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EPF Obligations: Treatment During Insolvency and Liquidation

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ABSTRACT

Insolvency and Bankruptcy Code, 2016 provides for a comprehensive mechanism for resolving the claims of creditors, whether secured or unsecured, of an organization. Meanwhile, The Employees Provident Fund Act, 1952 was brought into force to ensure the social security of employees of an organization. The claims of the employees under EPF Act are often brought up whenever there is a formation of a Resolution Plan for a company undergoing Corporate Insolvency Resolution Process or when the liquidation of a company commences. This paper is an attempt to analyze the order of priority of EPF dues of the employees under the IBC mechanism while a company is undergoing Corporate Insolvency Resolution Process by analyzing the provisions of the relevant acts, the waterfall mechanism under IBC and various orders passed by the NCLAT and Supreme Court while dealing with the same issue. Moreover, this paper will also analyze the order of priority given to EPF dues during liquidation of a company and the difference in the treatment between the two.

Keywords: *Insolvency Law, Liquidation, EPF, Provident Fund, Waterfall Mechanism.*

I. INTRODUCTION

The EPF obligations arose as a need for social security of the employees was realized and consequently, the Government of India developed Employees' Provident Fund (EPF) social security programme for the advantage of salaried workers. The Workers' Provident Funds and Other Provisions Act of 1952 authorized the introduction of the programme.³ The contribution is currently set at 12% of the employees' basic salary and dearness allowances. The Employees' Pension Fund Office (EPFO) oversees Workers' Deposit-Linked Insurance Scheme and the Employees' Pension Scheme in addition to the EPF. The EPF Act is regularly amended so that it can keep up with the needs and be beneficial to the employees.

There are various benefits that have been offered under EPF Act which are beneficial to the employees such as savings for retirement, portability of the account, tax benefits under Section 80C of the Income Tax Act, insurance through the Employees' Deposit-Linked Insurance

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³ Manorama G Savur, *Social Security Legislation in India—I: The Employees' Provident Fund Scheme*, 2 ECONOMIC AND POLITICAL WEEKLY 1769–1776 (1967).

programme, which offers life insurance coverage and loan/withdrawal options for the employees.

Under the Insolvency and Bankruptcy Code, 2016, a mechanism has been provided for efficient resolution of the obligations of a company undergoing liquidation or corporate insolvency resolution process. Under its provisions, it provides priority order to different creditors of the company by way of a clearly defined waterfall mechanism. EPF dues form a vital obligation of the company but their priority order has not been provided explicitly under the Code. Since both the Acts have non obstante clauses, there is sometimes a conflict between their implementation. Different provisions of the Code and the EPF Act have been interpreted in different manners by the Adjudicating Authorities to interpret their priority order and to harmonize this discord.

II. COMPANY'S EMPLOYEES PROVIDENT FUND OBLIGATIONS: PROVISIONS OF THE EPF ACT

India's Employees' Provident Fund (EPF) Act, which was passed in 1952, is aimed at providing social security. The Employees' Provident Fund Organization enforcing the EPF Act is applicable to all businesses employing 20 or more people (EPFO). Employers are obligated by the EPF Act to contribute on behalf of their employees to the Employees' Provident Fund (EPF). The employer's payments, which are presently set at 12% of the employee's income, are based on the employee's basic pay and dearness allowance. Employers must also make contributions to the Workers' Pension Programme (EPS), a part of the EPF, in addition to the EPF. The current EPS contribution rate is 8.33% of the employee's salary, which is based on their basic pay and dearness allowance and is limited to a monthly maximum of Rs. 1,250. The Employees' Deposit Linked Insurance (EDLI) Scheme, which offers life insurance coverage to employees, is another programme that requires contributions from employers.

The EPF Act also establishes rules for the management and administration of the EPF, including establishing EPFO and appointment of Board of Trustees to direct its operations. The act provides for establishment of The Workers' Provident Fund Appellate Tribunal, to hear appeals against EPFO judgements. Employers must abide with the EPF Act's rules in order to avoid fines and other legal repercussions. Penalties for breaking the Act include fines, jail time, and other sanctions.

Some of the relevant provisions under the Employees' Provident funds and the Miscellaneous Act, 1952, include Section 11 of the Act, which specifies the employer's responsibility to make payments to the Provident Fund as well as the method and time period for making contributions.

While section 11 (1) b specifies the manner in which it needs to be calculated . Section 11(2) creates the first charge on the assets of the employer's assets and provides for an overriding effect over all other laws. states that the terms of the Act take precedence over any other law or contract, and that any arrangement or contract that is inconsistent with the requirements of the Act is null and invalid. The clause also ensures that employees are entitled to the benefits given by the Act.

Section 14 of the EPF Act provides for punishment for violation of the provisions of the act, and allows the relevant authority to impose fines and penalties. Section 17 of the EPF Act addresses the recovery of money owed to the Provident Fund, as well as the authorities' rights to employ strict steps to recover the sum owed to the Provident Fund, such as attaching and selling the employer's movable or immovable property.

Section 17B of the act provides for liability in cases of transfer, and holds both parties as jointly and severally liable, however, the proviso to section 17B limits the liability of the transferee to the amount so received by them in terms of assets of the transferor.

III. EPF OBLIGATIONS UNDER IBC

The IBC stipulates a resolution procedure with the goal of reviving the business and paying off its obligations and therefore, several provisions of the Code deal with the EPF dues of the workmen or employees either directly or indirectly and have been referred to by the Adjudicating Authorities in interpreting their priority under the Code.

S. 18 of the Code provides that the interim resolution professional must take control of the assets of the corporate debtor but the explanation to this provision provides that the assets owned by third parties under contractual obligations but in possession of the corporate debtor, are not to be taken control of. According to S. 30(2), the resolution professional is required to review each resolution plan he receives in order to confirm that each resolution plan specifies the sum that will be paid to these creditors in the event that the corporate debtor is liquidated in accordance with section 53.

S. 36(4) of the Code excludes the sums due to employees from the provident fund, the pension fund, and the gratuity fund from the Liquidation Estate, thereby excluding them from being used to pay liquidation dues. The aforementioned clause was added perhaps to prevent a financial disaster brought on by inadequate liquidation revenues.

EPF or Gratuity dues do not directly fall within the waterfall mechanism under S. 53, which presents a further challenge for the liquidator when the corporate debtor has not specifically

given cash for these expenses. The purpose of S. 238 of the code is to give the IBC precedence over all other laws in cases of disagreement. But there is then an apparent conflict between IBC and EPFO which needs to be resolved.

In general, the IBC offers a framework that aims to strike a balance between the interests of all parties involved, including the workers of the firm going through bankruptcy resolution. To analyze the priority given to EPF dues of the employees, these provisions of the Code are interpreted by the Adjudicating Authorities.

IV. WATERFALL MECHANISM UNDER IBC

Waterfall mechanism under IBC describes how the proceeds from sale of a company's assets, which is going through liquidation, are divided among various stakeholders. It is a hierarchical structure that ranks different stakeholders in order of importance and allocates funds sequentially. It is laid down under section 53 of the code. It ranks expenses of the bankruptcy resolution process, secured creditors, workmen's compensation, unsecured creditors, government obligations, priority shareholders, and equity shareholders. It is crucial because it safeguards the interests of the stakeholders and upholds the integrity of the Liquidation proceedings.

The Employees' Provident Fund (EPF) liabilities of a firm undergoing liquidation are not separately included under section 53, IBC. EPF contributions, however, are prioritized to the extent they are covered by s 53(1)(b)(i), regarded as workmen's contributions. It includes unpaid salary, wages, and other employee obligations, such as provident fund, gratuity, and leave encashment obligations for the last twenty four months, which are given second priority. They fall after the expenses of the insolvency resolution process in the priority order, meaning employees who work during the CIRP will be covered under S53(1)(a). EPF dues shall be considered as workmen's dues and given precedence over unsecured creditors, government dues, priority shareholders, and equity owners if a firm that is undergoing liquidation has outstanding EPF obligations to its employees.

The Employees' Provident Funds and Miscellaneous Provisions Act, 1952, and the rules promulgated thereunder, and not the Indian Business Code, control a company's EPF duties. The priority given to workmen's dues, including EPF dues, under the IBC, however, ensures that the interests of the employees are safeguarded in the event of the insolvency of their employer. The IBC offers a system for the settlement of insolvency cases. Section 53, although applicable to liquidation proceedings, also is followed in a Resolution Plan by virtue of section 30(2)(b), IBC with regards to Operational creditors, which is what EPF dues will be classified

as.

V. LEGAL FICTION UNDER IBC

By the way of S. 36(4)(a), a legal fiction is created by the IBC that certain assets would be assumed to be in the possession of the Corporate Debtor but these assets are owned by the third parties such as assets of bailment, workmen's provident dues etc. To ensure that such assets do not form a part of the Liquidation Estate, this fiction is created and the dues of certain people are protected. This legal fiction also protects the workmen's or employees' gratuity fund dues. This legal fiction can also be extended to S. 18 wherein the Explanation also creates the same legal fiction of assets in possession of Corporate Debtor but owned by third parties and grants protection to them from being a part of assets in the Resolution Process and thereby, the Resolution Plan.

(A) Treatment of EPF dues under Companies Act

S. 11(2) of the EPF Act, 1952 provides that the amount due under the Act becomes a priority by becoming a first charge on the assets that are owned by the company. The Supreme Court recognised this treatment of EPF dues under the same in *EPFO v. O.L. of Esska*⁴ as well as *Maharashtra State Co-Operative Bank Limited v. APFC*⁵ when a company winds up under S. 271. The Apex Court also interpreted this treatment in *EPFO v. Govt. of Andhra Pradesh*⁶ and again upheld that the dues would be covered under Section 11 of the EPF Act and hence, the payment for the same would be made when the Company is winded up.

VI. JURISPRUDENCE: WHAT THE COURTS HAVE HELD?

(A) Cases where EPF dues were not treated as a priority

In *Savan Godiwala (Liquidator of Lanco Infratech Ltd) v. Apalla Siva Kumar*⁷, it was contended that payment of gratuity should not be made from running accounts of the Corporate Debtor. The NCLAT held that in case that there is a no fund for payment of gratuity which has been created by the Company to be a part of the Liquidation Estate, the Liquidator cannot make such payment as he has the responsibility over such Estate only and not all the assets of the Company and he can make payment to the creditors under S. 53 of IBC from that Estate only as he is the caretaker of the Liquidation Estate only.

The *Regional Provident Fund Commissioner- I v. Karpagam Spinners Private Limited*⁸ held the

⁴ (2011) 10 SCC 727

⁵ (2009) 10 SCC 123

⁶ (2018) 17 SCC 321

⁷ (2020) SCC OnLine NCLAT 191

⁸ (2019) SCC OnLine NCLT 1640

decision on the same lines. It was held that Section 238 of the Code will take precedence over anything that is at conflict with the Code which includes the EPF Act. The same was reaffirmed in *Regional Provident Commissioner EPFO v. Vandana Garg*⁹, where it was held that the stakeholders must continue to be bound by the authorized resolution plan and all the other claims were dismissed. A similar decision was held in *B. Parameshwara Udpa RP of Easun Reyrolle Ltd. v. Assistant PF Commissioner*¹⁰, holding that the RP is not required to make provident fund provisions when the Corporate Debtor has not made any such separate provisions.

In *Arun Kumar Jagatramka v. Jindal Steel and Power*¹¹ Ltd, the Supreme Court had held that there should be minimum interference by the Adjudicating Authority when dealing with Resolution Plan's approval as it is a commercial decision and the Authority just has to ensure that the Resolution Plan complies with the legal compliances provided under the IBC such as S. 30 and S. 31.

In *EPFO v. Dommeti Surya Rama Krishna Saibaba*¹², it was again reiterated by the NCLT that EPFO do not form a part of the Resolution Plan as the interference from the Adjudicating Authority should be kept minimum as is the objective of the Code and hence, the Authority cannot exceed its jurisdiction by examining the Resolution Plan beyond its scope. Therefore, if the approved resolution plan does not satisfy the EPF dues and has been approved by majority of the members and is also in compliance with the with S. 30 and S. 31 of the IBC, then the Authority cannot reject the plan on the basis that EPF obligations have not been fulfilled.

(B) When courts have given priority to EPF

As observed hereinabove, courts and tribunals have accorded different priority to EPF Obligations in different cases. While, in some cases, the courts have refused to interfere and offer any relief, in some other cases, they have gone so far as to direct the payment of entire EPF Obligations, including interest. In the case of *Tourism Finance Corporation of India Limited v. Rainbow Papers Limited*¹³, a three-judge bench of NCLAT decided upon a challenge by the Regional Provident Fund Commissioner, because the Resolution Plan only provided for payment of principal amount and no proposal for repayment of interest was made. NCLAT read provisions of EPF Act harmoniously with the IBC and held that there was no contradiction between the two. Relying on section 36(4)(iii), which excludes Provident Fund from assets of

⁹ (2021) SCC OnLine NCLAT 163

¹⁰ (2021) SCC OnLine NCLT 5287

¹¹ (2021) 7 SCC 474.

¹² (2022) SCC Online NCLAT 432.

¹³ (2019) SCC OnLine NCLAT 910.

the corporate debtor, the court directed the resolution applicant to release the fund along with interest, and modified the resolution plan to that extent. An appeal to NCLAT order was made before the Supreme Court, but the same was rejected.

In the case of *SBI v. Moser Baer Karamchhari Union*¹⁴ imposed an obligation to pay the provident fund dues in full, which could not be subjected to the waterfall mechanism under section 53, in case of liquidation under IBC.

In the case of *Sikander Singh Jamuwal v. Vinay Talwar*¹⁵, an application under s 17B of the EPF Act was made, and the case was decided by the principal bench of the NCLAT. In this case, the resolution applicant argued against interference by the tribunal, because the commercial wisdom of the Committee of Creditors shall not be interfered with. However, the court rejected this argument and relied upon S-30(2)(e) to bring the issue within the ambit of the tribunal's power to decide. It was held that the resolution plan must not violate any provisions of law, and it is an obligation on the tribunal, as well as the Resolution Applicant, to ensure that no such violation occurs. Therefore, section 17-B of the EPF Act cannot be violated and the resolution applicant will be liable to release Provident Fund to the full satisfaction of dues up until the date of transfer.

Such an analysis by the court puts the Resolution Applicant in a precarious situation, because every statutory obligation, which the corporate debtor failed to fulfill is likely to be a violation of the law, but at the end of the day, EPF Obligations are commercial in nature and will be factored in while making important economic and financial decisions by the Resolution Applicants. Hence, a contradictory position is given to the government as an operational creditor, under section 53, and judgements delivered by the court in various different case laws, where they are given a priority, which is not given under the IBC. This creates confusion, and makes formulation of a legally compliant resolution plan, which is also financially viable, an uncertain and difficult task.

In *Sunil Kumar Jain v Sundaresh Bhatt*¹⁶ held that dues to employees, who worked during the CIRP process, were to be treated in accordance with section 53(1)(a) of the IBC i.e. as cost of CIRP, and hence need to be paid first in the priority order. It was further clarified that Provident fund, gratuity fund and pension fund are outside the liquidation process and cannot be used for the purpose of recovery in liquidation proceedings, in light of section 36(4) of the act. The court further held, that employees and workmen “shall have to be paid the same out of such provident

¹⁴ (2019) SCC OnLine NCLAT 447.

¹⁵ (2022) SCC OnLine NCLAT 125.

¹⁶ (2022) 7 SCC 540.

fund, gratuity fund and pension fund, if any, available”.

However, NCLAT distinguished from this case in *Jet Aircraft Maintenance Engineers Welfare Association v. Ashish Chhawchharia RP of Jet Airways*¹⁷, and limited its findings to the liquidation process only. Therefore, while workman dues were kept outside the liquidation proceeding according to the Sunil Jain judgment, the same were to have to be paid in full by the successful Resolution Applicant, as it is a statutory duty. NCLAT also clarified that the Supreme Court judgment cannot be interpreted to mean that in case a fund is not available with the liquidator, workmen and employees will not be entitled to anything under the liquidation proceedings. To cast a statutory obligation on the applicant to pay EPF dues in full, NCLAT relied on *SBI v. Moser Bear Karamchari Union*¹⁸, which interestingly is also a case regarding liquidation proceedings.¹⁹

*Assam Tea Employees Provident Fund Organization v. Madhur Agarwal & Anr.*²⁰ gave a similar rationale and decision to the *Jet Aircraft* judgment, and held that provident fund will not be treated as assets of the Corporate Debtor, and dues for the same need to be settled in full.

(C) The position finally settled?

In *Jalan Fritsch Consortium v Regional Provident Fund Commissioner and Another*²¹, the apex court affirmed the decision passed by NCLAT in the case *Jet Airways*, directing the resolution applicant to disburse employee provident funds, as well as gratuity, in full because the same were statutorily due. The order passed by the court held that

“We find no error in the order of the National Company Law Appellate Tribunal dated 21 October 2022 read with clarification order dated 2 December 2022.”

Hence, the court settled the position on the subject, making the NCLAT decision the final ruling. However, it was not done by a reasoned judgment. The decision by NCLAT has been discussed hereinabove. In addition, it is important to note that NCLAT ordered the payment of, not just pending dues in provident and pension funds, but also the damages ordered by the EPF Authorities, for non-compliance with the provisions of the act. The court relied on *Maharashtra State Cooperative Bank Limited v Assistant Provident Fund Commissioner and Others*²², which

¹⁷ (2022) SCC OnLine NCLAT 418.

¹⁸ (2019) SCC OnLine NCLAT 447.

¹⁹ Malak Bhatt et al., *Payment Of EPF Dues Under The IBC – Supreme Court Paves Way For Full Realization*, LIVELAW, Feb. 26, 2023, <https://www.livelaw.in/columns/payment-of-epf-dues-under-the-ibc-supreme-court-paves-way-for-full-realization-222546> (last visited Mar 26, 2023)

²⁰ CA[AT][Ins] No. 262 of 2022.

²¹ (2023) SCC OnLine SC 106.

²² (2009) 10 SCC 123.

held that damages are included within the meaning of “amount due from an employer” in section 11(2) of the EPF Act.

The important tenets of the ruling laid down by Appellate tribunal include firstly, the parallelism drawn by the court in section 36 of the code, and section 18. Just as liquidation estate excludes provident, pension and gratuity fund dues under section 36, similar principles would apply in case of Corporate Insolvency Resolution Process also. The implication of this ruling is that any internal funds maintained by the company for these purposes will be excluded from the purview of control by the Resolution Professional or the successful resolution applicant. Only employees will have a right over such funds, and hence, they become assets owned and controlled by third parties. Secondly, it holds that if any such fund is in fact created by the Corporate Debtor, the obligation of continued maintenance of such fund is on the successful resolution applicant.

It is important to note that the obligation to pay remains even when no fund was maintained by the Corporate Debtor, as employees and workmen cannot be left remediless. The decision has been critiqued on the ground that this judgment creates an exception to the “clean slate” rule.²³ It has also been critiqued for treating Provident and Pension Fund and Gratuity funds in the same manner, because Payment of Gratuity Act, 1972 doesn't have a provision parallel to that of Section 11 of the EPF Act.²⁴ Overall, the judgment still provided much needed clarity in terms of treatment of EPF Obligations under the CIRP. But, because of the distinction made by the court from the *Sunil Jain* judgment, this finding applies only to the resolution process. However, the apex court confirmed the NCLAT Order in the case of *SBI v Moser Baer* by order dated 07 February 2023, which has settled the position with regards to liquidation proceedings also.

(D) How treatment under Liquidation and Resolution differs?

It is deduced from the reading of IBC and interpretation of the provisions of the same by various Adjudicating Authorities that the Provident or Gratuity fund of the employees or workmen is not taken to be a part of either the Liquidation Estate under S. 36 or is to be treated as an asset to be controlled by the Interim Resolution Professional under S. 18.

S. 36(4)(iii) of the Code explicitly states that all such funds from provident, pension or gratuity fund shall not be part of the Liquidation Estate of the Company such was also held in the *Sunil*

²³ Anshul Prakash et al., *Supreme Court dismisses successful resolution applicant's case in the matter of disbursement of gratuity and employees' provident fund dues*, KHAITAN & CO (2023), <https://www.khaitanco.com/thought-leaderships/Supreme-Court-dismisses-successful-resolution-applicants-case-in-the-matter-of-disbursement-of-gratuity-and-employees-provident-fund-dues> (last visited Apr 16, 2023).

²⁴ *Id.*

Jain and Jet Airways case. The *Moser Baer* judgment also provided that the workmen dues will not be part of the liquidation assets of the company. While S. 18(f) of the Code provides for the duties of the IRP which include taking over the control and custody of the assets owned by the Corporate Debtor but the Explanation to the same promptly provides that such assets would not include the assets of third party held under possession by the Corporate Debtor and the same was discussed in the case of *Jalan v. RPFO* wherein the Court observed that S. 18 of the Code should be interpreted in the light of S. 36 so as to fulfill the intent and purpose of the IBC. *Jalan* decision also expanded the scope of S. 36 by extending it to interpretation of Resolution Proceedings rather than the strict interpretation of the same in *Jet Airways* decision. Therefore, these funds should not form part of the assets of the Corporate Debtor with regards to the Resolution Plan.

While the established Provident or Gratuity Fund by the Corporate Debtor is excluded from the liquidation or resolution proceedings, the difference in treatment of the same comes when no such separate fund has been created by the Corporate Debtor. In *Savan Gowadia, Karpagam Spinners* as well as *Sunil Jain* judgments, the Adjudicating Authority has placed a restriction on the liquidation proceedings, that is, in case of absence of a separate fund of gratuity or pension of the employees or workmen, there would be no payment made for the same by the Liquidator. In the case of *Moser Baer*, NCLAT had held that the Liquidator would make up for any deficiency in the amount of the fund but it still did not address as to what would happen in absence of any fund.

While in the case of resolution, different benches have taken different stances on whether the Provident dues under EPF Act should form part of the Resolution Plan. For instance, in the case of *Vandana Garg and Easun Reyrolle*, the Bench decided against the inclusion of EPF Dues in the Resolution Plan where no separate fund has been made for the same. While the *Sunil Kumar* decision addressed the dues to employees which worked during the resolution process and iterated them to be the cost of the resolution proceedings under waterfall mechanism under S. 53. But in *Jet Airways* decision, NCLAT held that all such gratuity dues were to be paid in full by the Resolution Applicant as these dues were owed statutorily. This same position was taken in *Jalan* decision wherein the Supreme Court reaffirmed the *Jet Airways* decision and held that the Employee's provident, gratuity and pension dues were to be paid in full by the Resolution Applicant as they are the statutory requirement.

Therefore, while the treatment of EPF dues under the Resolution Process has reached a unanimous decision, their status under Liquidation is left open to interpretation on the basis of existence of the Provident Fund corpus and therefore, no order of priority has been established

with clarity.

VII. CONCLUSION

The position of EPF Obligations under liquidation proceedings as well as, Insolvency Resolution Process remained unclear under the statute, which led to uncertainty for Resolution applicants, Employees and Workmen, as well as statutory bodies. This gave rise to litigation and delayed the process. An analysis of the cases, hereinabove indicate that various benches of the tribunal, as well as the Appellate authority gave split decisions regarding treatment of EPF Obligations. Further, the rulings sometimes cross references resolution process and liquidation proceedings, without explicitly differentiating between the two. This created a need to separately understand the position under the two processes, and whether they have any impact on one another.

After a long and split jurisprudence, it is now clear that a situation where the corpus for fulfilling EPF Obligations was already created and maintained by the Corporate Debtor is different from a situation where no such fund is being maintained by the corporate debtor. The case law makes it clear that both in cases of resolution and liquidation, the funds provisioned for the purpose of Provident Fund in the balance sheet of Corporate Debtor cannot be utilized for any other purpose, and cannot be discounted or negotiated under the resolution plan.

The position, when no such fund exists, is a bit more challenging. Both statutes contain non-obstante clauses and hence, the clash between the two, and the priority of EPF dues has been considered by the court and tribunals in multiple cases. The settled position seems to be that even in cases, where no corpus exists, resolution applicants will have to settle all employee provident fund dues in totality. This decision is dominated by a social undertone, rather than commercial wisdom, but it is a necessary step in the right direction. In cases of liquidation, when no corpus exists, the situation seems to be unclear, and if the waterfall mechanism is followed, employees may be left with nothing. There are debates on the topic, and suggestions to ensure rate able distribution amongst all stakeholders are pouring in.²⁵ This might bring some respite to Employees.

²⁵ A. Srinivas, *Fast-tracking resolution*, THE HINDU BUSINESSLINE, Jan. 29, 2023, <https://www.thehindubusinessline.com/opinion/editorial/fast-tracking-ibc-resolution/article66446861.ece> (last visited Apr 16, 2023)

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