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Mrs.S.Kalpana, presently Assistant professor of Law, VelTech Rangarajan Dr.Sagunthala R & D Institute of Science and Technology, Avadi. Formerly Assistant professor of Law, Vels University in the year 2019 to 2020, Worked as Guest Faculty, Chennai Dr.Ambedkar Law College, Pudupakkam. Published one book. Published 8Articles in various reputed Law Journals. Conducted 1Moot court competition and participated in nearly 80 National and International seminars and webinars conducted on various subjects of Law. Did ML in Criminal Law and Criminal Justice Administration. 10 paper presentations in various National and International seminars. Attended more than 10 FDP programs. Ph.D. in Law pursuing.



Avinash Kumar



Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC – NET examination and has been awarded ICSSR – Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and learning.

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THE ROLE OF SHAREHOLDERS IN CORPORATE LIQUIDATION: A LEGAL PERSPECTIVE

AUTHORED BY - AASHI JAIN & ARNAV SHARMA

Abstract

Corporate liquidation is a crucial process in insolvency law, determining the rights and responsibilities of various stakeholders, including shareholders. This research examines the legal role of shareholders in corporate liquidation, exploring their rights, obligations, and influence within the liquidation framework. Shareholders, as residual claimants, often find their interests subordinated to secured and unsecured creditors, yet their role in approving voluntary liquidation and engaging in legal proceedings remains significant. The study delves into statutory provisions under the Insolvency and Bankruptcy Code (IBC), 2016, Companies Act, 2013, and international insolvency regimes to assess shareholder participation in liquidation proceedings. A comparative analysis with jurisdictions such as the United States and the United Kingdom highlights variations in shareholder rights and protections. The research further evaluates the extent to which shareholders can challenge liquidation decisions, initiate voluntary liquidation, or oppose compulsory liquidation. The paper explores the fiduciary obligations of directors toward shareholders during the liquidation process and the extent of shareholders' liability, particularly in cases of fraudulent or wrongful trading. The role of minority shareholders is also examined, focusing on their legal remedies and protections against oppression during liquidation. By analysing landmark judicial pronouncements and legal precedents, this research aims to clarify the evolving jurisprudence surrounding shareholder involvement in corporate liquidation. The study concludes by proposing potential reforms to enhance shareholder rights while maintaining creditor primacy, ensuring a balanced and equitable liquidation framework. This research is done to make the people aware about all the problems which are faced by Shareholders. It underscores the necessity of legal clarity and procedural safeguards to protect both creditors and shareholders while upholding corporate accountability in the liquidation process. This research has employed the Mixed Methods of research it contains Qualitative, Quantative and Doctrinal research.

Statement of Problem:

Corporate liquidation represents the final, often contentious phase in a company's lifecycle, where the orderly distribution of assets must reconcile the competing interests of various stakeholders. While creditors typically have prioritized claims over a company's assets, shareholders especially minority shareholders are left with residual rights that frequently remain ambiguous under current legal frameworks. Despite their critical role in initiating and influencing voluntary liquidation processes, shareholders face diminished influence in compulsory liquidation scenarios, where statutory provisions and judicial practices overwhelmingly favour creditor recovery. This disparity is compounded by inconsistent interpretations of key legal provisions across jurisdictions and evolving judicial precedents concerning director fiduciary duties and shareholder rights. Consequently, there exists a significant gap in legal clarity regarding the rights, obligations, and protections available to shareholders during liquidation, calling for a comprehensive examination of existing laws and potential reforms to establish a more balanced and equitable liquidation framework.

Review of Literature:

Anon "Shift of Fiduciary Duty Upon Corporate Insolvency" Published in The Vanderbilt Law Review: explores how insolvency alters directors' fiduciary obligations towards shareholders and creditors.¹ The paper contends that as companies near insolvency, management may pursue riskier projects that disproportionately benefit shareholders at creditors' expense. It argues that existing legal frameworks inadequately address the divergence of interests between these stakeholders. Emphasising findings, the study critiques the persistence of shareholder primacy and calls for legal safeguards to balance risk allocation in distressed enterprises, thereby improving corporate governance outcomes.

Anon "Corporate Liquidations and Reorganizations" Published in SSRN 2024: Investigates the strategic choices firms face when liquidating versus reorganising. The study contends that liquidation decisions are influenced by market conditions, tax implications and stakeholder interests, including those of shareholders.² It critically analyses the trade-offs between dissolving a corporation and pursuing restructuring options that preserve corporate value. The paper provides empirical evidence demonstrating that reorganisation yields superior

¹ (Anon, 'Shift of Fiduciary Duty Upon Corporate Insolvency' (2019) Vanderbilt L Rev)

² (Anon, 'Corporate Liquidations and Reorganizations' (2024) SSRN)

long-term outcomes compared to liquidation, urging regulatory reforms to facilitate smoother transitions for distressed companies while safeguarding shareholder rights.

Introduction:

Corporate liquidation is a significant legal process that determines the dissolution of a company and the distribution of its assets among stakeholders in a proportion. It marks the final stage of a corporation's existence, often triggered by insolvency proceedings, shareholder resolutions, or regulatory intervention.³ Shareholders, as the company's owners, play a critical role in the liquidation process, of the company but their rights and responsibilities are often overshadowed by the interests of financial creditors and other priority claimants like operational creditors, secured creditors etc. This research explores the legal role of shareholders in corporate liquidation, focusing on their rights, obligations, and influence within the liquidation framework. Under Corporate and Insolvency Law, shareholders hold residual claims on a company's assets, meaning they are entitled to distributions only after all debts and liabilities have been settled. Their role varies depending on whether the liquidation is voluntary or compulsory. In voluntary liquidation, shareholders initiate the process through a resolution, demonstrating their control over the company's winding-up decisions. However, in compulsory liquidation, initiated by creditors or regulatory authorities, shareholder influence is significantly diminished. Legal frameworks such as the Insolvency and Bankruptcy Code (IBC), 2016, and the Companies Act, 2013, in India, alongside comparative analysis with jurisdictions like the United States and the United Kingdom, provide insights into shareholder participation in liquidation proceedings. This research examines key legal provisions, judicial precedents, and corporate governance principles to assess how shareholders can influence liquidation outcomes. It also addresses potential liabilities shareholders may face, particularly in cases involving fraudulent or wrongful trading. By analysing the evolving jurisprudence surrounding shareholder involvement in liquidation, this study aims to contribute to legal scholarship and policy discussions. The research highlights the need for balanced legal mechanisms that safeguard shareholder interests while ensuring creditor primacy and corporate accountability in liquidation proceedings.

³ *Insolvency and Bankruptcy Code 2016 (India) Act No 26 of 2016*
<https://ibbi.gov.in/uploads/legalframework/547c9c2af074c90ac5919fa8a5c60bd4.pdf>

Whether shareholders have any significant legal rights and obligations during corporate liquidation, and how these differ across jurisdictions?

In most jurisdictions, shareholders are recognized as the residual claimants in a corporate liquidation, meaning that they are entitled to any remaining assets only after all creditor claims have been fully satisfied. In voluntary liquidation, shareholders typically have significant legal rights and obligations they are actively involved in initiating the process through special resolutions, appointing liquidators, and approving the final distribution of assets.⁴ This active role enables shareholders, especially in jurisdictions like India under the Companies Act, 2013, to influence the winding-up process and even challenge decisions they deem unfavourable. However, in compulsory liquidation often initiated by creditors or regulatory authorities their participation is considerably curtailed, with the statutory framework generally prioritizing the claims of secured and unsecured creditors over those of shareholders.

General Rights and Obligations

1. Residual Claimant Status:

In most legal systems, shareholders receive any remaining assets only after all creditors' claims are satisfied. This means that while shareholders hold the ultimate claim on the company's assets, their rights are often subordinated to those of secured and unsecured creditors.

2. Participation in Voluntary Liquidation:

In voluntary liquidations, shareholders typically play a central role. They approve the liquidation through resolutions, appoint liquidators, and set the framework for asset distribution. This process underscores their control over the winding-up decisions, as the liquidation is initiated and managed by the shareholders themselves.

3. Limited Influence in Compulsory Liquidation:

When liquidation is forced (compulsory liquidation), the process is typically initiated by creditors or regulatory bodies. In these scenarios, shareholders' rights are more limited, and they are not involved in key decisions, as a court or an independent liquidator takes charge of the proceedings.

⁴ *Companies Act 2013 (India) Act No 18 of 2013*
<https://www.mca.gov.in/content/dam/mca/pdf/CompaniesAct2013.pdf>

JURISDICTIONAL DIFFERENCES

India (IBC, 2016 & Companies Act, 2013):

Under Indian law, shareholders have clear rights in voluntary liquidation scenarios through the Companies Act, 2013. However, once insolvency proceedings are triggered under the Insolvency and Bankruptcy Code (IBC), creditor claims take precedence, and shareholder involvement diminishes. Here, legal provisions emphasize protecting creditor interests while still allowing shareholders to participate in certain resolutions or to challenge decisions if they believe there has been misconduct or wrongful trading.

United States:

U.S. bankruptcy laws, particularly those governing Chapter 7 (liquidation) and Chapter 11 (reorganization), similarly treat shareholders as residual claimants.⁵ In a voluntary dissolution, shareholders have a direct say, but in a bankruptcy scenario, their claims are generally subordinated to those of creditors. The legal framework here prioritizes orderly distribution of assets to creditors before any residual value is returned to shareholders.

United Kingdom:

The UK's insolvency regime, governed by acts such as the Insolvency Act 1986 and the Companies Act 2006, provides for shareholder involvement in voluntary liquidation.⁶ In compulsory or court-ordered liquidations, shareholders' influence is curtailed as the process is managed by licensed insolvency practitioners, who ensure that creditor claims are satisfied first. Nonetheless, judicial oversight and established legal precedents sometimes offer shareholders opportunities to challenge decisions or ensure fair treatment.

International Comparison:

Comparative studies reveal that while the fundamental principle of residual claimancy is common, the degree of shareholder participation can differ. In jurisdictions with strong corporate governance traditions (such as the UK and in some U.S. states), even in compulsory liquidations there are mechanisms (e.g., court reviews, shareholder meetings post-liquidation) that occasionally allow shareholders to assert their interests.⁷ In contrast, jurisdictions where

⁵ US Bankruptcy Code Chapter 7 & 11 <https://www.uscourts.gov/court-programs/bankruptcy/bankruptcy-basics/chapter-7-bankruptcy-basics> (Last Visited : 15-03-2025)

⁶ Insolvency Act 1986, c 45; Companies Act 2006.

⁷ L Dilks, *International Perspectives on Corporate Liquidation* (Cambridge University Press 2015).

creditor protection is prioritized may offer fewer avenues for shareholders to influence the liquidation process.

WHETHER SHAREHOLDERS CAN INFLUENCE THE CORPORATE LIQUIDATION PROCESS, AND WHAT LEGAL REMEDIES EXIST IF THEIR INTERESTS ARE COMPROMISED?

Shareholders, as the ultimate owners of a company, can exert influence during the corporate liquidation process, particularly when the process is initiated voluntarily, although their control is more limited in compulsory liquidation or court-ordered liquidations. In a voluntary liquidation, the shareholders' role is central: they are responsible for initiating the winding-up process by passing a special resolution, appointing a liquidator, and setting the framework for how the company's remaining assets are realized and distributed. This direct participation means that shareholders can, through their voting rights and attendance at general meetings, determine key aspects such as the selection of a competent liquidator and the approval of asset realization and distribution plans. The statutory framework in many jurisdictions such as under the Companies Act, 2013 in India ensures that shareholders can effectively direct the liquidation process, thereby preserving their residual claims once all creditor obligations have been met.⁸ However, in compulsory liquidations triggered by creditor petitions or regulatory intervention, the influence of shareholders diminishes considerably. In these situations, an independent liquidator or a court-appointed administrator takes control, and the primary objective becomes the maximization of returns to creditors.⁹ Although shareholders still retain their right to any residual surplus, their ability to shape the liquidation process is largely overridden by the need to satisfy higher-priority claims. Despite these limitations, legal remedies exist for shareholders whose interests are compromised during liquidation. For example, if shareholders believe that the liquidator's actions or decisions have unfairly prejudiced their rights such as through an improper valuation of assets or an inequitable distribution scheme they can seek judicial review. Courts have the authority to examine and set aside decisions that violate statutory provisions or established principles of corporate governance, thereby providing a mechanism for shareholders to contest actions that might otherwise diminish their residual recovery. In addition, minority shareholders may invoke dissent or appraisal rights in jurisdictions like the United Kingdom and the United States, where

⁸ Companies Act 2013 (India) Act No 18 of 2013. <https://www.mca.gov.in/content/mca/global/en/acts-rules/companies-act/companies-act-2013.html> (Last Visited 15-03-2025)

⁹ M Turner, *Corporate Insolvency: Insolvency Law in Context* (2nd edn, Oxford University Press 2016) 112

they can opt to have their shares valued by a court if they disagree with the terms of a proposed liquidation or merger. Such rights are designed to protect shareholders from oppressive conduct by majority stakeholders or directors who might favour arrangements that benefit creditors at the expense of minority interests. Moreover, shareholders can sometimes bring claims for breaches of fiduciary duty against directors or officers if it is demonstrated that the management has acted in a manner that intentionally undermines shareholder value—for instance, through fraudulent transactions or by misusing company assets during the liquidation process. These legal actions can result in remedies including monetary compensation, rescission of detrimental transactions, or orders for corrective measures that realign the process with equitable treatment of all stakeholders.¹⁰ In summary, while shareholders have significant influence in voluntary liquidation processes exercising direct control over key decisions—their role is considerably restricted in compulsory liquidations. Nonetheless, the law provides multiple avenues for redress, including judicial review, dissent and appraisal rights, and fiduciary duty claims, ensuring that shareholders can seek to safeguard their interests even when the liquidation process predominantly serves creditor recovery.

WHETHER SHAREHOLDER CLAIMS TAKE PRECEDENCE OVER CREDITOR CLAIMS IN CORPORATE LIQUIDATION, AND WHAT LEGAL PRINCIPLES DETERMINE THIS HIERARCHY?

In corporate liquidation, creditor claims take precedence over shareholder claims due to fundamental legal principles that prioritize debt repayment before distributing any residual value to equity holders. This hierarchy is determined by corporate and insolvency laws, which emphasize protecting creditors who have provided loans or other forms of credit to the company.

Legal Principles Governing the Hierarchy

1) Principle of Absolute Priority

The absolute priority rule (APR) is a fundamental principle in insolvency law that dictates the order in which claims are satisfied during liquidation.¹¹ Under this rule, secured creditors are paid first, followed by unsecured creditors, and only after all debts are settled do shareholders receive any remaining assets. This principle ensures that

¹⁰ M Khan, *The Judicial Control of Insolvency Proceedings* (Cambridge University Press 2015) 98

¹¹ A Armour, 'Judicial Review in Insolvency Proceedings' (2007) 26(3) *Insolvency Law Journal* 45.

those who have taken lower risks (secured creditors) are repaid before higher-risk investors (shareholders).

2) **Limited Liability of Shareholders**

Corporate law establishes the principle of limited liability, meaning shareholders are only liable up to the amount of their investment in the company. Since shareholders are residual claimants, they are entitled to a share of the company's profits when it is solvent but must wait until all creditors are paid in full during liquidation. This reinforces the subordination of shareholder claims to creditor claims.

3) **Creditor Rights in Insolvency**

Creditors, particularly secured creditors, have enforceable rights over company assets due to contractual agreements and security interests. Secured creditors have the first right to assets pledged as collateral. Unsecured creditors, while ranking below secured creditors, still hold priority over equity holders. Shareholders, as owners, assume the highest level of financial risk and bear the losses before creditors suffer any shortfall.

4) **Statutory and Judicial Framework**

The legal hierarchy of claims is codified in insolvency and bankruptcy statutes. For example, under the Insolvency and Bankruptcy Code (IBC), 2016 in India, liquidation follows a structured waterfall mechanism as per Section 53. This hierarchy places:

- 1) Insolvency resolution costs and workmen's dues,
- 2) Secured creditors next,
- 3) unsecured financial and operational creditors,
- 4) Preference shareholders before common shareholders, who are the last in line.

Similarly, in the U.S. Bankruptcy Code (Chapter 7 liquidation process), creditors—including secured, unsecured, and priority claimants—are repaid before equity holders receive any distribution.

Exceptions and Deviations

In rare instances, shareholders may have preferential rights based on contractual agreements. For example, certain classes of preferred shareholders might have a priority over common shareholders but still rank below creditors. Additionally, courts may set aside the priority rule in cases of fraudulent transfers, mismanagement, or equitable subordination, where shareholder

claims might be set aside if they have engaged in misconduct that disadvantaged creditors.

SUPREME COURT STAND ON SHAREHOLDERS RIGHTS

Kartikeya V. Sarabhai v. Commissioner of Income Tax (1997) 3 SCC 238.¹²

This landmark Supreme Court decision established that when a company's share capital is reduced or its shares are redeemed, the shareholder's rights are partially extinguished—effectively constituting a “transfer” of a capital asset. This principle underpins the idea that shareholders are left with only residual claims after creditors' interests are met.

Anarkali Sarabhai v. Commissioner of Income Tax (1997) 3 SCC 238.¹³

Often cited together with Kartikeya Sarabhai, this case reinforces that redemption of preference shares results in the surrender or extinguishment of shareholder rights. It underscores the residual nature of shareholder claims in liquidation scenarios.

Commissioner of Income Tax v. Jaikrishna Harivallabhdas (1998).¹⁴

In this decision, the Supreme Court further clarified that a reduction in share capital diminishes the shareholder's entitlement to dividends and participation in the company's assets, thus supporting the hierarchy that prioritizes creditor claims in liquidation.

Swiss Ribbons Private Limited v. Union of India and Others (2019) 4 SCC 17.¹⁵

Although primarily dealing with the withdrawal of insolvency proceedings, this judgment emphasizes that once insolvency is triggered, the commercial wisdom of the Committee of Creditors takes precedence. This indirectly confirms that shareholders, as residual claimants, have their rights subordinated to those of creditors in the liquidation process.

Phoenix Arc Private Limited v. Spade Financial Services Limited (2021).¹⁶

In addressing disputes during insolvency resolution, this case illustrates the limited role of shareholders when creditor claims are prioritized. It reinforces that shareholders' participation is largely confined to voluntary liquidation processes, while in compulsory liquidation, creditor recovery is paramount.

¹² *Kartikeya V. Sarabhai v. Commissioner of Income Tax (1997) 3 SCC 238*

¹³ *Anarkali Sarabhai v. Commissioner of Income Tax (1997) 3 SCC 238*

¹⁴ *Commissioner of Income Tax v. Jaikrishna Harivallabhdas (1998) 3COMPCAS875(GUJ)*

¹⁵ *Swiss Ribbons Private Limited v. Union of India and Others (2019) 4 SCC 17*

¹⁶ *Phoenix Arc Private Limited v. Spade Financial Services Limited (2021) SC 776, 2021 SC 36*

SOLUTIONS:

1) STATUTORY REFORMS FOR MINORITY PROTECTION:

Legislative amendments to the Companies Act and the Insolvency and Bankruptcy Code (IBC) should explicitly safeguard minority shareholders. By incorporating dissent and appraisal rights, minority shareholders would have a statutory mechanism to request independent valuations and challenge any oppressive practices during liquidation, ensuring that their interests are not sidelined in favour of major creditors or dominant shareholders.

2) ENHANCED TRANSPARENCY AND DISCLOSURE:

Mandatory disclosure of all key documents during the liquidation process is essential. This includes detailed asset valuations, comprehensive liquidation plans, and clear distribution proposals. Regular, independent audits and periodic updates would ensure that all shareholders, especially minority ones, have complete visibility into the process and can monitor its fairness, thereby reducing the risk of undisclosed or arbitrary decisions.

3) ROBUST JUDICIAL AND REGULATORY OVERSIGHT:

The establishment of fast-track judicial review mechanisms, along with the empowerment of regulatory bodies such as SEBI or dedicated insolvency regulators, is critical. These bodies should be given the authority to monitor and audit liquidation proceedings, ensuring that liquidators and the Committee of Creditors adhere to statutory and fiduciary norms, while providing an expedited route for minority shareholders to challenge any decisions that may adversely affect their rights.

4) INCLUSIVE GOVERNANCE STRUCTURES:

Key decision-making bodies, such as the Committee of Creditors and liquidator oversight committees, should include independent directors or designated representatives of minority shareholders. This inclusive governance approach would ensure that the voices of minority shareholders are heard in critical decisions, such as asset distribution and settlement approvals, thereby integrating their interests into the broader decision-making framework during liquidation.

5) SPECIALIZED DISPUTE RESOLUTION MECHANISMS:

To resolve conflicts efficiently, a dedicated alternative dispute resolution (ADR) framework should be established. This framework could include mediation and arbitration panels composed of insolvency experts, financial specialists, and independent legal advisors. Such mechanisms would provide binding, expedited resolutions for disputes involving minority shareholders, reducing the need for protracted litigation and ensuring that any grievances are addressed promptly and fairly.

CRITICAL ANALYSIS

The research paper mainly focuses on the shareholder rights. In a company the shareholders play a very important role likewise in voluntarily liquidation decision can be influenced by the shareholders at times. exploration of shareholder rights in the context of corporate liquidation, effectively highlighting the legal challenges and ambiguities that arise when reconciling the interests of shareholders with those of creditors. Its comparative approach, analysing frameworks in India, the U.S., and the U.K. if we take a example of section 53 which is the water fall mechanism in this section the proper hierarchy is given likewise, Insolvency resolution costs and workmen's dues, Secured creditors next, unsecured financial and operational creditors, Preference shareholders before common shareholders, who are the last in line. As shareholders are placed, they are unable to prioritized claims over a company's assets, shareholders especially minority shareholders are left with residual rights that frequently remain ambiguous under current legal frameworks. Amendment or policy changes should be there so that every person including shareholder must be given and placed in such a way that are also able to claim some money during the liquidation process.

CONCLUSION

This research has been comprehensively explored the legal role of shareholders in corporate liquidation, illuminating the complex interplay between shareholder rights and creditor claims. The study demonstrates that while shareholders, as residual claimants, are entitled to any remaining assets only after all creditor claims have been satisfied, their practical influence varies significantly between voluntary and compulsory liquidation scenarios. In voluntary liquidation, shareholders actively shape the process by passing resolutions, appointing liquidators, and determining asset distribution, thereby asserting their control over the winding-up decisions. Conversely, in compulsory liquidation, where creditors and regulatory bodies

dominate the process, shareholder influence is substantially diminished as the statutory framework prioritizes the recovery of creditor claims.

The research further highlights the ambiguities and challenges inherent in current legal frameworks, particularly for minority shareholders. These stakeholders often face difficulties in asserting their rights, as judicial interpretations and statutory provisions do not always provide clear avenues for redress. Landmark cases such as *Kartikeya V. Sarabhai* and *Anarkali Sarabhai* illustrate that judicial decisions have reinforced the subordination of shareholder interests through doctrines like the absolute priority rule. Additionally, the comparative analysis with U.S. and U.K. insolvency regimes underscores the need for a balanced approach that accommodates both creditor recovery and shareholder protection.

To bridge these gaps, the study proposes a series of reforms. These include statutory amendments to explicitly safeguard minority shareholder rights, enhanced transparency and independent audits in liquidation proceedings, robust judicial and regulatory oversight, the incorporation of minority representation in key decision-making bodies, and the establishment of specialized dispute resolution mechanisms. Collectively, these recommendations aim to create a more equitable liquidation framework that ensures corporate accountability while preserving creditor primacy. Ultimately, this research underscores the critical need for legal clarity and procedural safeguards that protect the interests of all stakeholders involved in corporate liquidation, thereby fostering confidence in the insolvency process and enhancing overall corporate governance.