
THE PARADOX OF CLEAN SLATE THEORY: STATUS OF UNLIQUIDATED CLAIMS OF WORKMEN

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I. Introduction

The Supreme Court of India in its recent decision in *Ghanashyam Mishra and Sons v. Edelweiss Asset Reconstruction Company* (“Edelweiss”) observed that after the approval of a resolution plan, all the claims shall be binding upon the corporate debtor and unadmitted claims shall stand extinguished on such date.¹ This judgement crystallizes the clean slate theory laid down in the case of *CoC of Essar Steel India Ltd. Through Authorised Signatory v. Satish Kumar Gupta & Ors.* (“Essar Steel”). The reasoning stemmed from the finality granted to a resolution plan by virtue of Section 31(1) of the Insolvency and Bankruptcy Code (“the Code”).

In this regard the Supreme Court in *Essar Steel* has observed, “All claims must be submitted...so that a prospective resolution applicant knows exactly what has to be paid in order that it may then take over and run the business of the Corporate Debtor.”²

While disposing the unadmitted claims of workmen in *Edelweiss*, the Court quashed the order of NCLAT,³ wherein the tribunal observed that workmen were entitled to continue proceedings before a competent court after the expiry of the moratorium period. While deciding in favour of the workmen of Sundargarh Mines & Transport Workers Union (SMTWU), the NCLAT placed reliance on the wordings of Section 60(6) of the Code. While doing so, the Hon’ble tribunal reaffirmed that for the purposes of bringing a suit before a civil court, the period of moratorium ought to be excluded from the limitation period.

Nevertheless, the Supreme Court quashed the impugned NCLAT order due to supremacy granted to an approved resolution plan under the clean slate theory. The Court in Paragraph 124 of the judgement observed, “Insofar as, the claims of Labour and Workmen are concerned...observing that a liberty is available to the workmen to raise their claims before a Civil Court or Labour Court, in our view, is totally in conflict with the provisions of I&B Code.”

¹ 2021 SCC OnLine SC 313.

² 2019 S.C.C. OnLine SC 1478.

³ *Edelweiss Asset Reconstruction Company Limited v. Orissa Manganese and Minerals Limited & Ors.* [2019] 154 SCL 18.

One point of distinction in this case is that the RP had already considered the claims under the resolution plan. There is still lack of clarity about the status of workmen's claims that are unliquidated, sub-judice and have not been considered by the RP. The ruling of the apex court in *Edelweiss* and *Essar Steel* has left the workmen remediless. It is crucial to analyse the current status of operational contingent liabilities of workmen under the Code.

II. Analysis of the Unsolved Issues

There are three issues with this well-intended clean slate theory.

First, the theory has caused an automatic extinguishment of undecided claims. If a resolution plan is approved before such liabilities are crystallized the operational creditors can neither bring a future claim to the rehabilitated corporate debtor, nor continue the proceedings before other competent courts. *Second*, the Supreme Court's decision does not provide clarity regarding the status of unliquidated and sub-judice workmen dues that have not been admitted by the RP. *Third*, the theory paves way for mala-fide disputes and frivolous litigation to whittle down the meritorious claims of operational creditors who do not even enjoy the right to an audience in the CoC.

It is ironic that while calling these contingent claims as "hydra heads popping up", the judgement creates a false sense of rehabilitation of the corporate debtor.

a. Status of Workmen under the Code

The paramount significance of workmen, as defined under Section 3(36), of a corporate debtor is reflected through the priority assigned by the drafters in the waterfall mechanism. Section 53 distinguishes between workmen (blue collar workers) and employees (white collar workers) by placing them differently under Section 53(1)(b)(i) and Section 53(c) respectively.

Workmen are considered as operational creditors under Section 5(20) of the Code and do not possess any voting rights. However, the Insolvency Committee itself has observed in its report that an operational creditor may possess voting rights if it has institutional capacities in the future.⁴ Time and again, workmen's right to representations have been facilitated in landmark cases such as *Suresh Narayan Singh v. Tayo Rolls Limited*,⁵ and *J.K Jute Mills Mazdoor Morcha v. J.K Jute Mills Co. Ltd.*⁶

⁴ Ministry of Corporate Affairs, *Report of the Insolvency Law Committee*, Government of India (June 20, 2021, 10:30 AM) 135, <https://ibbi.gov.in/uploads/resources/c6cb71c9f69f66858830630da08e45b4.pdf>.

⁵ (2018) S.C.C. OnLine NCLAT 557.

⁶ (2019) 11 S.C.C. 332.

The Supreme Court's decision with respect to the appeal of SMTWU in *Edelweiss* has deprived workmen of the due process to enforce their rightful wages before both the Adjudicating Authority and the RP.

b. Contingent Claims

The Code is silent upon the treatment of contingent claims, however the definition of claim under Section 3 (6) is broad and recognizes both disputed, under Section 5(6), and undisputed claims.⁷ A duty is also cast upon the RP to collate the claims and make the best estimates of such contingent claims based on the information available with him.⁸ A creditor may choose to admit such contingent claims to the RP by submitting a proof of claim.⁹

In *Andhra Bank v. F.M. Hamerele Textile Ltd.*, the NCLAT has held that future claims, if not taken into consideration by a resolution plan, do not automatically stand extinguished.¹⁰ Thus, before the ruling in *Edelweiss*, the creditors had an option to pursue the pending litigations.

Similarly, in *Tata Steel BSL Ltd. v. Varsha w/o Ajay Maheshwari*,¹¹ Bombay High Court held that sub-judice claims should be assigned a notional value and may be considered once they are crystallized. If the disputed claims, under appeal before a court proceeding, is decided in favour of the creditors, the resolution plan would be incomplete.¹² This also implies that the claim must be assigned an acceptable value and treated by the resolution plan. It means either the workmen should be able to negotiate an acceptable value under Reg. 37 (f) of CIRP Regulations or the RP must assign a higher value to such unliquidated claims. The latter is not possible, since a RP's powers are merely administrative in nature and not adjudicatory as per the case of *Swiss Ribbons v. Union of India*.¹³ Moreover, the *Edelweiss* judgement has closed doors for implementation of the former alternative.

III. The Way Forward

⁷ Insolvency and Bankruptcy Board of India, *Amendments to Corporate Insolvency Resolution Process Regulations*, Government of India (June 20, 2021, 10:00 AM), https://ibbi.gov.in/Agenda_04C_150318.pdf.

⁸ Reg. 14, Indian Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, (Aug.10, 2018).

⁹ Reg. 7 & 8, The Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, (Aug.10, 2018).

¹⁰ Company Appeal (AT) (Insolvency) No. 61 of 2018].

¹¹ (2020) 155 CLA 115 (Bom).

¹² ESSAR, *supra* note 2.

¹³ AIR 2019 SC 739.

There are several suggestions that may clear up the existing conundrum. *Firstly*, the claims that are not disputed in fact, but only with respect to the amount should be assigned an estimated value as per Reg. 14. These claims include amounts that are pending because an order adjudicating the amount is under appeal. It is suggested that an amendment in treatment of disputed claims with respect to the amount of claim under Section 5 (6)(a) should be brought by the legislature. This alternative is based on the previous decisions of the courts wherein it was held that a debt is considered disputed when there is a need for further investigation to assess the genuineness of a recurring operational debt.¹⁴ Thus, when there is no dispute regarding the occurrence of default on an amount due, the value assigned should be much more than a notional value of Rs. 1. The corporate debtor cannot raise such a mala-fide and moonshine defence of dispute.¹⁵ The ongoing practice also allows the corporate debtor to evade liabilities by voluntarily invoking insolvency proceedings and using the moratorium as a shield to protect itself.

Secondly, it is suggested that the powers of the RP should be assigned the same weight as that of a Liquidator. The wordings of Reg. 25 of the Liquidation Process Regulations and Reg. 14 of the CIRP Regulations are almost the same. The powers of the Liquidator are expressly stated as, "*where the amount claimed by a claimant is not precise...the liquidator shall make the best estimate of the amount of the claim based on the information available with him*".¹⁶ It is imperative for the legislature to grant RP the same powers as the Liquidator under Sections 38 and 40 of the Code.

Lastly, Section 14 of the Code must clarify the scope of moratorium. The proviso under section 14 and Section 60(6) of the Code allows appropriate forums to continue the adjudication in accordance with law after the expiry of the moratorium. However, the clean slate theory has vanished from the effect of this provision.

IV. Conclusion

Given that the Code is a beneficial legislation which is a complete code in itself, it cannot do away with the rights of operational creditors. While secured financial creditors may still find alternatives and be able to pull themselves back on their feet, operational creditors are once again left on a weak pedestal. Let alone, workmen are the nerve of any industry. If the workmen

¹⁴ Mobilox Innovations Private Ltd. v. Kirusa Software Private Ltd., AIR 2017 SC 4532.

¹⁵ Kirusa Software Private Ltd. v. Mobilox Innovations Private Ltd. Company Appeal (AT) (Insolvency) 6 of 2017.

¹⁶ Reg. 25, Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 (July 25, 2019).

are not able to recover their dues, they may lose their job that will in-turn affect the economy of India.¹⁷ Labour Unions represent unsecured creditors- workmen, and their non-representation further affects the efficiency of the litigation process.¹⁸

¹⁷ Bankruptcy Law Reforms Committee, *Interim Report of The Bankruptcy Law Reform Committee*, Government of India (June 20, 2021, 10:40 AM) 36 (Feb. 2015), <https://ibbi.gov.in/uploads/resources/57420f272e1515f0c9c137f1a6423d78.pdf>.

¹⁸ Ministry of Corporate Affairs, *J.J. Irani Expert Committee on Company Law*, Government of India (June 20, 2021, 10:00 AM) 150 (May 2005), <https://ibbi.gov.in/uploads/resources/May%202005,%20J.%20J.%20Irani%20Report%20of%20the%20Expert%20Committee%20on%20Company%20Law.pdf>.