

Not all wages and salaries form a part of the CIRP costs

In a recent judgment of *Sunil Kumar Jain and Ors. Vs Sundaresh Bhatt and Ors.*¹, the Supreme Court held that the wages or salaries of the workmen and employees who have actually worked during the corporate insolvency resolution process (“CIRP”) of a corporate debtor to enable the resolution professional (“RP”) to run the corporate debtor as a ‘going concern’ during the CIRP period will form a part of the CIRP costs.

Background

The National Company Law Tribunal, Ahmedabad bench (“NCLT”), vide its order dated August 1, 2017 (“**Insolvency Commencement Date**”), admitted an application under Section 7 of the Insolvency and Bankruptcy Code, 2016 (“IBC”) to initiate the CIRP against ABG Shipyard Limited (“**Corporate Debtor**”). The Corporate Debtor had its corporate office at Mumbai and was undertaking manufacturing operations at Dahej yard and Surat yard in Gujarat.

The appeal before the Supreme Court was filed by 272 employees and workmen, who were employed at Dahej and Mumbai (“**Appellants**”), against the order passed by the National Company Law Appellate Tribunal, New Delhi (“**Appellate Tribunal**”). The Appellate Tribunal had dismissed the appeal filed by the Appellants against the order passed by the NCLT, wherein the Appellants had, *inter alia*, claimed that salary and wages payable to them by the Corporate Debtor prior to the Insolvency Commencement Date and during the CIRP period should be qualified as CIRP costs² under Section 53(1)(a)³ of the IBC. Section 53 of the IBC provides a waterfall for payments to be made during liquidation of a company, and CIRP costs are to be paid first in that waterfall.

It was contended by the Appellants’ counsel that (a) the Appellants were on the payroll of the Corporate Debtor for the entire CIRP period, and (b) the RP did not terminate the employment contracts or retrench or layoff the workmen and employees during the CIRP period.

Key Issues:

The key issues addressed by the Supreme Court were as follows:

¹ Civil Appeal No. 5910 of 2019.

² Section 5(13) of the IBC defines “Insolvency Resolution Process Costs” to mean: (a) the amount of any interim finance and the costs incurred in raising such finance; (b) the fees payable to any person acting as a resolution professional; (c) any costs incurred by the resolution professional in running the business of the corporate debtor as a going concern; (d) any costs incurred at the expense of the Government to facilitate the insolvency resolution process; and (e) any other costs as may be specified by the Insolvency and Bankruptcy Board of India.

³ Section 53(1)(a) reads as follows: “Notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such period and in such manner as may be specified, namely: - (a) the insolvency resolution process costs and the liquidation costs paid in full; (b) ...”

- (a) Whether the wages and salaries of the workmen and employees, who were on the payroll of the Corporate Debtor during the CIRP period, would be a part of the CIRP costs.
- (b) Whether the amount due and payable to the workmen and employees under the pension fund, gratuity fund and provident fund form a part of the liquidation estate of the Corporate Debtor.

Analysis and findings of the Supreme Court:

- (a) The Supreme Court while analyzing the legislative history and the relevant provisions of the IBC, observed that it was an undisputed fact that the CIRP costs will include all the costs which are incurred by the RP to run the business of the Corporate Debtor as a going concern as per Section 5(13) of IBC.
- (b) Further, it was observed that there are two critical aspects to be considered to determine whether the dues to workmen and employees will form a part of the CIRP costs:
 - (i) Firstly, it must be established that the Corporate Debtor was in fact a going concern during the CIRP period. It cannot be presumed that the Corporate Debtor was a going concern during the CIRP period only because the RP made best efforts to keep it as a going concern and Section 20 requires RP to use his best endeavor to manage the operations of the Corporate Debtor as a going concern. Whether or not a corporate debtor was operated on a going concern basis during the CIRP period would vary on a case-to-case basis, since there is no certainty that the RP will be able to successfully run the corporate debtor as a going concern.
 - (ii) Secondly, once it is established that the Corporate Debtor was a going concern, only those workmen and employees will be entitled to receive wages and salaries as CIRP costs in priority over others, who have actually worked during the CIRP period. Only such workmen and employees will be paid in full and with first priority over all other dues of the Corporate Debtor as per Section 53(1)(a) of IBC. The remaining workmen and employees who have not worked or rendered any services during the CIRP period as well as any wages and salaries for the pre-CIRP period, will be paid out later in priority as per Section 53(1)(b)⁴ and Section 53(1)(c)⁵ of the IBC.
- (c) With respect to the second issue, the Supreme Court observed that Section 36(4) of IBC specifically excluded all the sums due to any workmen or employee from the provident fund, the pension fund and the gratuity fund, from the ambit of the liquidation estate. The same cannot be used for any recovery during the liquidation process of any corporate debtor. In view of the above, it held that the liquidator will have no claim over such funds, and the same will not form a part of the liquidation estate for the Corporate Debtor for distribution among the creditors.

Conclusion

This judgment makes it abundantly clear that the CIRP costs will only include the wages and salaries of those workmen and employees who have actively worked during the CIRP period. If the corporate debtor is not being operated as a going concern by the RP, then any wages and salaries payable to workmen and employees on the rolls of the corporate debtor will not form part of the CIRP Costs. Further (a) any wages and salaries payable to workmen and employees for any period prior to commencement of the CIRP; and (b) wages and salaries of workmen and employees who did not actively work during the CIRP period, will also not form part of CIRP costs and will instead be paid under Section 53(1)(b) and Section 53(1)(c) of the IBC.

⁴ Section 53(1)(b) reads as follows: “Notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such period and in such manner as may be specified, namely: - (a) ...; (b) the following debts which shall rank equally between and among the following: (i) workmen’s dues for the period of twenty-four months preceding the liquidation commencement date; and (ii) debts owed to a secured creditor in the event such secured creditor has relinquished security in the manner set out in section 52; (c) ...”.

⁵ Section 53(1)(c) reads as follows: “Notwithstanding anything to the contrary contained in any law enacted by the Parliament or any State Legislature for the time being in force, the proceeds from the sale of the liquidation assets shall be distributed in the following order of priority and within such period and in such manner as may be specified, namely: - (a) ...; (c) wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date”.

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