

## ERGO

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### SUPREME COURT DISMISSES SUCCESSFUL RESOLUTION APPLICANT'S CASE IN THE MATTER OF DISBURSEMENT OF GRATUITY AND EMPLOYEES' PROVIDENT FUND DUES

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In a significant development, a three judge bench of the Supreme Court of India, by way of its order in *Jalan Fritsch Consortium v Regional Provident Fund Commissioner and Another* [Civil Appeal Number 407 of 2023], upheld the judgment of the National Company Law Appellate Tribunal (NCLAT) in the matter of *Jet Aircraft Maintenance Engineers Welfare Association v Ashish Chhawchharia, Resolution Professional of Jet Airways (India) Limited and Others* [Company Appeal (AT) (Insolvency) Number 752 of 2021], whereby *Jalan Fritsch consortium* (Successful Applicant) was directed to disburse gratuity and employees' provident fund dues of the workmen of *Jet Airways (India) Limited* (*Jet Airways*) in entirety. In this ERGO, we examine the order of the NCLAT basis which the Successful Applicant's appeal was dismissed by the apex court, as the same has important implications on the lawfulness of a resolution plan which does not adequately allocate sums to discharge employees' provident fund and gratuity liabilities.

#### **Factual Background**

The issues arose in the context of corporate insolvency resolution process of *Jet Airways Limited* (CIRP) initiated under the Insolvency and Bankruptcy Code, 2016 (IBC), by State Bank of India. The resolution plan submitted by the Successful Applicant was approved by the committee of creditors (CoC), pursuant to which National Company Law Tribunal, Mumbai (NCLT) also approved the same.

Aggrieved by the order of NCLT, appeals were filed before the NCLAT *inter alia* by *Jet Aircraft Maintenance Engineers Welfare Association, Association of Aggrieved Workmen of Jet Airways (India) Limited, Bhartiya Kamgar Sena, All India Jet Airways Officers and Staff Association, and Regional Provident Fund Commissioner*.

#### **Contentions on Behalf of Employees**

The following are some contentions from the standpoint of employment liabilities that were put forth by the appellants before the NCLAT:

- Manner of absorption of employees by another entity: The resolution plan proposed that except for 50 employees and workmen forming part of the asset protection team at *Jet Airways*, all employees and workmen on the payroll of *Jet Airways* as on 15 September 2020 will be demerged from *Jet Airways* and absorbed into the rolls of *Airjet Ground Services Limited* (AGSL). As part of the demerger framework, all liabilities and dues associated with the non-retained employees (including employees' provident fund dues and gratuity) will also get demerged from *Jet Airways* and will be assumed by AGSL. As per the

submission of the appellants, the proposed transfer of workmen to AGSL did not factor in the requirements of Section 25-FF of the Industrial Disputes Act, 1947 (ID Act). It was argued that in terms of Section 25-FF of the ID Act, the demerger of workmen and employees to AGSL is, in essence, retrenchment of the workmen, and workmen were entitled to retrenchment compensation accordingly. Since the Successful Applicant did not offer any retrenchment compensation to the workmen, the Resolution Plan was contended to be in contravention of applicable laws and accordingly in breach of Section 30(2)(e) of the IBC.

- Inadequate discharge of liabilities by Successful Applicant: As per the appellant -associations, the aggrieved employees who are members of such associations have been on the rolls of Jet Airways and are entitled to the full amount of dues towards gratuity and employees' provident fund, among other payments. The said appellants alleged that the Successful Applicant did not account for these payments in their entirety. In this regard, they placed reliance on Section 36 of the IBC, which provides that *"the following shall not be included in the liquidation estate assets and shall not be used for recovery in the liquidation...all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund"*.

#### **NCLAT's Ruling**

At the outset, the NCLAT acknowledged that Section 36 of the IBC, which keeps employees' provident fund and gratuity dues out of the liquidation estate, applies in a situation of liquidation which was not the case with Jet Airways. However, the NCLAT observed that both the purpose and the object for which Section 36 was incorporated into the scheme of the IBC in the context of liquidation was also reflected under Section 18 of the IBC in the context of CIRP. The NCLAT held that in terms of Section 18 of the IBC, an insolvency resolution professional is required to take control and custody of any asset over which the corporate debtor has ownership rights, and that such asset shall not cover the assets owned by a third party in possession of the corporate debtor held under trust or under any contractual arrangement. Accordingly, *"the assets comprising provident funds, gratuity funds or a pension fund...are assets on which employees and workmen have right [and]...thus, are not to be taken control by IRP"*. In the same vein, it was observed that the said funds, i.e., provident fund, pension fund and gratuity fund maintained by the Corporate Debtor have to be utilized fully for payment of provident fund dues, pension dues and gratuity dues of the workmen and employees and, therefore, these assets cannot be included in the information memorandum as the assets of the Corporate Debtor, while inviting the resolution plan.

Applying the above legal position to the facts of the instant case, the NCLAT took note of the fact that the Corporate Debtor did not make any payments towards provident fund dues, pension fund dues or gratuity dues post February 2019. In this regard, the NCLAT held that the workmen are entitled to full payment of provident fund and gratuity dues and hence if the Corporate Debtor has not made payments towards provident fund dues, pension fund dues and gratuity dues of the workmen, then the onus of making good such unpaid dues falls on the Successful Applicant who is acquiring the Corporate Debtor. The acquisition of the Corporate Debtor without making such contributions would be a contravention of applicable laws, thereby making the resolution plan a contravention of Section 30(2)(e) of the IBC, which provides that the resolution plan should *"not contravene any of the provisions of the law for the time being in force"*.

Interestingly, the NCLAT extended the above direction to the damages imposed by Employees' Provident Fund Organisation (EPFO) in respect of the arrears in employees' provident fund contributions. The NCLAT followed the judgment of the Hon'ble

Supreme Court in the matter of Maharashtra State Cooperative Bank Limited v Assistant Provident Fund Commissioner and Others [(2009) 10 SCC] 123], which held that the expression "any amount due from an employer" in Section 11(2) of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (EPF Act) includes damages imposed by the EPFO. Accordingly, for a resolution plan to be compliant, it is required to make payment in full of all unpaid contributions of the Corporate Debtor towards provident fund dues, pension fund dues and gratuity dues, along with damages imposed on account of non-compliance with these statutory obligations.

The NCLAT did not accept the contention of non-compliance with Section 25-FF of the ID Act. The NCLAT observed that the proviso to Section 25-FF of the ID Act (Proviso) stipulates that the rigors of this provision will not apply to a case of business transfer if: (a) the services of the workmen have not been interrupted by such transfer; (b) the terms and conditions of service applicable to the workmen after such transfer are not in any way less favourable to the workmen than those applicable to them immediately before the transfer; and (c) the new employer is, under the terms of such transfer or otherwise, liable to pay to the workmen retrenchment compensation on the basis that their services remained continuous and has not been interrupted by the transfer.

The NCLAT held that the resolution plan is beneficial to the interests of the employees of the Corporate Debtor, who have been out of employment for the past three years; further, the scheme of demerger provides mechanisms for the protection of the interests of workmen and employees and satisfies the requirements set out in the Proviso. The appellants' contention of AGSL being a smokescreen was merely an apprehension.

#### Comment

The judgment of NCLAT as affirmed by the three judge bench of the Supreme Court of India is an important development in favour of employees. The judgment of NCLAT provided two important clarifications. First, the judicial precedents which laid down that the dues towards provident funds, pension funds and gratuity funds do not form part of the liquidation estate of the corporate debtor apply equally even in the context of CIRP of a corporate debtor. Hence, a company's internal funds in the form of employees' provident fund, pension fund, and gratuity fund are assets over which employees have rights and which cannot be assumed control over by insolvency resolution professional or the successful resolution applicant. Second and more importantly, the judgment clarified that if a company has created an internal fund for these dues, the *onus* of maintaining such internal funds falls on the successful resolution applicant acquiring the Corporate Debtor.

Having said that, while the objective behind according a special status to gratuity and employees' provident dues may be noble, it raises some important questions as well. While the NCLAT conferred such status on the basis that these are statutory dues and hence a resolution plan that does not provide for these payments in full is in violation of applicable laws, the same rationale may then apply to several other statutory dues towards employees as well (such as leave encashment etc.). Further, the obligation imposed on the successful resolution applicant to make good the unpaid contributions of the employers towards provident funds, pension funds and gratuity dues including damages accrued on account of breach of such obligations appears to be an exception to the well settled principle that in a CIRP, a successful resolution applicant acquires a corporate debtor on a "clean slate" basis.

Even if one takes a cue from Section 11(2) of the EPF Act to take the view that employees' provident fund dues are to be discharged in full, a similar provision does not exist under the Payment of Gratuity Act, 1972, which again raises the question as

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to the special status conferred upon gratuity dues by the NCLAT especially when the corporate debtor was not the subject of liquidation proceedings.

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