

## **Insolvency and Bankruptcy Board of India**

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**4<sup>th</sup> May, 2023**

***Subject: Judgment<sup>1</sup> of Hon'ble Supreme Court of India in the matter of Moser Baer Karmachari Union through President Mahesh Chand Sharma Vs, Union of India Writ Petition (C) No.421 of 2019 and other writ petitions***

### **I. Background:**

Sections 326 and 327 of Companies Act, 2013 (“CA 2013”) deal with overriding preferential payments and preferential payments respectively, in the winding up of a company. In terms of the above provision, workmen’s dues; and the debts due to secured creditors to the extent such debts rank under clause (iii) of the proviso to sub-section (1) of section 325 pari passu with such dues, shall be paid in priority to all other debts. However, clause 19(a) of the Eleventh Schedule to the Insolvency and Bankruptcy Code (“Code”) inserted section 327(7) of the CA 2013 which puts a statutory bar on the application of sections 236 and 237 of the CA 2013 to the liquidation proceedings under the Code. In the above regard, Moser Baer Karamchari Union and others have filed writ petition under Article 32 of the Constitution of India and prayed for striking down section 327(7) of the CA 2013 as arbitrary and violative of Article 21 of the Constitution of India; and also to leave the statutory claims of the “workmen’s dues” out of the purview of waterfall mechanism under section 53 of the Code; and for settlement of workmen dues should be done as per reasonable principles laid down in section 326 in case of liquidation under the Code.

### **II. Issues:**

Whether section 327(7) of the CA 2013 is arbitrary and violation of Article 21 of the Constitution of India and priority to worker’s dues is accorded in liquidation of a company under the Code.

### **III. Findings & Observations:**

SC held that Parliament/Legislature in its wisdom to keep out of all sums due to any workman/employee from the liquidation estate assets made the provisions under the Code. 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. Code is a complete Code and is a new insolvency mechanism, which cannot be compared with that of the earlier regime, CA 1956/ 2013.

SC observed that the workmen as a separate class also have a stake and benefit from the revival of the company. While drawing similarities with section 326 of the CA 2013, it observed that

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where the secured creditor opts to proceed under section 52 of the Code, interests of workmen is protected in terms of regulation 21A of the Liquidation Regulations which mandates the secured creditor not relinquishing security interest, to pay as much towards the amount payable under section 53(1)(a),(b)(i) to the liquidator within the time specified.

Further, it is observed that section 53 of Code begins with a *non-obstante* clause, is the complete and comprehensive which ensures collection of assets and then provides the manner in which the creditors are to be paid. The waterfall mechanism is based on a structured mathematical formula, and the hierarchy under section 236 of CA 2013 is created in terms of payment of debts in order of priority with several qualifications. Any change in the waterfall mechanism would have cascading effects in balancing the interests of secured creditors, Operational Creditors, Central and State Governments. Depending on facts of some cases, waterfall mechanism under the Code may be more beneficial than the hierarchy under section 236 of CA 2013 and *vice versa*. The unpaid dues of the workmen are adequately and significantly protected in line with the objectives sought to be achieved by the Code in terms of section 53 of the Code. Thus, the interests of workmen are protected whether secured creditor has relinquished his security interest or not. It held that while the secured creditors are taking haircut, workmen are being compensated equitably.

SC, while dismissing the writ petitions, held that section 327(7) of CA 2013 is not arbitrary and not violative of Article 21 of the Constitution of India. By virtue of section 327(7) of the Companies Act, 2013, sections 326 and 327 of the CA 2013 shall not be applicable in the liquidation of a company under the Code. It was further observed 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. Lastly note that 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.