REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL ORIGINAL JURISDICTION

WRIT PETITION (C) NO. 421 OF 2019

Moser Baer Karamchari Union Thr.
President Mahesh Chand Sharma …Appellant(s)

Versus

Union of India and Ors. …Respondent(s)

WITH

WRIT PETITION (C) NO. 777 OF 2020

Manoj Kumar Nagar …Appellant(s)

Versus

Union of India …Respondent(s)

AND

WRIT PETITION (C) NO. 712 OF 2020

Raj Kumar Verma …Appellant(s)

Versus

Union of India …Respondent(s)

J U D G M E N T

M.R. SHAH, J.

Writ Petition (C) No. 421 of 2019

1. By way of this writ petition under Article 32 of the Constitution of India, filed by the writ petitioner – Moser Baer Karamchari Union have prayed for an appropriate writ, direction or order striking down Section 327(7) of the Companies Act, 2013 (hereinafter referred to as "Act, 2013") as arbitrary and violative of Article 21 of the Constitution of India.

It is also prayed to issue an appropriate writ, direction or order in the nature of Mandamus so as to leave the statutory claims of the "workmen's dues" out of the purview of waterfall mechanism under Section 53 of the Insolvency and Bankruptcy Code, 2016 (hereinafter referred to either as "IBC" or "Code").

It is further prayed to issue an appropriate writ in the nature of Mandamus by giving a purposive interpretation to Section 53 of the IBC and pass necessary directions which will enable the petitioners to get their dues of 24 months released without any further delay.

Writ Petition (C) Nos. 777 and 712 of 2020

1.1 By way of these writ petitions under Article 32 of the Constitution of India, the respective writ petitioners have prayed that Clause 19(a) of the Eleventh Schedule of the IBC pursuant Section 255 of the IBC, be declared as unreasonable and violative of Article 14 of the Constitution of India as Clause 19(a) of the Eleventh Schedule of the IBC inserts sub-section (7) in Section 327 of the Companies Act, 2013, which puts statutory bar on the application of Sections 326 and 327 of the Companies Act, 2013, to the liquidation proceedings under the IBC.

It is further prayed that sub-section (7) of Section 327 of the Companies Act, 2013, be declared as unreasonable and violative of Article 14 of the Constitution of India as sub-section (7) of Section 327 of the Companies Act, 2013, which was inserted in Section 327 of the Companies Act, 2013 pursuant to Section 255 and the Eleventh Schedule of the Insolvency and Bankruptcy Code, 2016, Act 31 of 2016, creates unreasonable classification for the distribution of legitimate dues of workmen in the event of liquidation of the Company under the IBC and liquidation of Company under the provisions of the Companies Act, 2013.

It is also prayed that distribution of the workmen's due as envisaged under Section 53(1)(b)(i) of the IBC, be declared as unreasonable and violative of Article 14 of the Constitution of India, as Section 53(1)(b)(i) of the IBC limits the workmen's dues payable to workmen to twenty-four months only preceding the date of order of Liquidation and then rank the said workmen's dues equally with the secured creditors in the events such secured creditors has relinquished security in the manner set out in Section 52 of the IBC.

It is further prayed that settlement of Workmen Dues should be done in accordance with the reasonable principles laid down under Section 326 even in the event of liquidation under the IBC.

2. Shri K.V. Viswanathan, learned Senior Advocate has appeared as Amicus Curiae. Shri Gopal Sankaranarayanan, learned Senior Advocate, has appeared on behalf of the petitioner(s). Shri Balbir Singh, learned ASG has appeared on behalf of the respondent-Union of India.

3. Shri K.V. Viswanathan, learned Senior Advocate has first of all taken us to the legislative history of the

Companies Act and the Preferential Payments and also the framing of the Insolvency and Bankruptcy Code.

3.1 It is submitted that the Companies Act, 1956, as it existed prior to the Companies (Amendment) Act, 1985, did not provide for any "overriding preferential payments" to any party. It is submitted that in 1985, the Companies (Amendment) Bill, 1985 sought to introduce the proviso to sub-section (1) of Section 529, definition of "workmen", "workmen's dues" and "workmen's portion" through insertion of Section 529(3) and the "overriding preferential payments" through Section 529-A.

3.2 It is submitted that the Statement of Objects and Reasons for bringing these changes into effect was to ensure that the resources of the company are distributed even to workers whose labour and effort form a part of the capital of the Company. Resultantly, through Companies (Amendment) Act, 1985, the idea of "workmen's portion" and the "overriding preferential payments" were introduced and crystallised in the Companies Act, 1956.

3.3 It is submitted that a cumulative reading of Section 529 and Section 529-A of the Companies Act, 1956 indicates that firstly, the security of every secured creditor is deemed to be subject to a *pari passu* charge in favour

of the appellant - workmen, to the extent of the workmen's portion. Secondly, when the secured creditor opts to realise his security, so much of the debt due to such secured creditor as could not be realised by him by virtue of the proviso or the amount of workmen's portion in his security, whichever is less, will rank *pari passu* with the workmen's dues. Thirdly, the workmen's dues and debts of secured creditor as described in Section 529(1) Proviso (c) get overriding preferential payment and rank *pari passu*. These debts are payable in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

3.4 It is submitted that Section 530, when it provides for "Preferential Payments", restricts Government dues to a period of 12 months and wages or salary of an employee to a period not exceeding 4 months within 12 months next before the relevant date, subject to limit in sub-section (2) of Section 530(1)(b).

3.5 It is submitted that prior to enactment of the Companies Act, 2013, there were several Committees that were set-up in order to consider the proposals for reformation of the Companies Act, 1956. It is submitted that two of these Committees and their proposals are indicative of the issues that were sought to be addressed

through a new, refurbished legislation. In the year 2000, the Report of the High-Level Committee on Law relating to Insolvency and Winding Up of Companies was submitted under the chairmanship of Justice V. Balakrishna Eradi (popularly known as “Eradi Committee”). On consideration of various suggestions received by it, the Eradi Committee *inter alia* recommended that appropriate legislative action must be taken to ensure that the claims of all “employees of a company” and its secured creditors are ranked *pari passu*. Thereafter, in 2005, the Report of Expert Committee on Company Law, 2005 was submitted under the chairmanship of Dr. Jamshed J. Irani. The Irani Committee, on consideration of proposals before it, recommended that the status of secured creditors should be *pari passu* with “employees” in respect of their claims after payment of claims related to costs and expenses of administration of liquidation.

3.6 It is submitted that the focus of these two Committees was on bringing the claims of “employees of a company” *pari passu* with the secured creditors, when the existing provision as on that day only specified that “workmen’s dues” would rank *pari passu* with secured creditors. It is submitted that these two Reports were followed by the introduction of the Companies Bill, 2009

which retained the same structure as that of Section 529, 529-A and 530 of the Companies Act, 1956. It is submitted that it was clear that the recommendations qua ranking of dues of “employees of a company” were not accepted as the existing structure had been retained. It is submitted that however, this Companies Bill, 2009 lapsed and, therefore, the same was not given effect to.

3.7 It is submitted that thereafter, again, the Companies Bill, 2011 was introduced, which was then referred to a Standing Committee. The Report of the Standing Committee of 15th Lok Sabha on Companies Bill, 2011 notes the legislative changes made to the Companies Act, 1956 and the Companies Bill, 2009. It is submitted that this indicates that Section 326, which was being introduced in lieu of Section 529-A of Companies Act, 1956, will now include a proviso to Section 326(1) and amendment to Section 326(2) to ensure that wages/salaries payable to workmen for a period of 2 years is protected in the case of winding up. The rationale given for this legislative change was to protect interest of workmen in case of winding up. It is submitted that resultantly, the Companies Act, 2013, as enacted, while mostly retaining the structure of Section 529 and 529-A of

the Companies Act, 1956, introduced the proviso to Section 326(1) and also modified Section 326(2).

3.8 It is submitted that the consequence of this change was that while workmen's dues and dues owed to secured creditors as per Section 325(1) Proviso (c) ranked *pari passu*, the wages and salaries due to workmen for a period of 2 years preceding winding up order, shall be paid in priority to all other debts, within a period of 30 days of sale of assets and shall be subject to such charge over the security of secured creditors as may be prescribed. Importantly, the Government Dues and wages or salary owned to employees remained restricted to periods as they were in the Companies Act, 1956. It is submitted that another important aspect to be noted is that the definition of "workmen's dues" includes the Pension Fund, Gratuity Fund and the Provident Fund amounts and there was no exclusion of the said amounts in the case of liquidation. It is submitted that therefore, the position of law regarding "overriding preferential payments" and "preferential payments", as per the Companies Act, 1956 and the Companies Act, 2013, is that workmen have a charge over the property of the security of every secured creditor to the extent of workmen's portion, the workmen's dues rank *pari passu* with the debts owed to secured creditors

and specifically wages or salary due to workmen for a period of 2 years preceding the winding up order shall be paid in priority to all other debts.

3.9 That thereafter, Shri K.V. Viswanathan, learned Senior Advocate and Amicus Curiae has taken us to the framing of the IBC. It is submitted that the Bankruptcy Law Reforms Committee submitted its Report on 04.11.2015. The said Report discussed the changes that are to be made to the existing regime of insolvency and bankruptcy proceedings and *inter alia* provided for reasons as to why changes were being made to the existing position of law. It is submitted that important parts of the Bankruptcy Law Reforms Committee (BLRC) Report may be summarized as follows:

i. The Committee noted that operational creditors will include workmen and employees whose past payments are due.

ii. Further, the Committee notes that the Central and State Government dues will be kept at a priority below the unsecured financial creditors in addition to all kinds of secured creditors.

iii. The Committee also categorically notes that liquidation under the new regime will have an irreversible, time-bound

process with defined payout prioritisation. In the waterfall, secured creditors shall share highest priority along with a defined period of workmen dues.

iv. Thereafter, the Committee, in order to bring the law in India in line with global practice, established the priority of payout in liquidation and drafting instructions were accordingly given. As proposed, the costs of IRP and Liquidation would rank first. After that, secured creditors and workmen dues capped up to 3 months from the start of IRP will be given *pari passu* priority. This was to be followed by dues to employees capped up-to 3 months. As the next tier, workmen dues for 9 month period beginning 12 months before liquidation commencement date and ending 3 months before liquidation commencement date were to rank along with dues to unsecured financial creditors.

v. The Committee also notes that there was some debate on whether priority given to workmen in Companies Act, 2013 should be retained in the new Code.

3.10 It is submitted that thus, the BLRC Report recommended a waterfall mechanism that was different from the Companies Act, 1956 and the Companies Act, 2013, with due cognizance of the position of law as it existed then. It is submitted that having reviewed the position of law and in view of the objects sought to be achieved through the IBC, the BLRC Report recommended that workmen's dues will be capped at 3 months and will have *pari passu* priority with secured creditors and thereafter, the remaining dues will rank along with unsecured creditors.

3.11 It is submitted that the IBC was introduced as a Bill in 2015. It is submitted that Section 36, as introduced in the Bill, provided for formation of the liquidation estate. Section 36(4)(a)(iii), as introduced in the Bill, stated that the contributions in respect of employee pensions alone would be excluded from the liquidation estate assets and would not be used for recovery in liquidation. Section 53, as introduced in the Bill, provided for the waterfall mechanism for payout in case of liquidation. Section 53(1)(b)(i) and (ii) ranked debts owed to secured creditors in the event of them relinquishing security and workmen's dues for a period of 12 months preceding liquidation commencement date, *pari passu*. It is submitted that in

terms of the waterfall mechanism, this was therefore a step further than the path suggested by the BLRC Report since the workmen's dues were to rank *pari passu* for a defined period of 12 months. It is submitted that however, thereafter, the IBC, when introduced as a Bill, was then referred to a Joint Committee. The Joint Committee on Insolvency and Bankruptcy Code, 2015 of the 16th Lok Sabha submitted its report in April, 2016. It is submitted that the Joint Committee Report made two important recommendations in regard to the provisions contained in the Bill. Firstly, after noting representations from the workmen and employees, it was recommended that the Provident Fund, Pension Fund and Gratuity Fund are to be excluded from the liquidation estate assets under Section 36, since they provide the social safety net to the workmen and employees. Secondly, after consideration of the representations that workmen dues are to be paid as per the scheme contained in the Companies Act, 2013, the Joint Committee recommended that since the dues owed to Governments are being paid in respect of two years preceding liquidation commencement date, the workmen's dues must also be paid for a period of two years, instead of the existing period of 12 months, preceding liquidation commencement date. It is submitted

that this was recommended keeping in mind that the workers are the “nerve centre of any company” and that their interests were to be protected. It is submitted that keeping in view the Joint Committee Recommendations, the IBC was brought into force. It is submitted that Section 36(4)(a)(iii) of the IBC now excludes all sums due to any workman or employee from the Provident Fund, Pension Fund and Gratuity Fund from being included in the liquidation estate assets. It is further submitted that Section 53(1)(b)(i) and (ii) of the IBC now ranks workmen’s dues for a period of 2 years preceding the liquidation commencement date and the debts owed to secured creditors in event of them relinquishing their security *pari passu*. It is submitted that dues owed to the employees are placed in Section 53(1)(c), confined to a period of 12 months, and the dues to Central Government and State Government are placed in Section 53(1)(e)(i), confined to a period of 2 years and below that of the unsecured creditors. It is submitted that the result, therefore, is that the position and waterfall mechanism as provided for in the Companies Act, 1956 and the Companies Act, 2013 has now been altered after application of mind and resultantly, the workmen’s dues have been capped at 24 months preceding the liquidation

commencement date. The changes introduced from the erstwhile regime have been so done on the basis of an organic evolution of law and consultative process, after due consideration of the requirements of a new Code governing liquidation.

3.12 It is submitted that Section 53 Explanation (ii) of IBC states that the term “workmen’s dues” shall have the same meaning as assigned to it in Section 326 of the Companies Act, 2013. It is submitted that thereafter, the Eleventh Schedule to the IBC proposes Amendments to be made to Companies Act, 2013. It is submitted that importantly, Clause 18 of the Schedule omits erstwhile Section 325 of the Companies Act, 2013. It is submitted that Clause 19 of the Schedule amends Section 326 of Companies Act, 2013. Thereafter, Clause 20 of the Schedule inserts Section 327(7) to the Companies Act, 2013 which states that Section 326 and Section 327 shall not be applicable in the event of liquidation under the IBC. A conjoint reading of Section 53 Explanation (ii) of IBC and Section 327(7) of Companies Act, 2013 would indicate that only the meaning of “workmen’s dues” is incorporated by reference into the IBC. However, the waterfall mechanism, as has been fully altered by the IBC will apply to these “workmen’s dues” and not the waterfall

mechanism contained in Section 326 of Companies Act, 2013. It is submitted that the reason for introduction of Section 327(7) of Companies Act, 2013 is only to exclude the application of waterfall mechanism and the modalities contained in the Companies Act, 2013 which has now been changed through the IBC. It is submitted that therefore, the argument that the waterfall mechanism from the Companies Act, 2013 must apply even under the IBC, would be wholly untenable and unworkable.

3.13 It is submitted that subsequently, the Insolvency Law Committee submitted its report in 2018 under the chairmanship of Mr. Injeti Srinivas. The Report contained summary responses of the Committee to the comments and issues raised with respect to the IBC. It is submitted that importantly, all questions that raised the issue of workmen's dues either being unfairly ranked with secured creditors or that workmen's dues were not protected under the IBC, the Committee noted that the interests of workmen were protected in line with the Objects sought to be achieved by the IBC.

3.14 It is further submitted that therefore, the legislature through the IBC has attempted to overhaul the existing system of law and provide for a different modality through which liquidation would function. It is submitted that under

the Companies Act, 2013, the waterfall mechanism and preferential payments were being made, keeping in mind the scheme of winding up of a Company. It is submitted that admittedly, workmen's dues were given *pari passu* priority with secured creditors of a defined kind and the wages and salaries owed for two years preceding the Order of winding up was to get absolute priority. It is further submitted that on the contrary, the scheme of the IBC is different from that of the Companies Act, 2013. It is submitted that the focus, in the IBC, is to revive the Company and it is only as a matter of last resort that liquidation envisaged. In liquidation, from the time of the BLRC Report, the focus has been on defined payout prioritisation and organically, the workmen's dues have increased from 3 months to 12 months and now to 24 months to rank *pari passu* with secured creditors who relinquish their security. It is submitted that this evolution of the IBC has been as a result of a consultative process, the position of workmen's dues has been reviewed at multiple occasions and the legislature, in its wisdom, has opted to cap it to a period of 24 months prior to liquidation commencement date. It is further submitted that the Pension Fund, Gratuity Fund and Provident Fund are left out of the liquidation estate, in a bid to protect the social

safety net of the workmen. Therefore, the changes made through the IBC, to the existing scheme under the Companies Act, 2013 would not be unconstitutional.

3.15 Shri K.V. Viswanathan, learned Senior Advocate and Amicus Curiae has further submitted that this Hon'ble Court in a catena of judgments has considered the principle of "judicial hands-off" when it comes to economic legislations. It is submitted that in economic matters, a wider latitude is given to the law-maker and the Court allows for experimentation in such legislations based on practical experiences and other problems seen by the law-makers. It is submitted that in a challenge to such a legislation, the Court does not adopt a doctrinaire approach. Reliance is placed on the decisions of **Manish Kumar Vs. Union of India and Anr., (2021) 5 SCC 1** (Paras 169, 249-251); **Swiss Ribbons Private Limited and Anr. Vs. Union of India and Ors., (2019) 4 SCC 17** [(Paras 17-24, 25-28) [for objects of IBC] r/w Para 120]; **Small Scale Industrial Manufacturers Association (Registered) Vs. Union of India and Ors., (2021) 8 SCC 511** (Paras 60-72). It is further submitted that as observed in a catena of decisions, a vested right under a statute can be taken away by another statute, in view of

public interest and in view of it being an economic measure.

3.16 On IBC and reasonable classification, Shri K.V. Viswanathan, learned Senior Advocate and Amicus Curiae has submitted that in the case of **Swiss Ribbons Private Limited and Anr. (supra)**, this Court was concerned with a challenge to Constitutional Validity of several provisions of the IBC including the waterfall mechanism under Section 53 of the IBC, even though it was at the instance of the Operational Creditors. It is submitted that after noting the objects and reasons for enactment of the IBC, this Hon'ble Court held that there existed an intelligible differentia for classification of financial creditors and operational creditors under the IBC. It is further submitted that Section 53 of the IBC was also upheld from the perspective of this reasonable classification by placing reliance on the object sought to be achieved by the IBC

3.17 It is further submitted that in the case of **Committee of Creditors of Essar Steel India Limited Vs. Satish Kumar Gupta and Ors., (2020) 8 SCC 531**, this Court was concerned with whether a resolution plan was to treat operational creditors on par with financial creditors and further with amendments made to the IBC that provided

operational creditors with a minimum of liquidation value under the CIRP Process. It is submitted that this Court in the said decision held that the principle of “equality for all” cannot be stretched to treat financial and operational creditors on par as this would defeat the entire objective of the IBC. This Court also held that amendments made to the IBC that guaranteed a minimum of liquidation value to operational creditors was not *ultra vires* Article 14.

3.18 He has also further submitted that in the case of **Ghanashyam Mishra and Sons Private Limited Vs. Edelweiss Asset Reconstruction Company Limited, (2021) 9 SCC 657**, this Court was concerned with whether the approved resolution plan was binding on the Government, whether before or after the Amendment made to Section 31 of IBC by Amendment Act, 2019. It is submitted that this Court categorically held that the amendment was clarificatory in nature and that the approved resolution plan would be binding on the Government. While holding so, this Court noted the legislative intent in making the plan binding on all stake holders, to create a clean slate and to ensure that no surprise claims come up after the resolution process has begun.

3.19 On interpretation of “workmen’s portion” under Section 529 and 529-A of the Companies Act, reliance is placed on the decision of this Court in the case of **Allahabad Bank Vs. Canara Bank and Anr., (2000) 4 SCC 406** as well as **Andhra Bank Vs. Official Liquidator and Anr., (2005) 5 SCC 75.**

3.20 Making above submissions, it is prayed to allow the present writ petitions and grant the reliefs as prayed.

4. We have heard Shri Balbir Singh, learned ASG appearing on behalf of the respondent – Union of India.

4.1 Shri Balbir Singh, learned ASG has taken us to the relevant provisions under the Companies Act, 1956, more particularly, Sections 59A, 529A, 530 and the relevant provisions of the Companies Act, 2013.

4.2 It is submitted that initially the insolvency process in case of winding up of insolvent companies were provided under Section 325 of Act, 2013. However, Section 325 of the Act, 2013 has been omitted w.e.f. 15.11.2016 on advent of the IBC. It is submitted that therefore, as on today, the winding up proceeding in case of insolvency are not governed by Companies Act, 2013 and the provisions of the IBC is the only applicable law to deal

with such a situation as it is a complete Code in itself. It is submitted that furthermore, an amendment w.e.f. 15.11.2016 was brought in under Section 327(7) of the Act, 2013 wherein it has been clarified that the provisions of Section 326 and Section 327 of the Act, 2013 will not be applicable in the event of liquidation under the IBC.

4.3 It is submitted that only in case of any winding up under Companies Act, 2013, Sections 326 and 327 of the Companies Act, 2013 are relevant. He has submitted that following are the relevant features in case of winding up proceedings under Sections 326 and 327 of the Act, 2013:-

- workmen's portion in the security shall be paid in priority to all other debts;
- however, workmen's dues (given in (b)(i) and (ii) payable for the period of 24 months, shall be paid in priority to all other debts (including debts due to secured creditors). This means that wages/salary for the period of 24 months is over and above every other claim/debts (including debts due to secured creditors).
- workmen's dues include Provident Fund, Pension Fund and Gratuity Fund or any other Fund for the

welfare of the workmen maintained by the Company.

4.4 It is submitted that the waterfall mechanism is given in Section 327, which is similar to Section 530 of the Companies Act, 1956. It is submitted that thereafter the IBC has been introduced in the year 2016 wherein the workmen dues were duly protected and the Provident Fund, Gratuity Fund and Pension Fund are excluded from the liquidation estate. It is submitted that as per Section 53 of the IBC, the workmen dues are given the top priority in the waterfall mechanism.

4.5 It is submitted that the liquidation process is covered under Chapter III of the IBC, which comprises from Sections 33 to 54. Section 36 of the IBC provides for liquidation estate and Section 36(4) of the IBC specifies certain payouts not to be included in the liquidation estate assets. Therefore, as per the said provision, all these debts due are not to be included in the liquidation estate assets. It is submitted that as per the said provision, all payments due to any workmen or employee from Provident Fund, Pension Fund and The Gratuity Fund shall not be included in the list of assets under liquidation estate.

4.6 It is submitted that with respect to Section 53 of the IBC, sale of liquidation assets shall be distributed in certain order of priority. It is submitted that as per Section 53, the payment of insolvency resolution process costs and liquidation costs is paramount and the same shall be paid in full. The liquidation cost includes the salary and wages paid to workmen during the period of liquidation process to maintain the Company as going concern. Thereafter, the payment of workmen dues for a period of 24 months are to be paid alongwith secured creditors dues in the event of relinquishment of security. The workmen dues and debts of secured creditors in the case of relinquishment of security are ranked equally between them. However, in the case of enforcement of security any unpaid outstanding debt comes below in ladder to Section 53(1)(e)(iii) of the IBC.

4.7 It is submitted that the challenge has been made on the ground of Article 14 of the Constitution of India by comparing Section 53 of the IBC with the provisions of erstwhile Companies Act, 1956 and existing Companies Act, 2013 to state that workmen are at a disadvantageous position on the basis: (i) workmen's portion in the security

held by secured creditor has been done away with; (ii) preference/superiority given to 24 months over any other debt has been done away with; (iii) workmen and secured creditors have been placed in same pool.

4.8 To the aforesaid, it is submitted by Shri Balbir Singh, learned ASG that as such the IBC is a new insolvency mechanism in line with the international practices and with overarching objective of unlocking sick and insolvent companies primarily to revive such companies in event of failure, for transparent and equitable liquidation of assets. It is submitted that the IBC was introduced as a water-shed moment for insolvency law in India that consolidated process under several disparate statutes such as Act, 2013, SICA, SARFAESI, Recovery of Debts Act etc., into a single Code. It is submitted that the objective of the IBC was to introduce comprehensive and time bound insolvency framework and to maximize the value of assets of all persons and balance the interest of all stakeholders.

4.9 It is submitted that the UNICITRAL Legislative Guide on Insolvency Law was instructive for the Indian experience on drafting the IBC which provided critical guidance on what an insolvency law represents. It is

submitted that a reading together of the UNICITRAL Legislative Guide on Insolvency Law and Bankruptcy Law Report clarifies in no uncertain terms, that the procedure designed for the insolvency process under the IBC is critical for allocating economic coordination between the parties who partake in or are bound by the process. It is submitted that this Hon'ble Court has looked at overarching object and economic balance achieved by IBC and as such has appreciated the working and operation of IBC in unlocking value for all its stakeholders including financial institutions in the case of **Innoventive Industries Limited Vs. ICICI Bank and Anr., (2018) 1 SCC 407**, followed in **Arcelormittal India Private Limited Vs. Satish Kumar Gupta and Ors., (2019) 2 SCC 1; Arun Kumar Jagatramka Vs. Jindal Steel and Power Limited and Anr., (2021) 7 SCC 474** and **Sesh Nath Singh and Anr. Vs. Baidyabati Sheoraphuli Co-operative Bank Limited and Anr., (2021) 7 SCC 313**.

4.10 It is submitted that as per the objectives of the IBC, it is clear that corporate death of a Corporate Debtor is inevitable. However, every effort should be made to resuscitate the Corporate debtor in the larger public interest, which includes not only the workmen of the corporate debtor, but also its creditors and the goods it

produces in the larger interest of the economy of the country.

4.11 It is submitted that in the Bankruptcy Law Reforms Committee (Volume 1) (November, 2015), it was agreed that the assets held in by the entity in trust (such as employee pensions), assets held as collateral to certain financial market institutions and assets held as part of operational transactions where the entity has right over the asset but is not the owner of the same shall be excluded from the liquidation estate. It is further submitted that it was also debated with respect to the waterfall mechanism under the IBC and was agreed that the workmen dues capped up to 3 months will be given the second priority with the secured creditor after the costs of the corporate insolvency and resolution process and liquidation.

4.12 It is submitted that subsequently, a report of the Joint Committee on the Insolvency and Bankruptcy Code, 2015 was prepared and presented in Lok Sabha on 28.04.2016 wherein the issue of exclusion of Provident Fund, Pension Fund and Gratuity Fund from the liquidation estate assets and estate of bankrupt was

debated. It is submitted that the Committee, after an in-depth examination, was of the view that Provident Fund, Pension Fund and Gratuity Fund provide the social safety net to the workmen and employees and hence, need to be secured in the event of liquidation of a company or bankruptcy of partnership firm. It is submitted that the Committee further observed that the workers are the nerve center of any company and in the event of any company becoming insolvent or bankrupt, the workmen get affected adversely and therefore, priority must be given to their outstanding dues. Therefore, all sums due to any workman or employee from the Provident Fund, Gratuity Fund or Pension Fund should not be included in the liquidation estate assets. It is submitted that thus, to protect the interest of the workmen, the Committee decided that the workmen dues for a period of 12 months as provided under Section 53 of the IBC be increased to 24 months preceding liquidation commencement date.

4.13 It is submitted that in light of the same, Section 36 of the IBC has clearly given outright protection to workmen's dues under Provident Fund, Pension Fund and Gratuity Fund which is not treated as liquidation assets and liquidator has no claim over such funds. That therefore,

this share of workmen's dues has consciously been taken outside the liquidation process.

4.14 It is submitted that liquidation costs cover the wages and salary of the workmen during the liquidation process. It is submitted that the liquidation cost is defined in Section 5(16) of the IBC which includes the cost incurred by the liquidator during the period of liquidation subject to such regulations as specified by the Board. It is submitted that with respect to the liquidation process, the Board has notified the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016. It is submitted that Regulation 2(ea) talks about liquidation cost which under Section 5(16) of the IBC includes the costs incurred by the liquidator in carrying on the business of the Corporate Debtor as a going concern. That, therefore, the salary and wages of the workmen in case of going concern liquidation are protected under the liquidation costs. It is further submitted that under the Liquidation Regulations 2016, a mechanism is created wherein Regulation 19 provides for claim by workmen and employee and Regulation 31A has been inserted to bring in stakeholders Consultation Committee, where participation to workmen/ employees is given.

4.15 It is submitted that the issue with respect to the workmen and secured creditor being kept at equal footing under Section 53 of the IBC is only in the case wherein the secured creditor has relinquished its security and the same is the part of the liquidation pool. It is submitted that Section 52 of the IBC specifically states about the secured creditor in the liquidation proceedings and Regulation 21A talks about the presumption of security interest in the case of secured creditors. It is submitted that the said position has been duly considered by the respondent – Union of India in the Report of the Insolvency Law Committee (March, 2018) as well as Report of Insolvency Law Committee (February, 2020).

4.16 It is further submitted that the Committee in the Report of February, 2020 duly agreed that the priority for recovery to secured creditors under Section 53(1)(b)(ii) should be applicable only to the extent of the value of the security interest that is relinquished by the secured creditor. It is submitted that the Committee noted that the Code aims to promote a collective liquidation process and towards this end, it encourages secured creditors to relinquish their security interest by providing them second

highest priority in the recovery of their dues under Section 53(1)(b) of the IBC and are not treated as ordinary unsecured creditors under the IBC as they would have been under the Companies Act, 1956. That the said provision intends to promote the overall value maximization.

4.17 It is submitted that furthermore, the Committee in its report of February, 2020 also decided whether the secured creditors who realized their security interest should contribute towards the payment of dues of workmen. Regulation 21(A) of Liquidation Process requires that secured creditors who realise their security interest contribute towards the payment of dues of workmen as they would have if they had relinquished their security interest to the liquidation estate. It is submitted that thus, the requirement to contribute to workmen dues as provided under Regulation 21A, recognizes that workmen are key stakeholders and form the backbone of the efforts to preserve the business of the Corporate Debtor not just prior to commencement of insolvency but also during the insolvency proceedings.

4.18 It is submitted that thus, visualizing the objects and working of the IBC, it is clear that the rights and interest of the workers have been protected from the date of enactment of the IBC. It is submitted that in either case that is of relinquishment or non-relinquishment of the security by the secured creditor, the interest of the workmen is protected. It is submitted that in fact, the secured creditors are taking significant hair-cut and workmen are being compensated on equitable basis in a just and proper manner as per Section 53 of the IBC. It is submitted that therefore, it is unfair to say that ranking them with workmen is arbitrary, lest manifestly arbitrary to declare Section 53 as unconstitutional.

4.19 It is submitted that from examination of waterfall mechanism as provided under Section 53 of the IBC, it is clear that other stakeholders including the Central Government have seriously compromises their position in connection with the recovery of statutory dues so as to enable value maximization and reviving unhealthy companies on going concern basis. It is submitted that therefore, to say that workmen are in any way adversely affected to the tune of arbitrariness or inequity contemplated under Article 14 is erroneous.

4.20 It is further submitted by Shri Balbir Singh, learned ASG appearing on behalf of the respondent – Union of India that the IBC being a law relating to economic activities as observed and held by this Court in the case of **R.K. Garg Vs. Union of India and Ors., (1981) 4 SCC 675**, the laws relating to economy should be viewed with greater latitude than the laws touching civil rights.

4.21 Making above submissions and relying upon the decisions of this Court in the case of **R.K. Garg (supra)** (paras 8 and 16); **Rustom Cavasjee Cooper Vs. Union of India, (1970) 1 SCC 248** (paras 63 and 179)**; Delhi Science Forum and Ors. Vs. Union of India and Anr., (1996) 2 SCC 405** (para7); **BALCO Employees' Union (Regd.) Vs. Union of India and Ors., (2002) 2 SCC 333** (paras 46, 47, 92, 93, 94 and 98), it is prayed to observe and hold that Section 53 of the IBC, 2016 is neither arbitrary nor violative of Articles 14 and 21 of the Constitution of India.

5. We have heard learned counsel appearing on behalf of the respective parties at length.

6. By way of this writ petition under Article 32 of the Constitution of India, the petitioner - union has sought for an appropriate writ, direction or order striking down Section 327(7) of the Companies Act, 2013 as arbitrary and violative of Article 21 of the Constitution of India. The petitioner has also sought for an appropriate direction so as to leave the statutory claims of the "workmen's dues" out of the purview of waterfall mechanism under Section 53 of the Insolvency and Bankruptcy Code, 2016. As per Section 327(7), Sections 326 and 327 of the Act, 2013 shall not be applicable in the event of liquidation under the IBC. Sections 326 and 327 of the Act, 2013 provide for preferential payments in a winding up under the provisions of the Act, 2013. However, in view of the introduction of new regime under the IBC, in case of liquidation under IBC, distribution is to be made as per Section 53 of IBC. At this stage, it is required to be noted that IBC has been enacted w.e.f. 28.05.2016 and as per Section 53 of the IBC, the distribution of assets in case of liquidation under the IBC is required to be made. Section 53 of the IBC reads as under: -

> "**53. Distribution of assets**.—(1) 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*) 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*) wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date;

(*d*) financial debts owed to unsecured creditors;

(*e*) the following dues shall rank equally between and among the following:—

(*i*) any amount due to the Central Government and the State Government including the amount to be received on account of the Consolidated Fund of India and the Consolidated Fund of a State, if any, in respect of the whole or any part of the period of two years preceding the liquidation commencement date;

(*ii*) debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;

(*f*) any remaining debts and dues;

(*g*) preference shareholders, if any; and

(*h*) equity shareholders or partners, as the case may be.

(2) Any contractual arrangements between recipients under sub-section (1) with equal ranking, if disrupting the order of priority under that sub-section shall be disregarded by the liquidator.

> (3) The fees payable to the liquidator shall be deducted proportionately from the proceeds payable to each class of recipients under sub-section (1), and the proceeds to the relevant recipient shall be distributed after such deduction.
>
> *Explanation*.—For the purpose of this section—
>
> (*i*) it is hereby clarified that at each stage of the distribution of proceeds in respect of a class of recipients that rank equally, each of the debts will either be paid in full, or will be paid in equal proportion within the same class of recipients, if the proceeds are insufficient to meet the debts in full; and
>
> (*ii*) the term "workmen's dues" shall have the same meaning as assigned to it in Section 326 of the Companies Act, 2013 (18 of 2013)."

In view of the enactment of IBC and Section 53 of the IBC, it necessitated to amend the Act, 2013. As per Sub-Section (7) of Section 327, Sections 326 and 327 shall not be applicable in the event of liquidation under the IBC. The object and purpose of amending the Act, 2013 and to exclude Sections 326 and 327 in the event of liquidation under the IBC seems to be that there may not be two different provisions with respect to winding up/liquidation of a company. Therefore, in view of the enactment of IBC, it necessitated to exclude the applicability of Sections 326 and 327 of the Act, 2013 which cannot be said to be arbitrary as contended on behalf of the petitioner.

6.1 At this stage, it is required to be noted that Sub-Section (7) of Section 327 of which the vires are under challenge, shall be applicable in case of liquidation of a company under the IBC. Meaning thereby, in case of liquidation of a company under IBC, the provisions of Section 53 of the IBC and other provisions of the IBC shall be applicable as the company is ordered to be liquidated or wound up under the provisions of IBC. Therefore, merely because under the earlier regime and in case of winding up of a company under the Act, 1956/2013, the dues of the workmen may have *pari passu* with that of the secured creditor, the petitioner cannot claim the same benefit in case of winding up/liquidation of the company under IBC. The parties shall be governed by the provisions of the IBC in case of liquidation of a company under the provisions of the IBC.

6.2 Now so far as Section 53 of the IBC is concerned, it provides for distribution of the assets in case of liquidation of a company under IBC. As per Section 53(1)(b) the workmen's dues for the period of twenty-four months preceding the liquidation commencement date shall rank equally between the workmen and the secured creditor in the event such secured creditor has relinquished security in the manner set out in Section 52. Therefore, workmen's

dues for the period of twenty-four months preceding the liquidation commencement date shall have *pari passu* with the dues of secured creditor. At this stage, it is required to be noted that as per Section 36(4) of IBC, all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund shall not be included in the liquidation estate assets and shall not be used for the recovery in the liquidation. Therefore, a conscious decision has been taken by the Parliament/Legislature in its wisdom to keep out of all sums due to any workman/employee from the provident fund, the pension fund and the gratuity fund from the liquidation estate assets [as per Section 36(4)] and that the workmen's dues for the period of twenty-four months preceding the liquidation commencement date shall rank equally between the workmen's dues to the said extent and the dues to the secured creditor. Therefore, the same cannot be said to be arbitrary and violative of Article 21 of the Constitution of India as contended on behalf of the petitioner. As per the settled position of law, IBC is a complete Code and the object and purpose of IBC is altogether different than that of the Act, 1956/2013. The IBC is a new insolvency mechanism, therefore, the provisions under the IBC cannot be compared with that of

the earlier regime, namely, the Companies Act, 1956/2013.

6.3 At this stage, it is required to be noted that the issue with respect to the workman and the secured creditor being kept at equal footing under Section 53 of the IBC is only in a case wherein the secured creditor has relinquished its security and the same is the part of the stage of the liquidation pool.

7. Section 271[1] of the Companies Act 2013, as originally enacted, had as many as seven grounds on which a company could be wound up. Ground (a) on

---

1 **271. Circumstances in which company may be wound up by Tribunal. –** (1) A company may, on a petition under section 272, be wound-up by the Tribunal, -
(a) If the company is unable to pay debts;
(b) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;
(c) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
(d) if the Tribunal has ordered the winding up of the company under Chapter XIX;
(e) if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that is proper that the company be wound up;
(f) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or
(g) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

***

which the company could be wound up was when the company is unable to pay its debts. The other grounds were, when the company, by special resolution, has decided to be wound up; when the company has acted against the interests of sovereignty and integrity of India, the security of the State, friendly relations with foreign State, public order, decency or morality; if the Tribunal has ordered winding up of the company under Chapter XIX of the Companies Act, 2013, a chapter relating to revival and rehabilitation of sick companies; if on an application made by the Registrar or any other person authorised by the Central Government by notification, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company has been formed for fraudulent and unlawful purpose, or persons concerned in formation or management of its affairs have been guilty of fraud, misfeasance, misconduct in connection therewith, which makes it proper that the company be wound up; or if the company has made default in filing its financial statements or annual returns with the Registrar for immediately preceding five consecutive financial years; lastly, if the Tribunal is of the opinion that it is just and equitable to wind up the company.

7.1 The provision as enacted was never enforced till it was substituted by Act No. 31 of 2016 and the Eleventh Schedule in paragraph 10 of the Insolvency and Bankruptcy Code, 2016[2], with effect from 15th November 2016. This coincided with the enactment and enforcement of the Code, also applicable with effect from 15th November 2016. Consequent to the substitution, Section 271[3] of the Companies Act 2013 now envisages only five grounds for winding up of the company under the Companies Act 2013. The first ground is where the company, by special resolution, has resolved to be wound up by the Tribunal. The other grounds are when the company has acted against the sovereignty and integrity

---

2 For short, "Code".

3 **271. Circumstances in which company may be wound up by Tribunal. –** A company may, on a petition under section 272, be wound-up by the Tribunal, -
(a) if the company has, by special resolution, resolved that the company be wound up by the Tribunal;
(b) if the company has acted against the interests of the sovereignty and integrity of India, the security of the State, friendly relations with foreign States, public order, decency or morality;
(c) if on an application made by the Registrar or any other person authorised by the Central Government by notification under this Act, the Tribunal is of the opinion that the affairs of the company have been conducted in a fraudulent manner or the company was formed for fraudulent and unlawful purpose or the persons concerned in the formation or management of its affairs have been guilty of fraud, misfeasance or misconduct in connection therewith and that is proper that the company be wound up;
(d) if the company has made a default in filing with the Registrar its financial statements or annual returns for immediately preceding five consecutive financial years; or
(e) if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

of India, security of the State, friendly relations with foreign States, public order, decency or morality; if the Tribunal on an application made by the Registrar or any other person authorised by the Central Government by a notification is satisfied that the affairs of the company have been conducted in a fraudulent manner, or the company was formed for a fraudulent or unlawful purpose, or the persons concerned in the formation or management of its affairs have been found to be guilty of fraud, misfeasance or misconduct in connection therewith, which makes it proper for the company to be wound up; if the company has defaulted in filing financial statements and annual returns with the Registrar for immediately preceding five consecutive financial years; and lastly if the Tribunal is of the opinion that it is just and equitable that the company should be wound up.

7.2 Clearly, the legislature has now removed clause (a) to Section 271 of the Companies Act, 2013, when a company is unable to pay the debts, and clause (d) to Section 271 of the Companies Act, 2013, when a company is directed to be wound up under the Chapter XIX of the Companies Act, 2013. In fact, Chapter XIX of the Companies Act 2013 was deleted/omitted in terms of Act No. 31 of 2016 and the Eleventh Schedule in

paragraph 8 of the Code, with effect from 15th November 2016. The Code, as enacted, is a separate and consolidated enactment specifically relating to and dealing with companies which are insolvent and unable to pay dues, and envisages a procedure with a mandate to first explore possibility of rehabilitation and revival of the company, and the dissolution/winding up as the last call.

7.3 This is significant and must be highlighted when we examine the question of the Constitutional challenge made by the petitioners, so as to not frustrate the objective and purpose of the Code, which completely replaces the then existing framework for insolvency and bankruptcy resolution that was inadequate, ineffective and guilty of causing undue delays. The enactment of the Code and the amendments thereafter are a consequence of detailed consultation and deliberations by several committees, commissions and experts[4], in a matter which deals with the economy of the country as a whole. Earlier position was far from satisfactory in spite of enactment of the Sick Industrial Companies (Special Provisions) Act,

4 See – The Report of High Level Committee on Law Relating to Insolvency and Winding Up of Companies, 2000, The Report of the Expert Committee on Company Law dated 31.05.2005, 57th Report of the Standing Committee of 15th Lok Sabha on Finance on The Companies Bill, 2011, The Report of the Bankruptcy Law Reforms Committee dated 04.11.2015, The Report of Joint Committee on Insolvency and Bankruptcy Code, 2015 of the 16th Lok Sabha and The report of the Insolvency Law Committee dated 26.03.2018.

1985, the Recovery of Debts Due to Banks and Financial Institutions Act, 1993, and the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. The Code has been enacted with the objective of reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time-bound manner for maximisation of the value of assets, promote entrepreneurship, enhance availability of credit and balance the interests of all stakeholders, including by alteration in the priority of payment of government dues, to establish an Insolvency and Bankruptcy Fund, and matters connected therewith or incidental thereto. The objective is to improve the ease of doing business and facilitate more investments, leading to higher economic growth and development.

8. We have earlier referred to, in detail, the divergent opinions expressed while enacting the Code on the status of the workmen's dues and the hierarchy in which they should be placed. The waterfall mechanism now prescribed in the Code with reference to the workmen’s dues is a well-considered and thought-out decision. The waterfall mechanism and the hierarchy prescribed to the workmen’s dues should be seen in the overall objective of the Code, which is to explore whether the corporate

debtor can be revived so that jobs are not lost, the use of economic assets is maximised, and there is an effective legal framework which enhances the viability of credit in the hands of banks and financial institutions. The Code recognises the financial impact on secured creditors or financial institutions dealing with public money, as their economic health is equally important for the general public as well as the national economy. Unless there is economic growth and fresh investments in the industry, employment opportunities will not be available, which would in turn lead to economic woes, insolvencies and bankruptcies. These are all complex economic matters wherein various conflicting interests have to be balanced, and a holistic rather than a one-sided, approach is to be taken. Each opinion may have merit, but the court can hardly substitute its own wisdom or view for that of the legislature, especially when the enactment is the outcome of a thought-out and ruminated review on complex fiscal and commercial challenges facing the economy. It is in this context, this Court, while upholding the Constitutional validity of the Code on the challenge of discrimination made by the operational creditors in ***Swiss Ribbons Private Limited and Another***. v. ***Union of India and Others***.[5] had observed as under:

5 (2019) 4 SCC 17.

"***Judicial hands-off qua economic legislation***

****

21. In this country, this Court in *R.K. Garg* v. *Union of India*, (1981) 4 SCC 675, has held :

> "*8*. Another rule of equal importance is that laws relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of speech, religion, etc. It has been said by no less a person than Holmes, J., that the legislature should be allowed some play in the joints, because it has to deal with complex problems which do not admit of solution through any doctrinaire or straitjacket formula and this is particularly true in case of legislation dealing with economic matters, where, having regard to the nature of the problems required to be dealt with, greater play in the joints has to be allowed to the legislature. The court should feel more inclined to give judicial deference to legislative judgment in the field of economic regulation than in other areas where fundamental human rights are involved. Nowhere has this admonition been more felicitously expressed than in *Morey* v. *Doud* where Frankfurter, J., said in his inimitable style:
>
> > *'In the utilities, tax and economic regulation cases, there are good reasons for judicial self-restraint if not judicial deference to legislative judgment. The legislature after all has the affirmative responsibility. The courts have only the power to destroy, not to reconstruct. When these are added to the complexity of economic regulation, the uncertainty, the liability to error, the bewildering conflict of the experts, and the number of times the Judges have been overruled by events — self-*

limitation can be seen to be the path to judicial wisdom and institutional prestige and stability.'

The Court must always remember that *"legislation is directed to practical problems, that the economic mechanism is highly sensitive and complex, that many problems are singular and contingent, that laws are not abstract propositions and do not relate to abstract units and are not to be measured by abstract symmetry"*; 'that exact wisdom and nice adaption of remedy are not always possible' and that 'judgment is largely a prophecy based on meagre and uninterpreted experience'. *Every legislation, particularly in economic matters is essentially empiric and it is based on experimentation or what one may call trial and error method and therefore it cannot provide for all possible situations or anticipate all possible abuses. There may be crudities and inequities in complicated experimental economic legislation but on that account alone it cannot be struck down as invalid*. The courts cannot, as pointed out by the United States Supreme Court in *Secy. of Agriculture* v. *Central Roig Refining Co.* be converted into tribunals for relief from such crudities and inequities. There may even be possibilities of abuse, but that too cannot of itself be a ground for invalidating the legislation, because it is not possible for any legislature to anticipate as if by some divine prescience, distortions and abuses of its legislation which may be made by those subject to its provisions and to provide against such distortions and abuses. Indeed, howsoever great may be the care bestowed on its framing, it is difficult to conceive of a legislation which is not capable of being abused by perverted human ingenuity. *The Court must therefore adjudge the constitutionality of such legislation by the*

generality of its provisions and not by its crudities or inequities or by the possibilities of abuse of any of its provisions. If any crudities, inequities or possibilities of abuse come to light, the legislature can always step in and enact suitable amendatory legislation. That is the essence of pragmatic approach which must guide and inspire the legislature in dealing with complex economic issues.

***

19. …. It would be outside the province of the Court to consider if any particular immunity or exemption is necessary or not for the purpose of inducing disclosure of black money. That would depend upon diverse fiscal and economic considerations based on practical necessity and `administrative expediency and would also involve a certain amount of experimentation on which the Court would be least fitted to pronounce. The Court would not have the necessary competence and expertise to adjudicate upon such an economic issue. The Court cannot possibly assess or evaluate what would be the impact of a particular immunity or exemption and whether it would serve the purpose in view or not. There are so many imponderables that would enter into the determination that it would be wise for the Court not to hazard an opinion where even economists may differ. The Court must while examining the constitutional validity of a legislation of this kind, "be resilient, not rigid, forward looking, not static, liberal, not verbal" and the Court must always bear in mind the constitutional proposition enunciated by the Supreme Court of the United States in *Munn* v. *Illinois*, namely, 'that courts do not substitute their social and economic beliefs for the judgment of legislative bodies'. *The Court must defer to legislative judgment in matters relating to social and economic policies and*

must not interfere, unless the exercise of legislative judgment appears to be palpably arbitrary. The Court should constantly remind itself of what the Supreme Court of the United States said in *Metropolis Theater Co.* v. *City of Chicago*:

> *"12. … The problems of government are practical ones and may justify, if they do not require, rough accommodations, illogical it may be, and unscientific. But even such criticism should not be hastily expressed. What is best is not always discernible, the wisdom of any choice may be disputed or condemned. Mere error of Government are not subject to our judicial review."*

It is true that one or the other of the immunities or exemptions granted under the provisions of the Act may be taken advantage of by resourceful persons by adopting ingenious methods and devices with a view to avoiding or saving tax. But that cannot be helped because human ingenuity is so great when it comes to tax avoidance that it would be almost impossible to frame tax legislation which cannot be abused. Moreover, as already pointed out above, the trial and error method is inherent in every legislative effort to deal with an obstinate social or economic issue and if it is found that any immunity or exemption granted under the Act is being utilised for tax evasion or avoidance not intended by the legislature, the Act can always be amended and the abuse terminated. We are accordingly of the view that none of the provisions of the Act is violative of Article 14 and its constitutional validity must be upheld."

(emphasis supplied)

22. Likewise, in *Bhavesh D. Parish* v. *Union of India* (2000) 5 SCC 471, this Court held :

> "*26*. The services rendered by certain informal sectors of the Indian economy could not be belittled. However, in the path of economic progress, if the informal system was sought to be replaced by a more organised system, capable of better regulation and discipline, then this was an economic philosophy reflected by the legislation in question. Such a philosophy might have its merits and demerits. But these were matters of economic policy. They are best left to the wisdom of the legislature and in policy matters the accepted principle is that the courts should not interfere. Moreover in the context of the changed economic scenario the expertise of people dealing with the subject should not be lightly interfered with. The consequences of such interdiction can have large-scale ramifications and can put the clock back for a number of years. The process of rationalisation of the infirmities in the economy can be put in serious jeopardy and, therefore, it is necessary that while dealing with economic legislations, this Court, while not jettisoning its jurisdiction to curb arbitrary action or unconstitutional legislation, should interfere only in those few cases where the view reflected in the legislation is not possible to be taken at all.
>
> ***
>
> *30*. Before we conclude there is another matter which we must advert to. It has been brought to our notice that Section 45-S of the Act has been challenged in various High Courts and a few of them have granted the stay of provisions of Section 45-S. When considering an application for staying the operation of a piece of legislation, and that too pertaining to economic reform or change, then

the courts must bear in mind that unless the provision is manifestly unjust or glaringly unconstitutional, the courts must show judicial restraint in staying the applicability of the same. Merely because a statute comes up for examination and some arguable point is raised, which persuades the courts to consider the controversy, the legislative will should not normally be put under suspension pending such consideration. It is now well settled that there is always a presumption in favour of the constitutional validity of any legislation, unless the same is set aside after final hearing and, therefore, the tendency to grant stay of legislation relating to economic reform, at the interim stage, cannot be understood. *The system of checks and balances has to be utilised in a balanced manner with the primary objective of accelerating economic growth rather than suspending its growth by doubting its constitutional efficacy at the threshold itself*."

(emphasis supplied)

23. In *Directorate General of Foreign Trade* v. *Kanak Exports*, (2016) 2 SCC 226, this Court has held :

"*109*. Therefore, it cannot be denied that the Government has a right to amend, modify or even rescind a particular scheme. It is well settled that in complex economic matters every decision is necessarily empiric and it is based on experimentation or what one may call trial and error method and therefore, its validity cannot be tested on any rigid prior considerations or on the application of any straitjacket formula. In *BALCO Employees' Union* v. *Union of India*, (2002) 2 SCC 333] , the Supreme Court held that laws, including executive action relating to economic activities should be viewed with greater latitude than laws touching civil rights such as freedom of

speech, religion, etc. that the legislature should be allowed some play in the joints because it has to deal with complex problems which do not admit of solution through any doctrine or straitjacket formula and this is particularly true in case of legislation dealing with economic matters, where having regard to the nature of the problems greater latitude require to be allowed to the legislature."

****

The raison d'être for the Insolvency and Bankruptcy Code

****

27. As is discernible, the Preamble gives an insight into what is sought to be achieved by the Code. The Code is first and foremost, a Code for reorganisation and insolvency resolution of corporate debtors. Unless such reorganisation is effected in a time-bound manner, the value of the assets of such persons will deplete. Therefore, maximisation of value of the assets of such persons so that they are efficiently run as going concerns is another very important objective of the Code. This, in turn, will promote entrepreneurship as the persons in management of the corporate debtor are removed and replaced by entrepreneurs. When, therefore, a resolution plan takes off and the corporate debtor is brought back into the economic mainstream, it is able to repay its debts, which, in turn, enhances the viability of credit in the hands of banks and financial institutions. Above all, ultimately, the interests of all stakeholders are looked after as the corporate debtor itself becomes a beneficiary of the resolution scheme —workers are paid, the creditors in the long run will be repaid in full, and shareholders/investors are able to maximise their investment. Timely resolution of a corporate debtor who is in the red, by an effective legal framework, would go a long way to support the development of credit markets. Since more

investment can be made with funds that have come back into the economy, business then eases up, which leads, overall, to higher economic growth and development of the Indian economy. What is interesting to note is that the Preamble does not, in any manner, refer to liquidation, which is only availed of as a last resort if there is either no resolution plan or the resolution plans submitted are not up to the mark. Even in liquidation, the liquidator can sell the business of the corporate debtor as a going concern. (See *ArcelorMittal (India) (P) Ltd.* v. *Satish Kumar Gupta*, (2019) 2 SCC 1 at para 83, fn 3).

****

Epilogue

120. The Insolvency Code is a legislation which deals with economic matters and, in the larger sense, deals with the economy of the country as a whole. Earlier experiments, as we have seen, in terms of legislations having failed, "trial" having led to repeated "errors", ultimately led to the enactment of the Code. The experiment contained in the Code, judged by the generality of its provisions and not by so-called crudities and inequities that have been pointed out by the petitioners, passes constitutional muster. To stay experimentation in things economic is a grave responsibility, and denial of the right to experiment is fraught with serious consequences to the nation. We have also seen that the working of the Code is being monitored by the Central Government by Expert Committees that have been set up in this behalf. Amendments have been made in the short period in which the Code has operated, both to the Code itself as well as to subordinate legislation made under it. This process is an ongoing process which involves all stakeholders, including the petitioners.

****"

9. As elucidated above, the Companies Act, 2013 does not deal with insolvency and bankruptcy when the companies are unable to pay their debts or the aspects relating to the revival and rehabilitation of the companies and their winding up if revival and rehabilitation is not possible. In principle, it cannot be doubted that the cases of revival or winding up of the company on the ground of insolvency and inability to pay debts are different from cases where companies are wound up under Section 271 of the Companies Act 2013. The two situations are not identical. Under Section 271 of the Companies Act, 2013, even a running and financially sound company can also be wound up for the reasons in clauses (a) to (e). The reasons and grounds for winding up under Section 271 of the Companies Act, 2013 are vastly different from the reasons and grounds for the revival and rehabilitation scheme as envisaged under the Code. The two enactments deal with two distinct situations and in our opinion, they cannot be equated when we examine whether there is discrimination or violation of Article 14 of the Constitution of India. For the revival and rehabilitation of the companies, certain sacrifices are required from all quarters, including the workmen. In case of insolvent companies, for the sake of survival and regeneration,

everyone, including the secured creditors and the Central and State Government, are required to make sacrifices. The workmen also have a stake and benefit from the revival of the company, and therefore unless it is found that the sacrifices envisaged for the workmen, which certainly form a separate class, are onerous and burdensome so as to be manifestly unjust and arbitrary, we will not set aside the legislation, solely on the ground that some or marginal sacrifice is to be made by the workers. We would also reject the argument that to find out whether there was a violation of Article 14 of the Constitution of India or whether the right to life under Article 21 Constitution of India was infringed, we must word by word examine the waterfall mechanism envisaged under the Companies Act, 2013, where the company is wound up in terms of grounds (a) to (e) of Section 271 of the Companies Act, 2013; and the rights of the workmen when the insolvent company is sought to be revived, rehabilitated or wound up under the Code. The grounds and situations in the context of the objective and purpose of the two enactments are entirely different.

10. We now turn to the difference in the waterfall mechanism provided in the Companies Act, 2013 and the

Code. As per Section 324[6] of the Companies Act, 2013, all debts payable on a contingency, or all claims against the company, present or future, certain or contingent, ascertained or sounding only in damages, are admissible to proof against the company. A just estimate can be made so far as possible in respect of value of such debts or claims as may be subject to any contingency, damages, etc. and do not bear a certain value. Section 326[7] of the Companies Act, 2013 deals with overriding

6 **324. Debts of all descriptions to be admitted to proof.—** In every winding up (subject, in the case of insolvent companies, to the application in accordance with the provisions of this Act or of the law of insolvency), all debts payable on a contingency, and all claims against the company, present or future, certain or contingent, ascertained or sounding only in damages, shall be admissible to proof against the company, a just estimate being made, so far as possible, of the value of such debts or claims as may be subject to any contingency, or may sound only in damages, or for some other reason may not bear a certain value.

7 **326. Overriding preferential payments.—**(1) In the winding up of a company under this Act, the following debts shall be paid in priority to all other debts:

(a) workmen's dues; and;

(b) where a secured creditor has realised a secured asset, so much of the debts due to such secured creditor as could not be realised by him or the amount of the workmen's portion in his security (if payable under the law), whichever is less, pari passu with the workmen's dues:

Provided that in case of the winding up of a company, the sums referred to in sub-clauses (i) and (ii) of clause (b) of the Explanation, which are payable for a period of two years preceding the winding up order or such other period as may be prescribed, shall be paid in priority to all other debts (including debts due to secured creditors), within a period of thirty days of sale of assets and shall be subject to such charge over the security of secured creditors as may be prescribed.

(2) The debts payable under the proviso to sub-section (1) shall be paid in full before any payment is made to secured creditors and thereafter debts payable under that sub-section shall be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions.

Explanation.—For the purposes of this section, and Section 327—

(a) “workmen”, in relation to a company, means the employees of the company, being workmen within the meaning of clause(s) of Section 2 of the Industrial

preferential payments which have to be paid in priority to all other debts. These include the workmen debts, and dues of the secured creditor where the secured creditor has realised the secured asset but could not realise the entire amount, or the amount of workmen's portion in his security payable under the law, whichever is less, *pari passu* with the workmen's dues. Thus, this balances and

---

Disputes Act, 1947;
(b) "workmen's dues", in relation to a company, means the aggregate of the following sums due from the company to its workmen, namely—

(i) all wages or salary including wages payable for time or piece work and salary earned wholly or in part by way of commission of any workman in respect of services rendered to the company and any compensation payable to any workman under any of the provisions of the Industrial Disputes Act, 1947;
(ii) all accrued holiday remuneration becoming payable to any workman or, in the case of his death, to any other person in his right on the termination of his employment before or by the effect of the winding up order or resolution;
(iii) unless the company is being wound up voluntarily merely for the purposes of reconstruction or amalgamation with another company or unless the company has, at the commencement of the winding up, under such a contract with insurers as is mentioned in Section 14 of the Workmen's Compensation Act, 1923, rights capable of being transferred to and vested in the workmen, all amount due in respect of any compensation or liability for compensation under the said Act in respect of the death or disablement of any workman of the company;
(iv) all sums due to any workman from the provident fund, the pension fund, the gratuity fund or any other fund for the welfare of the workmen, maintained by the company;

(c) "workmen's portion", in relation to the security of any secured creditor of a company, means the amount which bears to the value of the security the same proportion as the amount of the workmen's dues bears to the aggregate of the amount of workmen's dues and the amount of the debts due to the secured creditors.

Illustration

The value of the security of a secured creditor of a company is Rs. 1,00,000. The total amount of the workmen's dues is Rs. 1,00,000. The amount of the debts due from the company to its secured creditors is Rs. 3,00,000. The aggregate of the amount of workmen's dues and the amount of debts due to secured creditors is Rs. 4,00,000. The workmen's portion of the security is, therefore, one-fourth of the value of the security, that is Rs. 25,000.

equates the rights of the secured creditor to realise the secured asset, but in case the secured creditor is not able to realise the full amount or has paid an amount to the workmen if payable under the law, whichever is less, these dues rank *pari passu* with the workmen's dues. Explanation to Section 326 of the Companies Act, 2013 defines 'workmen', which means employees within the meaning of Section 2(s) of the Industrial Disputes Act, 1947; and the expressions "workmen's dues"; and "workmen's portion", which expressions are terms of the Companies Act, 2013 specially used in clause (b) of sub-section (1) to Section 326 of the Companies Act, 2013. The workmen's portion in relation to the security of any secured creditor of a company means the amount which bears to the value of security, the same proportion as the amount of workmen's dues bears to the aggregate of the amount of workmen's dues and the amount of debts due to the secured creditors. The illustration clarifies the formula by way of an hypothetical case, where the secured creditors and workmen's dues are both Rs.1 lakh. The amount of the debts due from the company to the secured creditors is hypothetically taken as Rs. 3 lakhs. Accordingly, the aggregate amount due towards workmen's dues and the amount of debts due to the

secured creditors is Rs. 4 lakhs. In this background, when the value of the security of the secured creditors is Rs. 1 lakh, one-fourth of the value of the security, i.e. Rs.25,000/- would be the workmen's portion. To this extent, there is no difficulty or dispute. As noticed below there is hardly any difference in the said hierarchy and the waterfall mechanism under the Code.

11. However, the *proviso* to sub-section (1) to Section 326 of the Companies Act, 2013 states that in case of winding up of the company, the sums referred to in sub-clauses (i) and (ii) to clause (b) of the Explanation to Section 326 of the Companies Act, 2013, which are payable for a period of two years preceding the winding up order or such other period as may be prescribed, shall be paid in priority to all other debts, including debts due to secured creditors. This payment is to be made within a period of thirty days from the sale of assets and shall be subject to such charge over the security of the secured creditors. Sub-clause (i) to clause (b) of the Explanation to Section 326 of the Companies Act, 2013 refers to all wages or salary, including wages payable for time or piece work and salary earned wholly or in part, etc. under any provisions of the Industrial Disputes Act, 1947. Sub-clause (ii) to clause (b) of the Explanation to Section 326

of the Companies Act, 2013 deals with all accrued holiday remuneration payable to any workmen or, in the case of his death, to any other person in his right on termination of his employment, etc. Sub-clauses (iii) and (iv) of clause (b) of the Explanation to Section 326 of the Companies Act, 2013 are excluded from the *proviso*. These sub-clauses deal with liability of compensation under the Workmen's Compensation Act, 1923 in respect of death or disablement of the workmen or all sums due to any workman from the provident fund, the pension fund, the gratuity fund or any other fund of the welfare of the workmen[8]. What is clear from the provision is that the *proviso* applies in case of winding up of a company to the sums referred to in sub-clauses (i) and (ii) of clause (b) of the Explanation to Section 326 of the Companies Act, 2013 which are payable for a period of two years preceding the winding up order or such other period as may be prescribed. We are not informed that a different period has been prescribed and, therefore, the sums referred to in sub-clauses (i) and (ii) to clause (b) of the Explanation to Section 326 of the Companies Act, 2013

8 For the purpose of the present decision, we are not required to comment on the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 and the payment of workmen's dues under the Companies Act,1956 or even Section 36 (4)(a)(iii) of the Code. However, see - *Employees Provident Fund Commissioner* v. *Official Liquidator of Esskay Pharmaceuticals Limited*, (2011) 10 SCC 727 and Bhupinder Singh v. Unitech Limited, (2022) 8 SCC 749.

are payable for two years preceding the winding up order. Thus, this period of two years is with reference to the date of the winding up order, and not with reference to the date earlier in point of time, that is, when a winding up petition is filed. This restricts the period for which payment under sub-clauses (i) and (ii) to clause (b) of the Explanation to Section 326 of the Companies Act, 2013 would apply. Entire unpaid dues are not covered by the *proviso* to sub-section (1) to Section 326 of the Companies Act, 2013.

12. When we turn our attention to the Code, it is to be first noted that in terms of Section 36(4)(a)(iii) of the Code, all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund, do not form part and are not to be included in the liquidation proceedings.[9] Sub-section (1) to Section 52 of the Code gives two options to a secured creditor. First, the secured creditor in a liquidation proceeding may relinquish its security interest and receive the proceeds from the sale of assets by the liquidator in the manner specified in Section

9 For the purpose of the present decision, we are not interpreting sub-clause (iii) to clause (a) of sub-section (4) to Section 36 of the Code as this is an issue of some debate and pending consideration in other matters. The legal effect of exclusion is that, the amount of sums due to any workmen or employee from the provident fund, the pension fund or the gratuity fund cannot be made subject matter of reduction or dilution even in a rehabilitation or revival plan. They are excluded from the waterfall mechanism and would not be used in recovery on liquidation, and they cannot be shared.

53 of the Code. The second option is to realise the security interest, but in the manner specified in Section 52 of the Code. Sub-section (2) to Section 52 of the Code states that where the secured creditor realises the security interest, he shall inform the liquidator of such security interest and identify the asset subject to such security interest to be realised. The liquidator is to verify the security interest and shall permit the secured creditor to realise such security interest, which is proved either by records of such security interest maintained by an information utility, or by such other means as may be specified by the Board. Sub-section (4) to Section 52 of the Code states that the secured creditor may enforce, realise, settle, compromise or deal with the secured asset in accordance with such law as applicable to the security interest being realised and to the secured creditor. The secured creditor is to accordingly apply the proceeds to recover the debts due to him. We need not refer to sub-section (5) to Section 52 of the Code as it relates to the action which the secured creditor may take if he faces resistance from the corporate debtor or any other person connected therewith in taking possession of, selling or otherwise disposing off the security. Sub-section (6) to Section 52 of the Code applies when an adjudicating

authority is in receipt of an application under sub-section (5) to Section 52 of the Code. Sub-section (7) to Section 52 of the Code, however, is important as it states that where on enforcement of the security interest, an amount by way of proceeds is in excess of the debts due to the secured creditor, the secured creditor shall account for and pay the excess/surplus amount to the liquidator from enforcement of such secured assets. The amount of insolvency resolution process costs, due from secured creditors who realise their security interests in the manner provided in the section, are to be deducted from the proceeds of any realisation by such secured creditors. They are to be transferred and included in the liquidation estate. Sub-section (9) to Section 52 of the Code states that where proceeds for realisation of the secured assets are not adequate to repay the debts owed to the secured creditor, the unpaid debts of such secured creditor shall be paid by the liquidator in the manner specified in clause (e) to sub-section (1) to Section 53 of the Code.

13. To protect the interest of the workmen where the secured creditor does not relinquish its security interest to fall under Section 53 of the Code, Regulation 21A[10] of the

10 **21A. Presumption of security interest.—** (1) A secured creditor shall inform the liquidator of its decision to relinquish its security interest to the liquidation estate or realise its security interest, as the case may be, in Form C or Form D of

Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 has been enacted, and it requires that the secured creditor, who opts to realise its security interest as per section 52 of the Code, has to pay as much towards the amount payable under the clause (a) and sub-clause (i) to clause (b) of sub-section (1) to Section 53 of the Code to the liquidator within the time and the manner stipulated therein. The workmen's dues, even when the secured creditor opts to proceed under Section 52 of the Code, are therefore protected in terms of sub-clause (b) of sub-section (1) to Section 53 of the Code.

Schedule II:
Provided that, where a secured creditor does not intimate its decision within thirty days from the liquidation commencement date, the assets covered under the security interest shall be presumed to be part of the liquidation estate.

(2) Where a secured creditor proceeds to realise its security interest, it shall pay -
(a) as much towards the amount payable under clause (a) and sub-clause (i) of clause (b) of sub-section (1) of section 53, as it would have shared in case it had relinquished the security interest, to the liquidator within ninety days from the liquidation commencement date; and
(b) the excess of the realised value of the asset, which is subject to security interest, over the amount of his claims admitted, to the liquidator within one hundred and eighty days from the liquidation commencement date:

Provided that where the amount payable under this sub-regulation is not certain by the date the amount is payable under this sub-regulation, the secured creditor shall pay the amount, as estimated by the liquidator:

Provided further that any difference between the amount payable under this sub-regulation and the amount paid under the first proviso shall be made good by the secured creditor or the liquidator, as the case may be, as soon as the amount payable under this sub-regulation is certain and so informed by the liquidator.

(3) Where a secured creditor fails to comply with sub-regulation (2), the asset, which is subject to security interest, shall become part of the liquidation estate.

14. Before we refer to Section 53 of the Code, we would like to take note of Section 30 of the Code, which relates to the submission of resolution plan, which is required to be examined by the resolution professional in the manner stipulated in sub-section (2) to Section 30[11] of the Code. Substantial part of clause (b) of sub-section (2) to Section

11 **30. Submission of resolution plan.—**(1) A resolution applicant may submit a resolution plan along with an affidavit stating that he is eligible under Section 29-A to the resolution professional prepared on the basis of the information memorandum.

(2) The resolution professional shall examine each resolution plan received by him to confirm that each resolution plan—

(a) provides for the payment of insolvency resolution process costs in a manner specified by the Board in priority to the payment of other debts of the corporate debtor;
(b) provides for the payment of debts of operational creditors in such manner as may be specified by the Board which shall not be less than—

(i) the amount to be paid to such creditors in the event of a liquidation of the corporate debtor under Section 53; or
(ii) the amount that would have been paid to such creditors, if the amount to be distributed under the resolution plan had been distributed in accordance with the order of priority in sub-section (1) of Section 53,

whichever is higher, and provides for the payment of debts of financial creditors, who do not vote in favour of the resolution plan, in such manner as may be specified by the Board, which shall not be less than the amount to be paid to such creditors in accordance with sub-section (1) of Section 53 in the event of a liquidation of the corporate debtor.

Explanation 1.—For the removal of doubts, it is hereby clarified that a distribution in accordance with the provisions of this clause shall be fair and equitable to such creditors.

Explanation 2.—For the purposes of this clause, it is hereby declared that on and from the date of commencement of the Insolvency and Bankruptcy Code (Amendment) Act, 2019, the provisions of this clause shall also apply to the corporate insolvency resolution process of a corporate debtor—

30 of the Code relates to the payment of debts of operational creditors, which is not relevant for us. However, the later portion of clause (b) of sub-section (2) to Section 30 of the Code provides for the payment of debts of financial creditors who do not vote in favour of the resolution plan. The amount payable to them, it stipulates, shall not be less than the amount to be paid to such creditors in accordance with sub-section (1) to Section 53 of the Code in the event of a liquidation of the corporate debtor. Sub-section (4) to Section 30 of the Code states when and how a Committee of Creditors is to approve the resolution plan. Sub-section (6) states that

---

(i) where a resolution plan has not been approved or rejected by the Adjudicating Authority;

(ii) where an appeal has been preferred under Section 61 or Section 62 or such an appeal is not time barred under any provision of law for the time being in force; or
(iii) where a legal proceeding has been initiated in any court against the decision of the Adjudicating Authority in respect of a resolution plan;

(c) provides for the management of the affairs of the corporate debtor after approval of the resolution plan;
(d) the implementation and supervision of the resolution plan;
(e) does not contravene any of the provisions of the law for the time being in force;
(f) conforms to such other requirements as may be specified by the Board.

Explanation.—For the purposes of clause (e), if any approval of shareholders is required under the Companies Act, 2013 (18 of 2013) or any other law for the time being in force for the implementation of actions under the resolution plan, such approval shall be deemed to have been given and it shall not be a contravention of that Act or law.

****

the resolution professional shall submit the resolution plan as approved by the Committee of Creditors to the adjudicating authority. Section 31[12] of the Code relates to approval of the resolution plan. The adjudicating authority is to satisfy that the resolution plan as approved by the Committee of Creditors under sub-section (4) of Section 30 of the Code, meets the requirements as referred to in sub-section (2) to Section 30 of the Code. Further, the resolution plan has provisions for its effective implementation. Sub-section (2) to Section 31 of the Code states that where the adjudicating authority is satisfied that the resolution plan does not confirm to the requirements referred to in sub-section (1) to Section 31 of the Code, it may by an order reject the resolution plan.

---

12 **31. Approval of resolution plan.—**(1) If the Adjudicating Authority is satisfied that the resolution plan as approved by the committee of creditors under sub-section (4) of Section 30 meets the requirements as referred to in sub-section (2) of Section 30, it shall by order approve the resolution plan which shall be binding on the corporate debtor and its employees, members, creditors, including the Central Government, any State Government or any local authority to whom a debt in respect of the payment of dues arising under any law for the time being in force, such as authorities to whom statutory dues are owed, guarantors and other stakeholders involved in the resolution plan:
Provided that the Adjudicating Authority shall, before passing an order for approval of resolution plan under this sub-section, satisfy that the resolution plan has provisions for its effective implementation.

(2) Where the Adjudicating Authority is satisfied that the resolution plan does not confirm to the requirements referred to in sub-section (1), it may, by an order, reject the resolution plan.

****

We need not refer to other sub-sections of Section 31 of the Code.

15. We now turn our attention to Section 53 of the Code which begins with a *non-obstante* clause and states that 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 liquidation assets shall be distributed in the order of priority, which is stipulated, and within such period and such manner as may be specified. The consequence of sub-section (1) to Section 53 of the Code is that it will override the rights of parties, including the secured creditor, when the said provision applies. Section 53 of the Code is the complete and comprehensive code which ensures collection of assets and then provides the manner in which the creditors are to be paid. Even the rights of the secured creditor falling under Section 53 of the Code to enforce, realise, settle, compromise or deal with the secured assets as applicable to the security interest are diluted and compromised.

15.1 Clause (a) to sub-section (1) to Section 53 deals with insolvency resolution process costs and the liquidation costs which are to be paid in full. No grievance or issue can be raised in respect of the said clause.

Clause (b) to sub-section (1) to Section 53 states that the debts due in the form of workmen's dues for a period of twenty four months preceding the liquidation commencement date and the debts owed to the secured creditor in the event such secured creditor has relinquished security in the manner set out in Section 52 of the Code shall rank equally between and amongst the workmen and the secured creditors. The Explanation to Section 53 of the Code states that 'workmen's dues' shall have the same meaning as assigned to it in Section 326 of the Companies Act, 2013. In other words, Explanation to Section 326 of the Companies Act, 2013 has been incorporated and applies to the waterfall mechanism as prescribed in clause (b) to sub-section (1) to Section 53 of the Code. What is significant here is that under clause (b) to sub-section (1) to Section 53 of the Code, the workmen's dues are for the period of twenty four months preceding the liquidation commencement date. The liquidation commencement date, as defined in terms of sub-section (17) to Section 5 of the Code, is much earlier in point of time and need not coincide with the date of winding up. This is in the interest of the workmen. Clause (i) of Explanation to Section 53 of the Code states that where the distribution of proceeds in respect of class of

recipients that rank equally, each of the debts would be paid either in full or would be paid in equal proportion within the same class of recipients, if the proceeds are insufficient to meet the debts in full. *Ex facie*, the clause is very just and fair. It is to be noted that the wages and unpaid dues owed to employees other than the workmen fall in clause (c), which is below clause (b) to sub-section (1) to Section 53 of the Code. They are to be paid wages and unpaid dues only for a period of twelve months preceding the liquidation commencement date, and that too only if surplus funds are available after making payment in terms of clause (a) and (b) of sub-section (1) to Section 53 of the Code. Clause (d) of sub-section (1) to Section 53 of the Code relates to financial debts owed to unsecured creditors. The amounts due to the Central Government and the State Government, etc., and the debts owed to a secured creditor for any amount that remains unpaid following the enforcement of security interest, have been clubbed together in clause (e) of sub-section (1) to Section 53 of the Code, and have to be ranked equally between and among both of them. The remaining debts and dues fall in clause (f) of sub-section (1) to Section 53 of the Code. Preference shareholders fall under clause (g) of sub-section (1) to Section 53 of the

Code, and equity shareholders or partners fall under clause (h) of sub-section (1) to Section 53 of the Code. Sub-section (2) to Section 53 of the Code states that any contractual arrangements between recipients under sub-section (1) with equal ranking, if disrupting the order of priority under the said sub-section will be disregarded by the liquidator.

16. The waterfall mechanism is based on a structured mathematical formula, and the hierarchy is created in terms of payment of debts in order of priority with several qualifications, striking down any one of the provisions or rearranging the hierarchy in the waterfall mechanism may lead to several trips and disrupt the working of the equilibrium as a whole and stasis, resulting in instability. Every change in the waterfall mechanism is bound to lead to cascading effects on the balance of rights and interests of the secured creditors, operational creditors and even the Central and State Governments. Depending upon the facts, in some cases, the waterfall mechanism in the Code may be more beneficial than the hierarchy provided under Section 326 of the Companies Act, 2013 and *vice-versa*. Therefore, we hesitate and do not accept the arguments of the petitioners.

17. The Code is based on the organic evolution of law and is a product of an extensive consultative process to meet the requirements of the Code governing liquidation. It introduced a comprehensive and time-bound framework to maximise the value of assets of all persons and balance the interest of the stakeholders. The guiding principle for the Code in setting the priority of payments in liquidation was to bring the practices in India in line with global practices. In the waterfall mechanism, after the costs of the insolvency resolution process and liquidation, secured creditors share the highest priority along with a defined period of dues of the workmen. The unpaid dues of the workmen are adequately and significantly protected in line with the objectives sought to be achieved by the Code and in terms of the waterfall mechanism prescribed by Section 53 of the Code. In either case of relinquishment or non-relinquishment of the security by the secured creditor, the interests of workmen are protected under the Code. In fact, the secured creditors are taking significant hair-cut and workmen are being compensated on an equitable basis in a just and proper manner as per Section 53 of the Code. The Code balances the rights of the secured creditors, who are financial institutions in which the general public has

invested money, and also ensures that the economic activity and revival of a viable company is not hindered because it has suffered or fallen into a financial crisis. The Code focuses on bringing additional gains to both the economy and the exchequer through efficiency enhancement and consequent greater value capture. In economic matters, a wider latitude is given to the law-maker and the Court allows for experimentation in such legislations based on practical experiences and other problems seen by the law-makers. In a challenge to such legislation, the Court does not adopt a doctrinaire approach. Some sacrifices have to be always made for the greater good, and unless such sacrifices are *prima facie* apparent and *ex facie* harsh and unequitable as to classify as manifestly arbitrary, these would be interfered with by the court.

18. In view of the above and for the reasons stated above and as sub-section (7) of Section 327 of the Act, 2013 provides that Sections 326 and 327 of the Act, 2013 shall not be applicable in the event of liquidation under the IBC, which has been necessitated in view of the enactment of IBC and it applies with respect to the liquidation of a company under the IBC, Section 327(7) of

the Act, 2013 cannot be said to be arbitrary and/or violative of Article 21 of the Constitution of India. In case of the liquidation of a company under the IBC, the distribution of the assets shall have to be made as per Section 53 of the IBC subject to Section 36(4) of the IBC, in case of liquidation of company under IBC.

19. In view of the above and for the reasons stated above, the writ petition(s) lack merits and the same deserve to be dismissed and are accordingly dismissed. However, in the facts and circumstances of the case, there shall be no order as to costs.

Pending applications, if any, also stand disposed of.

……J.
[M.R. SHAH]

NEW DELHI; ……J.
MAY 02, 2023. **[SANJIV KHANNA]**