institutional creditors. Prevailing laws have laid down several disqualifications that attach to persons held as bankrupt. Corporate liquidation made its way in our legal domain only in 2007 BS, much later than our Western or even Indian counterparts. Involuntary liquidation of insolvent companies got legal recognition only in 2063 BS with the adoption of Insolvency Act, the same year. The underlying reason behind such delayed practice of liquidation and insolvency proceedings may be attributed to the underdevelopment of business ventures and industries, and the common tendency found among the investors to just practically shut down the company and tilt towards another business, not caring for the legal consequences thereof.

Hence, with the passage of a new Companies Act in 2063 BS, the voluntary liquidation of solvent companies got well organized across legal parameters while the introduction of Insolvency Act in the same year has incorporated court-initiated insolvency proceedings of sick companies. Both the statutes encapsulate the underlying norms and practices of liquidation proceedings. Now, both forms of liquidation have been given ample recognition in our corporate laws, but lack of timely amendments matching with the international developments in this area leaves us a lot to be desired.

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