

Certain employee statutory dues are not a part of the “liquidation estate” of a corporate debtor

In the case of *State Bank of India v. Moser Baer Karamachari Union & Ors.*,¹ the Supreme Court of India (“**Supreme Court**”) has upheld the order of the National Company Law Appellate Tribunal (“**NCLAT**”) in the matter of *State Bank of India v. Moser Baer Karamachari Union & Anr.* (“**Moser Baer Case**”).² In the Moser Baer Case, the NCLAT held that the provident fund, the pension fund and the gratuity fund owed by a corporate debtor to its workmen do not fall within the purview of “liquidation estate” for the purpose of distribution of assets under Section 53 of the Insolvency and Bankruptcy Code, 2016 (“**IBC**”).

Further, the Supreme Court overruled the order of the NCLAT in the matter of *Savan Godiwala v. Apalla Siva Kumar*³ (“**Savan Godiwala Case**”) where the NCLAT had held that a liquidator is not required to make payment of gratuity to employees if there is no separate fund for gratuity payments.

Brief Background

1. The Moser Baer Case

Moser Baer India Limited, the corporate debtor, was admitted into liquidation by the Principal Bench (New Delhi) of the National Company Law Tribunal (“**NCLT**”) by its order dated September 20, 2018.

Subsequently, the liquidator denied the payment of the gratuity fund, the provident fund and the pension fund to the workmen on a preferential basis, stating that the same will be paid to them as per the waterfall mechanism under Section 53 of IBC.

Consequently, the Moser Baer Karamchhari Union filed an application before the NCLT praying for the following directions to the liquidator:

- a) to exclude the amounts due to workmen towards the gratuity fund, the provident fund and the pension fund from the purview of the liquidation waterfall mechanism as these dues do not constitute a part of the “liquidation estate” of the corporate debtor; and
- b) to pay such amounts to the workmen.

The NCLT granted these prayers of the Moser Baer Karamchhari Union.

¹ Civil Appeal No. 258 of 2020 with Civil Appeal No. 2520 of 2020.

² Company Appeal (AT) (Insolvency) No. 396 of 2019

³ Company Appeal (AT) (Insolvency) No. 1229 of 2019

The State Bank of India filed an appeal before the NCLAT against the order of the NCLT. The NCLAT held that Section 53 of IBC, which provides the order of priority for the distribution of proceeds from the sale of the liquidation estate assets, does not cover the amounts due towards gratuity fund, provident fund and pension fund for the following reasons:

- a) As per Section 36(4)(a)(iii) of IBC, all sums due to any workmen from the provident fund, the pension fund and the gratuity fund do not form part of the liquidation estate assets and cannot be used for recovery in liquidation proceedings.
- b) As per Section 326 of the Companies Act, 2013, “workmen’s dues” include all sums due to any workman from the provident fund, the pension fund and the gratuity fund. However, it is to be noted that Section 53(1)(b)(i) is a specific provision covering the distribution of workmen’s dues in liquidation proceedings and has an overriding effect over any other law for the time being in force as per the provisions of IBC. Further, it differs from Section 326 of the Companies Act, 2013 as the workmen’s dues under it are confined to a period of 24 (twenty four) months before the liquidation commencement date. Thus, a reference cannot be made to Explanation (iv) of Section 326 of the Companies Act, 2013 to derive the meaning of “workmen’s dues” under Section 53(1)(b)(i) of IBC.

Accordingly, the NCLAT dismissed the appeal against the order of the NCLT. Consequently, the liquidator was required to make payment of the amounts due towards these funds to the workmen. Aggrieved by the decision of the NCLAT, the State Bank of India preferred an appeal before the Supreme Court.

2. The Savan Godiwala Case

Lanco Infratech Limited, the corporate debtor, was admitted into liquidation by the Hyderabad bench of the NCLT by its order dated August 27, 2018.

Subsequently, the ex-employees of the corporate debtor filed an interim application before the NCLT praying for a direction to the liquidator to repay their gratuity dues in priority and not treat such dues as a part of the “liquidation estate” of the corporate debtor. Notably, the corporate debtor had failed to maintain a separate fund for payment of gratuity to its employees as required under the Payment of Gratuity Act, 1972.

The NCLT observed that the liquidator cannot avoid the liability to pay gratuity to the employees of the corporate debtor on the ground that the corporate debtor did not maintain separate funds for such payment. Therefore, the NCLT directed the liquidator to make necessary arrangements for payment of gratuity to the employees of the corporate debtor in priority to any payments made under the waterfall mechanism and according to their eligibility.

The liquidator filed an appeal before the NCLAT against the order of the NCLT. The NCLAT observed as follows:

- a) The provident fund, the pension fund and the gratuity fund do not constitute a part of the “liquidation estate” of the corporate debtor for the purpose of distribution of assets as per the liquidation waterfall mechanism under Section 53 of IBC.
- b) As per Section 36(2) of IBC, the liquidator must hold the liquidation estate in fiduciary for the benefit of all the creditors. Therefore, the liquidator has no domain to deal with any property of the corporate debtor which is not a part of the liquidation estate. Accordingly, the liquidator cannot be directed to make payment of gratuity to the employees in the absence of a separate fund for this purpose as gratuity does not fall under the purview of the liquidation estate of the corporate debtor.

Accordingly, the NCLAT set aside the order of the NCLT. Aggrieved by the decision of the NCLAT, the employees of the corporate debtor preferred an appeal before the Supreme Court.

Judgment of the Supreme Court

After considering the submissions of the parties, the Supreme Court held that there was no cogent reason to entertain the appeal against the order of the NCLAT in the Moser Baer Case. Accordingly, the Supreme Court upheld the legal position that the gratuity fund, the provident fund and the pension fund are not a part of the “liquidation estate” of the corporate debtor, and hence, do not fall within the ambit of the waterfall mechanism prescribed under Section 53 of IBC. Accordingly, this appeal was dismissed.

However, the Supreme Court set aside the order of the NCLAT in the Savan Godiwala Case which did not recognise the liability of the liquidator to pay gratuity to the employees of the corporate debtor in the absence of a separate fund for such payment. The Supreme Court stated that this order was not in conformity with the observations made by the NCLAT in the Moser Baer Case wherein such payment was allowed to the workmen. Hence, the order passed by the NCLT was restored by the Supreme Court.

JSA Comments

In its report dated April 28, 2016, the Joint Parliamentary Committee on the Insolvency and Bankruptcy Code, 2015 had observed that the provident fund, the pension fund and the gratuity fund provide a social safety net to workmen and employees and hence they need to be secured in the event of liquidation of a company. Accordingly, Section 36(4) of the IBC provides that all sums due to any workmen from the provident fund, the pension fund and the gratuity fund do not form part of the liquidation estate assets of a corporate debtor and cannot be used in recovery in liquidation of the corporate debtor.

On various occasions,⁴ the NCLT, the NCLAT and the High Courts have recognised the need to protect the rights and interests of the workmen and employees of a corporate debtor. This judgment of the Supreme Court puts to rest the contradiction created by the differing views taken by the NCLAT in the Moser Baer Case and the Savan Godiwala Case.

The judgement upholds the principle that since amounts due towards the provident fund, the pension fund and the gratuity fund are not part of the liquidation estate of the corporate debtor, they cannot be utilized for payments under the liquidation waterfall under Section 53 of the IBC and such payments must be made separately to the employees and workmen. By overruling the NCLAT judgement in the Savan Godiwala Case, the Supreme Court appears to have affirmed the view that even where there are no funds available towards payment of provident fund, pension and gratuity, the liquidator must make such payments.

Given this interpretation by the Supreme Court, it would be prudent for liquidators to consider if adequate funds are available for payment of such statutory dues, and if not, then whether the proceeds from the sale of any assets should be used for payment of such statutory dues.

Further, lenders must also actively consider if they want to diligence the pending statutory dues for employees and workmen to understand the potential outstanding liabilities of a borrower on this account before they lend. Additionally, appropriate covenants may also be built into financing documents on timely discharge of such statutory dues by borrowers as well as periodic information to lenders on the paid and outstanding statutory dues to employees.

⁴ UCO Bank v. EPFO & Anr., (2022) ibclaw.in 222 HC.

Supriyo Kumar Chaudhuri & Anr. v. JVL Agro Industries Ltd., 2020 SCC OnLine NCLT 1470.

Precision Fasteners Limited v. EPFO Thane & Ors., [2018] ibclaw.in 10 NCLT.

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