

**NATIONAL COMPANY LAW APPELLATE TRIBUNAL, NEW DELHI**

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

[Arising out of Impugned Order dated 20<sup>th</sup> August 2019 passed by the Hon'ble National Company Law Tribunal, Hyderabad Bench in C.P. (IB) No.111/7/HDB/2017 filed under Section 9 of the Insolvency and Bankruptcy Code, 2016]

**IN THE MATTER OF:**

**Mr Savan Godiwala  
The liquidator of Lanco Infratech Limited  
Deloitte Touche Tohmatsu India, LLP  
19<sup>th</sup> Floor, Shapath – V, S.G. Highway  
Ahmedabad – 380015, India**

**...Appellant**

**Versus**

**Mr. Apalla Siva Kumar  
In representative capacity on behalf of  
66 Ex-employees of the Corporate Debtor  
Having its address at:  
Flat No.405, III-B, SMR Vinay Fountain Head  
Near Calvary Temple, Hafeezpat, Hyderanagar  
Hyderabad - 500049**

**...Respondent**

**Present:**

**For Appellant : Ms Misha, Mr Vijayant Paliwal and Ms Moulshree Shukla, Advocates**

**For Respondent : Mr Kuishnendu Datta, Mr Rahul Gupta, Ms Shivangi Krishna and Mr Manish Srivastava, Advocates**

**J U D G M E N T**

**[Per; V. P. Singh, Member (T)]**

This Appeal emanates from the Order passed by the Adjudicating Authority/National Company Law Tribunal, Hyderabad Bench, Hyderabad in I.A. No. 96 of 2019 in connection with C.P. (IB) No.111/7/HDB/2017, whereby the Adjudicating Authority had directed the Liquidator to pay the Gratuity to the employees, and further observed that the Liquidator could not avoid the liability to pay Gratuity to the employees on the ground that

the 'Corporate Debtor' didn't have separate funds for payment of gratuity. The Adjudicating Authority further directed the Liquidator to provide sufficient provision for payment of Gratuity, according to the eligibility of the employees. By the impugned order, the Adjudicating Authority has rejected the contention of the Liquidator that payment of Gratuity cannot be treated as part of Liquidation Estate.

Parties are represented by their original status represented in the Interim Application for the sake of convenience.

2. Brief facts of the case are as follows:

The Interim Application was filed by the ex-employees of the 'Corporate Debtor' seeking direction to the Liquidator, **to treat Gratuity dues of the applicants on the highest priority**, by not treating it as part of the Estate of the 'Corporate Debtor.'

3. The Applicant contends that the Adjudicating Authority vide its order dated 13<sup>th</sup> July 2018 directed the Resolution Professional to pay Gratuity, if payable to the Applicants after verifying the records of the Company, **subject to availability of necessary funds out of its operations on 27<sup>th</sup> August 2018**. The list of ex-employees and workmen, along with their dues as on 08<sup>th</sup> August 2018, with a footnote, stating that Rs.33,91,22,120/- (Rupees thirty-three crores ninety-one lacs twenty-two thousand one hundred and twenty only) have been proposed in the CIRP costs towards dues payable to employees, which have been accrued and have become due during the CIRP period, was uploaded by the Resolution Professional on the website of the 'Corporate Debtor'.

4. After that, on August 27, 2018, the Adjudicating Authority passed an order for Liquidation of the 'Corporate Debtor' under Section 33 of the Code.

5. In compliance of the said order, the public announcement was issued by the Liquidator under Regulation 12 of the Code, and the Applicants submitted their claims to the Liquidator in prescribed Form 'E' of the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016. The dues of the Applicants have been verified and accepted by the Liquidator.

6. The Corporate Debtor has failed to maintain a Gratuity fund or obtain insurance for the fulfilment of its liability towards payment of the gratuity to its employees, under the Payment of Gratuity Act, 1972. The applicant contends **that Section 4(1) of the Payment of Gratuity Act, 1972 mandates payment of gratuity by the employer to an employee in consideration of his continuous service for the employer. In the absence of the creation of gratuity fund by the 'Corporate Debtor', the gratuity dues payable to the employee shall be treated as an asset of the employee lying in possession of 'Corporate Debtor' and as such, cannot be treated as a claim at par with other creditors.**

7. The Applicant also contends that payment of gratuity to the employees is like the reward for them in return of their continuous services rendered to the company for five years or more. Section 36(4)(a)(iii) of the Code has excluded the gratuity dues of the employees from the liquidation estate assets, treating it as an asset of the employees, lying with the 'Corporate Debtor'. Therefore, the waterfall mechanism as prescribed under Section 53

of the Code, will not apply to the payment of gratuity dues, **and payment of the same should be paid in priority to any payment made under the waterfall mechanism.**

8. Applicant further contended that as per the requirement of the payment of Gratuity Act, 1972 and Section 36(4)(a)(iii) of the Code, the charge will remain in force, against the assets of the 'Corporate Debtor', until the gratuity dues have been paid off, before making any payment, to any entity falling under waterfall mechanism, devised under Section 53 of the Code. The I&B Code gives statutory priority to the amount payable to the employees on account of gratuity, over other debts of the 'Corporate Debtor'.

9. We have heard the arguments of the Learned Counsel for the parties and perused the record.

10. In reply to the contention of the applicant, the liquidator contended that the gratuity fund of the employees had not been treated as part of the Liquidation Estate. Since the 'Corporate Debtor' never maintained a separate fund for payment of gratuity to its employees, thus it can not be paid from the running accounts of the Corporate Debtor, as and when the same became due.

11. It is further contended by the Liquidator, that out of 66 employees, who have filed the present application, most have left the organization, much before the commencement of the insolvency resolution process period, and only 14 employees worked with the Corporate Debtor after the commencement of CIRP. The employee's dues before the commencement of CIRP can in no event be termed as insolvency resolution process cost.

12. **The Adjudicating Authority, by the impugned order, gave the direction that:**

**“The Liquidator must arrange gratuity to be paid to the employees, as per the eligibility criteria provided under the Payment of Gratuity Act, 1972.**

*It is the case of Liquidator that some of the employees, who are Applicants herein, have left the employment. The Liquidator is to verify and fix the eligibility of Applicants for payment of gratuity. So when gratuity is outside the Liquidation Estate, then Liquidator has to make arrangements for payment to the Applicants according to their eligibility.*

*The Liquidator cannot avoid the liability to pay gratuity to the employees on the ground that Corporate Debtor did not maintain separate funds, even if, there is no fund maintained, the Liquidator has to provide sufficient provision for payment of gratuity to the Applicants according to their eligibility. However, Liquidator has made it clear that payment of gratuity is not treated as Liquidation Estate. Therefore, the only direction which can be given to the Liquidator is to make necessary arrangements for payments of gratuity to the Applicants, according to their eligibility, and it should be given priority. With these observations, the Application is disposed of.”*

13. The direction of the Adjudicating Authority that “the Liquidator cannot avoid the liability to pay gratuity to the employees, even if the Corporate

Debtor did not maintain a separate fund for payment of gratuity, is under consideration before us.

The validity of the direction of the Adjudicating Authority to the Liquidator **“to make provision for payment of gratuity to the Applicants ,according to their eligibility.”** is to be determined in this appeal.

14. The statutory provision relating to the Employees Provident Fund, Gratuity and Pension and relevant part of the I&B Code 2016 are given below for ready reference.

**“Employees' Provident Funds and Miscellaneous Provisions Act, 1952**

**Section 5. Employees' Provident Fund Schemes**

**“Employees' Provident Fund Schemes.—**

[(1)] The Central Government may, by notification in the Official Gazette, frame a scheme to be called the Employees' Provident Fund Scheme for the establishment of provident funds under this Act for employees or for any class of employees and specify the [establishments] or class of [establishments] to which the said Scheme shall apply [**and there shall be established, as soon as may be after the framing of the Scheme, a Fund in accordance with the provisions of this Act and the Scheme**].

[(1-A) **The Fund shall vest in, and be administered by, the Central Board constituted under Section 5-A.**

(1-B) Subject to the provisions of this Act, a Scheme framed under sub-section (1) may provide for all or any of the matters specified in Schedule II.]

[(2) A Scheme framed under sub-section (1) may provide that any of its provisions shall take effect either prospectively or

retrospectively on such date as may be specified in this behalf in the Scheme.]

## **Payment of Gratuity Act, 1972**

### **Section 4. Payment of gratuity**

#### **4. Payment of gratuity.—**

***(1) Gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years,—***

***(a) on his superannuation, or***

***(b) on his retirement or resignation, or***

***(c) on his death or disablement due to accident or disease:***

***Provided that the completion of continuous service of five years shall not be necessary where the termination of the employment of any employee is due to death or disablement:***

[Provided further that in the case of death of the employee, gratuity payable to him shall be paid to his nominee or, if no nomination has been made, to his heirs, and where any such nominees or heirs is a minor, the share of such minor, shall be deposited with the controlling authority who shall invest the same for the benefit of such minor in such bank or other financial institution, as may be prescribed, until such minor attains majority.]

*Explanation.*—For the purposes of this section, disablement means such disablement as incapacitates an employee for the work which he was capable of performing before the accident or disease resulting in such disablement.

(2) For every completed year of service or part thereof in excess of six months, the employer shall pay gratuity to an employee at the rate of fifteen days' wages based on the

rate of wages last drawn by the employee concerned:

Provided that in the case of a piece-rated employee, daily wages shall be computed on the average of the total wages received by him for a period of three months immediately preceding the termination of his employment, and, for this purpose, the wages paid for any overtime work shall not be taken into account:

Who is employed in a seasonal establishment and who is not so employed throughout the year], the employer shall pay the gratuity at the rate of seven days' wages for each season.

[*Explanation.*—In the case of a monthly rated employee, the fifteen days' wages shall be calculated by dividing the monthly rate of wages last drawn by him by twenty-six and multiplying the quotient by fifteen.]

(3) The amount of gratuity payable to an employee shall not exceed [such amount as may be notified by the Central Government from time to time].

(4) For the purpose of computing the gratuity payable to an employee who is employed, after his disablement, on reduced wages, his wages for the period preceding his disablement shall be taken to be the wages received by him during that period, and his wages for the period subsequent to his disablement shall be taken to be the wages as so reduced.

(5) Nothing in this section shall affect the right of an employee to receive better terms of gratuity under any award or agreement or contract with the employer.

(6) Notwithstanding anything contained in sub-section (1),—

(a) the gratuity of an employee, whose services have been terminated for any act, wilful omission or negligence



causing any damage or loss to, or destruction of, property belonging to the employer, shall be forfeited to the extent of the damage or loss so caused;

(b) the gratuity payable to an employee [may be wholly or partially forfeited]—

(i) if the services of such employee have been terminated for his riotous or disorderly conduct or any other act of violence on his part, or

(ii) if the services of such employee have been terminated for any act which constitutes an offence involving moral turpitude, provided that such offence is committed by him in the course of his employment.

### **Section 6-A. Employees' Pension Scheme**

#### **[6-A. Employees' Pension Scheme.—**

(1) The Central Government may, by notification in the Official Gazette, frame a scheme to be called the Employees' Pension Scheme for the purpose of providing for—

(a) superannuation pension, retiring pension or permanent total disablement pension to the employees of any establishment or class of establishments to which this Act applies; and

(b) widow or widower's pension, children pension or orphan pension payable to the beneficiaries of such employees.

(2) Notwithstanding anything contained in Section 6, there shall be established, as soon as may be after framing of the Pension Scheme, a Pension Fund into which there shall be paid, from time to time, in respect of every employee who is a member of the Pension Scheme,—

- (a) such sums from the employer's contribution under Section 6, not exceeding eight and one-third per cent of the basic wages, dearness allowance and retaining allowance, if any, of the concerned employees, as may be specified in the Pension Scheme;
- (b) such sums as are payable by the employers of exempted establishments under sub-section (6) of Section 17;
- (c) the net assets of the Employees' Family Pension Fund as on the date of the establishment of the Pension Fund;
- (d) such sums as the Central Government may, after due appropriation by Parliament by law in this behalf, specify.

(3) On the establishment of the Pension Fund, the Family Pension Scheme (hereinafter referred to as the ceased scheme) shall cease to operate and all assets of the ceased scheme shall vest in and shall stand transferred to, and all liabilities under the ceased scheme shall be enforceable against, the Pension Fund and the beneficiaries under the ceased scheme shall be entitled to draw the benefits, not less than the benefits they were entitled to under the ceased scheme, from the Pension Fund.

(4) The Pension Fund shall vest in and be administered by the Central Board in such manner as may be specified in the Pension Scheme.

(5) Subject to the provisions of this Act, the Pension Scheme may provide for all or any of the matters specified in Schedule III.

(6) The Pension Scheme may provide that all or any of its provisions shall take effect either prospectively or retrospectively on such date as may be specified in that behalf in that scheme.

(7) A Pension Scheme, framed under sub-section (1), shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in

one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the scheme or both Houses agree that the scheme should not be made, the scheme shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that scheme.]

## **Insolvency and Bankruptcy Code, 2016**

### **Section 36. Liquidation Estate**

**36. Liquidation Estate.**— (1) For the purposes of liquidation, the liquidator shall form an estate of the assets mentioned in sub-section (3), which will be called the liquidation estate in relation to the corporate debtor.

(2) **The liquidator shall hold the liquidation estate as a fiduciary for the benefit of all the creditors.**

(3) **Subject to sub-section (4), the liquidation estate shall comprise all liquidation estate assets which shall include the following:**—

(a) any assets over which the corporate debtor has ownership rights, including all rights and interests therein as evidenced in the balance sheet of the corporate debtor or an information utility or records in the registry or any depository recording securities of the corporate debtor or by any other means as may be specified by the Board, including shares held in any subsidiary of the corporate debtor;

(b) assets that may or may not be in possession of the corporate debtor including but not limited to encumbered assets;

(c) tangible assets, whether movable or immovable;

(d) intangible assets including but not limited to intellectual property, securities (including shares held in a subsidiary of the corporate debtor) and financial instruments, insurance policies, contractual rights;

(e) assets subject to the determination of ownership by the court or authority;

(f) any assets or their value recovered through proceedings for avoidance of transactions in accordance with this Chapter;

(g) any asset of the corporate debtor in respect of which a secured creditor has relinquished security interest;

(h) any other property belonging to or vested in the corporate debtor at the insolvency commencement date; and

(i) all proceeds of liquidation as and when they are realised.

(4) **The following shall not be included in the liquidation estate assets and shall not be used for recovery in the liquidation—**

(a) assets owned by a third party which are in possession of the corporate debtor, including—

(i) **assets held in trust for any third party;**

(ii) bailment contracts;

(iii) **all sums due to any workman or employee from the provident fund, the pension fund and the gratuity fund;**

(iv) other contractual arrangements which do not stipulate transfer of title but only use of the assets; and

- (v) such other assets as may be notified by the Central Government in consultation with any financial sector regulator;
- (b) assets in security collateral held by financial services providers and are subject to netting and set-off in multilateral trading or clearing transactions;
- (c) personal assets of any shareholder or partner of a corporate debtor as the case may be provided such assets are not held on account of avoidance transactions that may be avoided under this Chapter;
- (d) assets of any Indian or foreign subsidiary of the corporate debtor; or
- (e) any other assets as may be specified by the Board, including assets which could be subject to set off on account of mutual dealings between the corporate debtor and any creditor.

**Sec 5 of the I& B Code 2016**

**(13) “Insolvency Resolution Process costs” means—**

- (a) the amount of any interim finance and the costs incurred in raising such finance;
- (b) the fees payable to any person acting as a resolution professional;
- (c) any costs incurred by the resolution professional in running the business of the corporate debtor as a going concern;
- (d) any costs incurred at the expense of the Government to facilitate the insolvency resolution process; and
- (e) any other costs as may be specified by the Board;

**In case of** State Bank of India **v** Moser Baer Karamchari Union and Another ,**2019 SCC OnLine NCLAT 447** the coordinate bench of this Appellate Tribunal has held that:

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**16.** In terms of sub-section (4) (a) (iii) of Section 36, as all sums due to any workman or employees from the provident fund, the pension fund and the gratuity fund, do not form part of the liquidation estate/ liquidation assets of the 'Corporate Debtor', the question of distribution of the provident fund or the pension fund or the gratuity fund in order of priority and within such period as prescribed under Section 53(1), does not arise.

**20.** There is a difference between the distribution of assets and preference/ priority of workmen's dues as mentioned under Section 53(1) (b) of the 'I&B Code' and Section 326(1) (a) of the Companies Act, 2013. It has also been noticed that Section 53(1) (b) (i) which relates to distribution of assets, workmen's dues is confined to a period of twenty-four months preceding the liquidation commencement date.

**21.** While applying Section 53 of the l&B Code', Section 326 of the Companies Act, 2013 is relevant for the limited purpose of understanding 'workmen's dues' which can be more than provident fund, pension fund and the gratuity fund kept aside and protected under Section 36(4) (iii).

**22.** On the other hand, the workmen's dues as mentioned in Section 326(1) (a) is not confined to a period like twenty-four months preceding the liquidation commencement date and, therefore, the Appellant for the purpose of determining the workmen's dues as mentioned in Section 53(1) (b), cannot derive any advantage of Explanation (iv) of Section 326 of the Companies Act, 2013.

**23.** This apart, as the provisions of the l&B Code' have overriding effect in case of consistency in any other law for the time being enforced, we hold that Section 53(1) (b) read with Section 36(4) will have overriding effect on Section 326(1) (a), including the Explanation (iv) mentioned below Section 326 of the Companies Act, 2013.

**24.** Once the liquidation estate/ assets of the 'Corporate Debtor' under Section 36(1) read with Section 36 (3), do not include all sum due to

*any workman and employees from the provident fund, the pension fund and the gratuity fund, for the purpose of distribution of assets under Section 53, the provident fund, the pension fund and the gratuity fund cannot be included.*

**25.** *The Adjudicating Authority having come to such finding that the aforesaid funds i.e., the provident fund, the pension fund and the gratuity fund do not come within the meaning of ‘liquidation estate’ for the purpose of distribution of assets under Section 53, we find no ground to interfere with the impugned order dated 19<sup>th</sup> March, 2019.”*

Thus it is the settled position of law, that the provident fund, the pension fund and the gratuity fund, do not come within the purview of ‘liquidation estate’ for the purpose of distribution of assets under Section 53 of the Code. Based on this, the only inference which can be drawn is that Pension Fund, Gratuity Fund and Provident Fund can’t be utilised, attached or distributed by the liquidator, to satisfy the claim of other creditors. Sec 36(2) of the I B Code 2016 provides that **the Liquidator shall hold the Liquidation Estate in fiduciary for the benefit of all the Creditors.** The Liquidator has no domain to deal with any other property of the corporate debtor, which is not the part of the Liquidation Estate.

**In a case, where no fund is created by a company, in violation of the Statutory provision of the Sec 4 of the Payment of Gratuity Act, 1972, then in that situation also, the Liquidator cannot be directed to make the payment of gratuity to the employees because the Liquidator has no domain to deal with the properties of the Corporate Debtor, which are not part of the liquidation estate.**

On perusal of the statutory provision of Section 5 of the Employees' Provident Fund and Miscellaneous Provisions Act, 1952. It is apparent that the establishment, to which the said Scheme of Employees' Provident Fund applies, has to create a fund in accordance with the provision of the Act and the Scheme. Section 5(1-a) provides that the Fund shall vest in, and be administered by the Central Board constituted under Section 5(a). Section 4 of the Payment Gratuity Act, 1972 provides that Gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years –

- (a) On his superannuation,
- (b) On his retirement or resignation,
- (c) On his death or disablement due to accident or disease.

In this case, we are not concerned with determination about the entitlement of Gratuity by the employees of the 'Corporate Debtor'. Payment of Gratuity to employees depends on their entitlement of Gratuity, subject to the fulfilment of the conditions laid down under the payment of Gratuity Act, 1972 **and also on the availability of the fund in this regard.**

Based on the judgment of this Appellate Tribunal in case of the State Bank of India Vs. Moser Baer Karamchari Union and Another, 2019 SCC Online NCLAT 447, it is clear that in terms of sub-Section (4)(a)(iii) of Section 36 all sums due to any workman or employees from the Provident Fund, Pension Fund and the Gratuity Fund, do not form part of the liquidation estate/liquidation assets of the 'Corporate Debtor'. Therefore, the



question of distribution of Provident Fund or the Pension Fund or the Gratuity Fund in order to priority, and within such period as prescribed under Section 53(1), does not arise. It is further held in the above case that 53(1)(b)(i) of the I&B Code, regarding distribution of assets, relating to workmen's dues is confined to a period of 24 months, preceding the liquidation commencement date. This question has already been decided that Gratuity Fund does not form the part of the liquidation asset. Therefore, the question of distribution of the Gratuity Fund in order of priority, provided under Section 53(1) of the Code does not arise. However, the Adjudicating Authority has given direction to the Liquidator that, "the Liquidator cannot avoid the liability to pay Gratuity to the employees, on the ground, that 'Corporate Debtor' did not maintain separate funds, even if, there is no fund maintained, the Liquidator has to provide sufficient provision for payment of Gratuity to the Applicants according to their eligibility".

It is pertinent to mention that the Annual Report of 2016-17 of the 'Corporate Debtor' shows that there was the provision of Gratuity for the employees and 9.77 crores were proposed for payment of Gratuity in the Financial Year ending 2017 and 11.53 Crore was proposed for Gratuity payment to the employee in the financial ending year 2016.

It is stated that in para 40 of the Annual Report that "*the Company has a defined benefit Gratuity plan. Every employee, who has completed 5 years or more, gets a Gratuity on departure, i.e. 15 days salary for each*

*completed year of service, subject to a maximum of Rs.0.15 crores. **The plan for the same is unfunded.***

It is further noticed in the report that “*In respect of defined contribution plan (Provident Fund), an amount of Rs.6.72 (31<sup>st</sup> March, 2016 and Rs.6.85 crores have been recognised as expenditure in the statement of Profit and loss.*”

The annual cash flow statement for the ending 31<sup>st</sup> March, 2017 show that Gratuity Fund was proposed. However, it is noticed that no such fund was created. In the circumstances, the Liquidator should not have been directed to make provision for the payment of gratuity to the workmen as per their entitlement.

Therefore, this Appellate Tribunal is of the considered opinion that the Adjudicating Authority erred in directing the Liquidator to make provision for payment of Gratuity to workers, as per their entitlement. Thus, Appeal is allowed and the impugned direction to ‘Liquidator’ to make provision for payment of Gratuity, without their being a separate fund in this regard, is set aside.

[Justice Venugopal M.]  
Member (Judicial)

[V. P. Singh]  
Member (Technical)

**NEW DELHI**  
**11<sup>th</sup> FEBRUARY, 2020**

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