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Employees of Distressed Companies

Ritesh Kavdia and Shweta Vashishtha

A key characteristic of a good insolvency regime is its ability to maximise an economy's growth and employment prospects by differentiating between viable and unviable businesses. The Bankruptcy Law Reforms Committee (BLRC)[1] noted that if a business is sustainable, this determination prevents premature liquidation, thus preserving the firm as an agent of future growth, protecting employees' jobs, and safeguarding the network of suppliers and customers. For a business deemed unviable, a fast and low-cost liquidation proceeding permits an effective re-allocation of resources to more productive and efficient sectors of the economy. Therefore, determining the viability of a business is the crucial first stage in resolving insolvency: keeping viable firms in existence and helping unviable firms make way for new firms, thereby promoting healthy competition in the economy.[2]

The US Chapter 11 legislation, the Japanese Bankruptcy Reform of 2003 and the Swedish 2010 Bankruptcy legislation are designed to weed out bankrupt firms deemed unproductive when re-organisation is not likely to result in increased project.[3] All these countries understand the need to recycle resources from bankruptcies, i.e., fixed assets in the firm and employees' human capital.

Employees and workmen are among the strongest pillars of the economy. Hence, adequate safeguards are required to protect helpless employees in situations of insolvency and bankruptcy of their employers. Also, concentrating on the need to recuperate jobs of employees-the so called human and social capital, from an unviable to a viable enterprise, becomes indispensable.

The International Association of Restructuring, Insolvency and Bankruptcy Professionals (INSOL International)[4] made the following comments on the inability of insolvency regimes to resolve the problems employees experience when their company becomes insolvent:

> 'For employees of a financially distressed company, there is seldom a more emotionally wrenching issue than the treatment of their wage and benefit claims in a restructuring process. Employees, who are the lifeblood of the enterprise, too often find that they are treated as expendable and their pension or retirement savings may have evaporated. Stories about the loss of employee benefits and resulting hardships abound in the newspapers throughout the world. The legacy costs associated

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[1] Report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design, November 2015.

[2] International Finance Corporation, Saltane V., Chen R., Guzmán MN, Measurable Results! Doing Business Project Encourages Economies to Reform Insolvency Frameworks, January 2013

[3] Lee, S.-H., Peng, M. W., & Barney, J. B. (2007). Bankruptcy law and entrepreneurship development: a real options perspective. Academy of Management Review, 32(1), 257–272.; Peng, M. W., Yamakawa, Y., & Lee, S. H. (2010). Bankruptcy laws and entrepreneur-friendliness. Entrepreneurship Theory and Practice, 34(3), 517–530.; White, M. J. (2001). Bankruptcy and small business. Regulation, 24(2), 19–20.

[4] International Association of Restructuring, Insolvency and Bankruptcy Professionals, 2005

with employee wages, benefits and pension claims can be enormous and are often among the most intractable issues confronted in a restructuring company.'

The Code not only empowers the employees with necessary legislative mechanism to recover their unpaid salaries and wages in the course of resolution process of the corporate debtors but also provides opportunities to keep alive their source of livelihood.

EMPLOYEES OR WORKMEN UNDER THE CODE

The Code differentiated between two categories of persons: workmen and employees. For insolvency process, both employees and workmen qualify as operational creditors (OCs). Since the term employee is not defined under the Code, a general definition of employee has been referred to. An employee can be said to be a person who is hired by the employer to perform a particular job or specific labour of the employer. The employee is entitled to a specific wage or salary and performs the work under the control or regulation of the employer.[5]

Section 3 (36) of the Code mentions that the term workmen shall have the same meaning as provided under the Industrial Disputes Act, 1947[6] which under its section 2(s) defines a workman as '*a person who is employed in any industry to do any manual, unskilled, skilled, technical, operational, clerical or supervisory work, for hire or reward, terms of employment be express or implied and includes any such person who has been dismissed, discharged or retrenched in connection with, or as a consequence of dispute*.'

Ranking of Employee and Workmen in Waterfall Mechanism

Section 53 of the Code contains provisions for priority of payment of debts from the proceeds from the sale of the liquidation assets. It reads that notwithstanding anything to the contrary to any law for the time being in force, while distributing the assets, the order of priority as mentioned in section 53 has to be followed. Sub-section (1) clause (b) mentions that the workmen's dues for the period of 24 months preceding the liquidation commencement date shall be treated equally with the debts owed to secured creditors. Clause (c) provides priority to wages and unpaid dues owed to employees other than workmen for the period of 12 months preceding the liquidation commencement days over the dues unpaid to Central or State Governments and unsecured debts.

Unless the first category is paid in full, the second or subsequent category does not get any amount if the assets of the bankrupt company are insufficient to meet them. The claimants as specified in the same category or rank take it *pari passu.*

Assumption on Methodology of Resolving Insolvency- Ease of Doing Business[7]

The World Bank in Doing Business, Measuring Business Regulations makes a common basic assumption while studying the methodology to resolve insolvency of various countries that financial creditors (FCs) want to recover as much as possible of their loan, as quickly and cheaply as possible. The unsecured creditors will do everything permitted under the applicable laws to avoid a piecemeal sale of the assets. The majority shareholder wants to keep the company operating and under her/his control. Management wants to keep the company operating and preserve its employees' jobs.

[5] Ibid.
[6] Industrial Disputes Act, 1947 (Act 14 of 1947)
[7] World Bank (2019), Resolving Insolvency Methodology. Doing Business.

LEGISLATIVE PROTECTION TO EMPLOYEES

Role of Adjudicating Authorities in Protecting Rights of Employees through Recent Judgments

For the matters relating to insolvency and liquidation proceeding against companies, the National Company Law Tribunal (NCLT) and the National Company Law Appellate Tribunal (NCLAT) are the competent judicial bodies under the Code.

The following orders clearly reflects the role that Adjudicating Authorities (AA)have played over the three years of existence of the Code empowering employees and workmen under the Code.

Issue 1: Unpaid dues of salary form part of Operational Debt under the Code

Nitin Gupta v. M/s Applied Electro-Magnetic Pvt. Ltd.,[8] NCLT New Delhi

This case dealt with the admissibility of application under section 9 of the Code by an employee for non-payment of salary amounting to roughly Rs. 47 lakh. The corporate debtor (CD) accepted the non-payment of salary amounting to Rs. 29 lakh but raised objections regarding the balance amount. NCLT admitted the case citing that it fell under the definition of operational debt as mentioned under section 5 (21) of the Code and in such a case the employee is an OC as mentioned under section 5 (20).

Issue 2: Recovery of dues against former employer

Mr. N. Subramanian v. M/s Aruna Hotels Limited[9], NCLT Chennai

In this case, the employee approached NCLT for recovery of his dues against former employer. The employee had left his job in the year 2013 and in spite of multiple assurances by the CD regarding the payment of the dues, in form of letters and correspondences, the amount was not settled. The employee, thereafter, sent a demand notice to the CD on June 29, 2017 and the CD replied to it on July 6, 2017 stating that the salary had been paid by it and only a gratuity amount of around Rs. 6 lakh was due as on that date. In the meantime, the CD approached the City Civil Court in Chennai on July 6, 2017 and filed a suit against the employee with a prayer to declare that previous letter, notice and communications be declared as null and void.

NCLT held that such a civil suit was instituted by the CD in order to circumvent the initiation of the insolvency process by the OC against the CD. The claim of employee was admitted by NCLT for payment of the unpaid dues.

Issue 3: Single application by collective workers through Authorised Representative

Mr. Suresh Narayan Singh v. Tayo Rolls Ltd.,[10] NCLAT

The appeal in this case was filed by Mr. Suresh Narayan Singh, who was the authorised representative of 284 workers of the CD against an order dated January 3, 2018 passed by the NCLT, Kolkata. The NCLT had rejected an application filed by Mr. Suresh Narayan Singh under section 9 of the Code against the CD on the ground that the application under section 9 of the CD has to be filed individually and not jointly. The NCLT also noted that it is not practicable for more

[8] [2018] 142 CLA 527 (NCLT), IB 334(ND)/2017
[9] C.P. No. 597/(IB)/CB/2017.
[10] Company Appeal (AT) Insolvency No. 112 of 2018.

than one OC to file a joint petition as they will have to issue individual demand notices under section 8 of the Code.

However, the NCLAT held that there is a clear existence of all the required factors, i.e., a debt and a default, which were not disputed by the CD, and the application made under section 9 was complete. NCLAT held that NCLT should have admitted the application instead of rejecting it on a technical ground that it was filed by the authorised representative on behalf of 284 workmen.

Issue 4: Right Sizing/ Down Sizing of employees as per Resolution Plan

Edelweiss Asset Reconstruction Company Ltd. v. Bharati Defence and Infrastructure Ltd[11], NCLT Mumbai

NCLT rejected the resolution plan providing for right-sizing of employees, without mentioning the approximate number of employees to be terminated or to be retained, without complying with labour laws, and held not to be permissible under law. The extract from the order reads:

> ' The resolution applicant wants all powers to decide the fate of employees/workmen/consultants of the company and further seeks exemption from complying with the applicable laws and immunity from any claims from the employees/workmen/consultants so terminated. We are of the strong opinion that it would be inappropriate to approve such a plan, which contravenes the law, and which is prejudicial and causing injustice to the existing employees/workers/consultants.'

Issue 5: Priority of Payment of Provident Funds against the unpaid dues of the creditor

Precision Fasteners Ltd. v. EPFO, Thane; EPFO, Vapi; EPFO Vashi in ARC (India) Ltd. v. Precision Fasteners Ltd,[12] NCLT Mumbai

In this case, NCLT observed that any amount due to the workmen/ employees from the provident fund/ pension fund or gratuity will not be included within the purview of liquidation asset. It was further clarified by NCLT that provident fund dues are excluded from the liquidation assets[13] enabling the workmen/ employees to realise their savings as well as the employer's contributions as a part of their fundamental right to life while the right of the creditors is merely a property right.[14] Provident Fund payable were held to be deemed assets of employee/workmen.

EMPLOYEE PARTICIPATION UNDER THE CODE

Employee participation in management is not commonplace in India, but the model could be explored for some companies hauled before insolvency courts, where affected staff-members at units without hopes of a revival have urged courts to liquidate the entities as going concerns.[15] There is a growing tendency among employees and workers to save their companies going into liquidation.

On November 14, 2017, a Kolkata-based company namely *Keshav Sponge and Energy Pvt. Ltd.*[16] was liquidated as a 'going concern'. NCLT approved the plan taking in to account interest of all stakeholders and in the interest of welfare of workmen around 150 persons

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[11] MA 170 of 2018 in CP 29I&B/NCLT/MAH/2017.
[12] MA 576 & 752/2018 in CP (IB) 1339 (MB)/ 2017.
[13] Ibid.
[14] Mondaq. 'India : NCLT directs PF to be paid before clearing dues.' (August 20, 2019).
[15] Saikat Das (January 17, 2018). Now, employees step in to save bankrupt companies. *The Economic Times*.
[16] Company Petition (I.B.) No. 40/KB/2017.

and nearly 600 persons who are directly or indirectly dependent upon the operation of the company for their livelihood. This case manifested a path to a new chapter in the evolving Code.

This move of NCLT served two benefits. Firstly, it helped lenders recover more money against the unpaid loans, and secondly, it created future job opportunities for those employees who used to work for the company.

In the matter of *Gujarat NRE Coke*,[17] employees including workers intervened to liquidate the company as going concern. Considering that 1178 employees including workers, their families, numerous small vendors, suppliers, contractors, Job workers and transporters totalling about 10,000 people were getting affected, the NCLT asked the liquidator to sell the company's assets within three months from the date of order without disrupting operations.

In the matter of *Reid and Taylor*,[18] the Mumbai bench of the NCLT accepted a proposal by an unregistered union of the premium apparel brand to take over the firm thereby obstructing liquidation. The company had around 1,200 employees and has a plant in Mysuru, which was running at under 30 percent of its installed capacity and thus incurring cash losses.[19] Accepting the interest of the employees to take over the company and thus stall liquidation which the creditors want, NCLT noted that *'...liquidation will get only a meagre value, the creditors will be most affected and the workmen will be losing their livelihood...*' NCLT ordered for liquidation as going concern.

In wake of widespread job losses and these series of rulings, the introduction of sale of a company as a going concern in liquidation, was primarily motivated by the objective of keeping employment potential and economic activities intact.[20]

The amendments to the IBBI (Liquidation Process) Regulations, 2016 (Liquidation Regulations), introduced on July 29, 2019 by incorporating regulation 32A of the Liquidation Regulations, made it explicitly possible for the liquidator to transfer a company in liquidation as a going concern.[21]

CONCLUSION

The Code is a socially beneficial legislation and a great measure in the corporate arena to empower the employees and workmen and mitigate their losses in adverse situations like insolvency or liquidation of companies.

The Code provides the workmen and employees of the companies with an opportunity to recover their unpaid dues from the CD, by approaching the NCLT in a systematic and time-bound manner. Within a strict time-limit to resolve or liquidate the CD, the Code is an effective mean to reform debtor behaviour in India. It empowers employees with the right to initiate insolvency proceedings against the CD as an OC and places them in a higher priority during the payment of the unpaid debts from the liquidation of assets of the liquidating company.

The AAs have regarded this empowerment as a necessary measure and this has been reflected in the progressive and positive decisions upholding the rights and interests of the workmen and employees as cited in forestated judgments. Inspite of all said above, it cannot be denied that the occupational hazard hovering the employees persists.

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[17] C.P. (I.B.) No. 182/KB/2017.
[18] C.P. No. 382/IB/MB/MAH/2018.
[19] PTI (January 6, 2019). Reid and Taylor: NCLT stalls liquidation, accept union bid for the Company. *Bloomberg |Quint.*
[20] Vinod Kothari and Shikha Bansal (2019). Enabling Going Concern Sale in Liquidation. *India Corp Law.*
[21] IBBI (Liquidation Process) (Amendment) Regulations, 2019 notified on July 25, 2019.

Looking at other jurisdictions, it was found that the Marcora Law in Italy was instrumental in facilitating employee buyouts[22] to overcome such situation of employee rescue fromdistressed company. The Marcora Law of Italy provided a framework that enabled collaboration among various stakeholders and also by making available financial support schemes that helped these distressed enterprises navigate the difficult economic conditions they often faced. It also often involved the workmen participation in the running of the firm. When worker buyouts in Italy took off, it led to the creation of 257 new employee-owned firms and saved or created 9,300 jobs.[23] Almost all of these were set up as worker co-operatives, owned and managed by their employees. In Italy, the phenomenon has been accelerated by a favourable legal framework and different mechanisms that enabled employees to raise capital.

In UK, the transfer of an insolvent business is conducted under corporate or commercial law, peculiar insolvency matters are addressed exclusively by insolvency law while matters affecting employees in the context of a business transfer are governed by employment law, i.e., Transfer of Undertakings (Protection of Employment) Regulations (TUPE).[24] To rescue a financially distressed business, some jobs might have to be sacrificed. But, TUPE limits the employer's ability to do this. It impinges on managerial decision-making powers. TUPE reduces, rather than increases, entrepreneurial freedom.[25]

Every regime is somewhere struck between creating a balance between the employment protection goals on the one hand and the rescue of insolvent companies on the other.

In similar scenario being faced in India, where reconstruction is posed with ongoing challenges, a different model can be thought as one that will also accommodate the bottom up process of an employee buyout. Employees buy-out has been used as a reactive strategy by workers, trade unions and labour governments in a number of countries to rescue companies, save jobs and preserve communities in economic downturns. In most instances it has sprung from direct action by the employees to prevent plant closure and save their jobs. It is expected that the buyout attempts by employees can pave way for future deals to resolve distressed companies.

In the conclusion, while the AA and IBBI are playing their roles effectively, other areas must be explored as possible options for resolution. Though there are substantial challenges in terms of limited knowledge and information about employee buyouts and their potential in business rescue however if developing employee buyouts as part of a cluster of employee-owned companies networked with trade unions has proven to be the best method of maximising company survival in other countries then it might be an option for India as well.[26] Nevertheless, the study on success or failure of this model in India necessitates further in-depth research.

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[22] An employee buyout is part of a business restructuring or conversion process whereby employees purchase an ownership stake in the entire business

[23] Voinea Anca (September 7, 2015). The path to worker buyouts: Does the UK need its own 'Marcora Law'?

[24] Etukakpan, Samuel Edwin (2012). A Thesis on Transfer of Undertakings: The Tension Between Business Rescue and Employment Protection in Corporate Insolvency.

[25] Hardy and Adnett (n 69); Jeffery (n 90) 670

[26] Jensen Anthony. (2006). A report on Insolvency, Employee Buy Rights and Employee Buyouts, A strategy for Restructuring. Ithaca Consultancy.