

INSOLVENCY & BANKRUPTCY

SALARIES OF THOSE EMPLOYESS WHO WORKED DURING CIRP CONSTITUTE CIRP COSTS & PROVIDENT FUND, GRATUITY FUND TO BE KEPT OUT OF THE LIQUIDATION ESTATE

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The Supreme Court bench comprising of Justices MR Shah and Aniruddha Bose in the recent Judgment[1] held that:

– the wages or salaries of only such workmen/employees, who worked during the Corporate Insolvency Resolution Process ("**CIRP**"), shall be included in the CIRP costs; and

– the provident fund, gratuity fund and pension fund shall be kept out of the liquidation estate assets

Facts of the Case

In this case, the appeal was filed against the order of National Company Law Appellate Tribunal which dismissed an appeal against order National Company Law Tribunal ("NCLT"), which denied relief to the employees who claimed salary for the CIRP period and the period before that.

The appeal stated that salaries and the dues which are payable to the employees, during the timeframe of CIRP can be considered as CIRP costs as per Section 5 (13) under Insolvency and Bankruptcy Code, 2016 ("**IB Code"**) and are liable to be disbursed even prior to the amount distributed as per Section 53 of the Code.

The appeal further submitted that under Section 36(4) of the IB Code, the amounts of provident fund, gratuity, and pension fund should be separated from the liquidation.

The Respondents on the other hand contended that salaries of the appellants, who did not work during CIRP, or during the liquidation process, could not be considered as the CIRP costs under the Section 5 (13) (c) of IB Code.

Judgment

The Court held that before the claims of the concerned workers with respect to their salaries during CIRP period can be considered, primarily it should be established that during CIRP the corporate debtor was a going concern and that the concerned workers actually worked during this timeframe.

"*The wages/salaries of such workmen/employees who actually worked, shall be included in the CIRP costs and in case of liquidation of the corporate debtor, dues towards the wages and salaries of such workmen/employees who actually worked when the corporate debtor was a going concern during the CIRP, being a part of the CIRP costs are entitled to have the first priority and they have to be paid in full first as per Section 53(1)(a) of the IB Code.*

Therefore, while considering the claims of the concerned workmen/employees towards the wages/salaries payable during CIRP, first of all it has to be established and proved that during CIRP, the corporate debtor was a going concern and that the concerned workmen/employees actually worked while the corporate debtor was a going concern during the CIRP.

The wages and salaries of all other workmen/employees of the Corporate Debtor during the CIRP who actually have not worked and/or performed their duties when the Corporate Debtor was a going concern, shall not be included automatically in the CIRP costs. Only with respect to those workmen/employees who actually worked during CIRP when the Corporate Debtor was a going concern, their wages/salaries are to be included in the CIRP costs and they shall have the first priority over all other dues as per Section 53(1)(a) of the IB Code."

The Court went on to add that "*on a fair reading of Section 5(13) of the IB code which defines "insolvency resolution process costs", it is observed and held that the dues towards the wages/salaries of only those workmen/employees who actually worked during the CIRP are to be included in the CIRP costs. The rests of the claims towards the wages/salaries of the workmen/employees, as observed hereinabove, shall be governed by Sections 53(1)(b) & (c) of the IB Code."*

The Court further noted that *"If it is established and proved that during CIRP, the Corporate Debtor was a going concern and the concerned workmen/employees actually worked during the CIRP when the Corporate Debtor was a going concern, the wages and salaries of such workmen/employees to be included in the CIRP costs as defined under Section 5(13) of the IB Code and they will have to be paid such wages/salaries as per Section 53(1)(a) of the IB Code as part of the CIRP costs in full before making any payment as per priorities mentioned in Section 53(1) of the IB code."*

The Court observed that there is no presumption that the caproate debtor is a going concern during CIRP Period. It has to be decided depends on facts of each case.

The Court noted that so far as the dues of the workmen/employees on account of provident fund, gratuity and pension are concerned, they shall be governed by Section 36(4) of the IB Code.

"*Section 36(4)(iii) of the IB Code specifically excludes "all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund", from the ambit of "liquidation estate assets". Therefore, Section 53(1) of the IB Code shall*

not be applicable to such dues, which are to be treated outside the liquidation process and liquidation estate assets under the IB Code. Thus, Section 36(4) of the IB Code has clearly given outright protection to workmen's dues under provident fund, gratuity fund and pension fund which are not to be treated as liquidation estate assets and the Liquidator shall have no claim over such dues. Therefore, the concerned workmen/employees shall be entitled to provident fund, gratuity fund and pension fund from such funds which are specifically kept out of liquidation estate assets and as per Section 36(4) of the IB Code, they are not to be used for recovery in the liquidation."

The Court concluded the case as under:

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that the wages/salaries of the workmen/employees of the Corporate Debtor for the period during CIRP can be included in the CIRP costs provided it is established and proved that the Interim Resolution Professional/Resolution Professional managed the operations of the corporate debtor as a going concern during the CIRP and that the concerned workmen/employees of the corporate debtor actually worked during the CIRP and in such an eventuality, the wages/salaries of those workmen/employees who actually worked during the CIRP period when the resolution professional managed the operations of the corporate debtor as a going concern, shall be paid treating it and/or considering it as part of CIRP costs and the same shall be payable in full first as per Section 53(1)(a) of the IB Code;

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considering Section 36(4) of the IB code and when the provident fund, gratuity fund and pension fund are kept out of the liquidation estate assets, the share of the workmen dues shall be kept outside the liquidation process and the concerned workmen/employees shall have to be paid the same out of such provident fund, gratuity fund and pension fund, if any, available and the Liquidator shall not have any claim over such funds.

The Court allowed the appeal accordingly.

Remarks

Section 36(4) of the IB Code provides for exclusion of third-party assets in the possession of the corporate debtor from the liquidation assets. The legal proposition is also explained in the Explanation to Section 18 of the IB Code which states that 'assets' shall not include 'the assets owned by a third party in possession of the corporate debtor held under trust".

The exclusion under Section 36(4) also extends to "provident fund, pension fund, and gratuity funds" due to the workers payable by the Corporate Debtor and treat them as a 'third-party' asset in possession of the Corporate Debtor. The order confirms that these funds shall be kept out of the liquidation estate assets and liquidator shall not have any claim over such funds. However, usually these funds are not readily available with the corporate debtor to pay to respective workmen. After deduction of these funds, corporate debtor is required to remit these funds to respective regulatory authority. However, when in distress, corporate debtor often diverts these funds and usually not in possession of these funds when RP/IRP takes over the corporate debtor under IB Code. In such cases, these funds are not third-party fund in possession of the corporate debtor or available with corporate debtor; yet liquidator is required to pay these funds out of the sale proceeds of the liquidation estate in priority over the other claimants.

1 Sunil Kumar Jain vs Sundaresh Bhatt | 2022 LiveLaw (SC) 382 | CA 5910 OF 2019 | 19 April 2022