

# **The Social Dynamics of Corporate Insolvency Law and Workers/Employees of Distressed Companies: Comparing Select Asian Jurisdictions**

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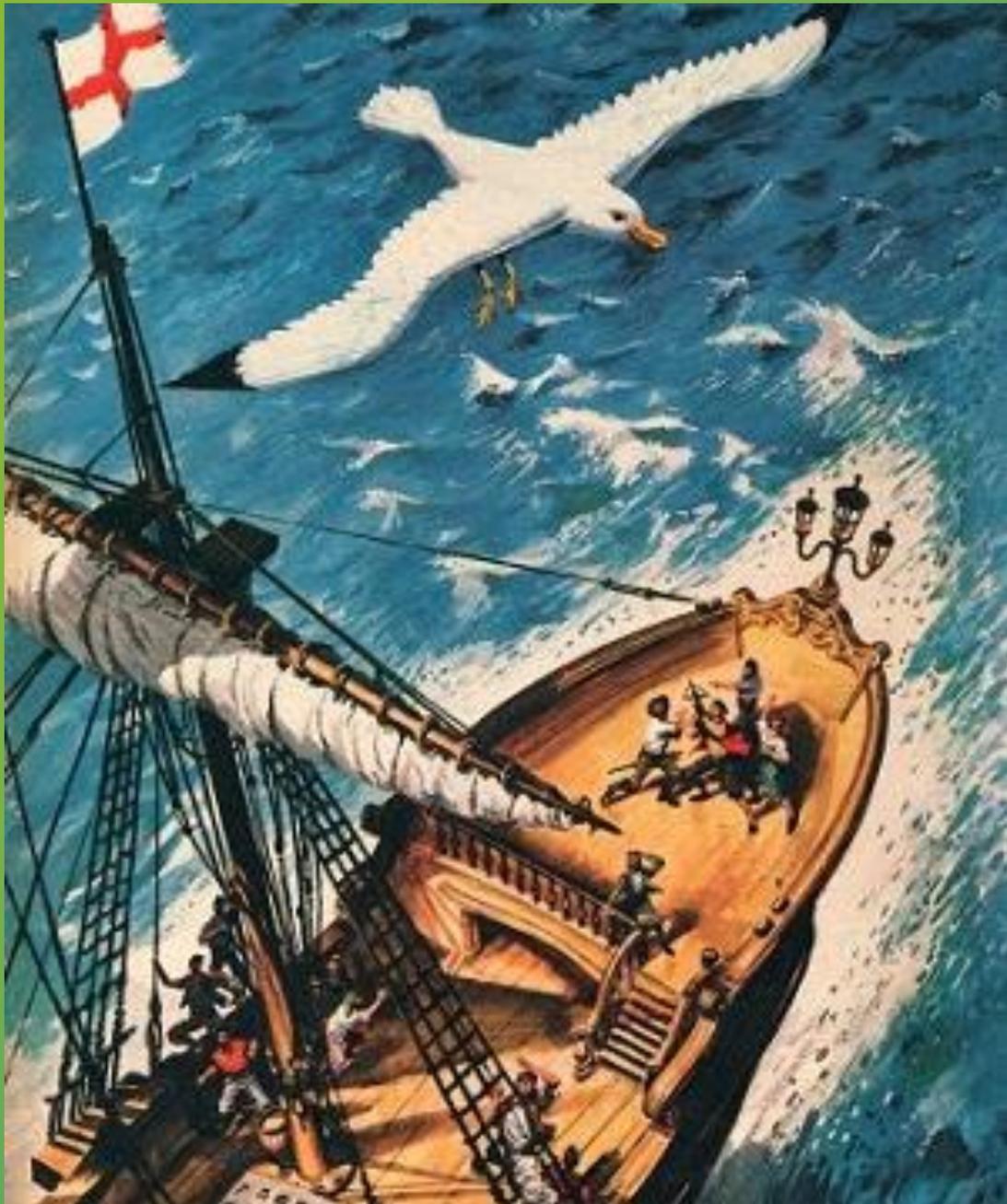
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# Agenda

- Introduction
- Research objectives and questions
- Research Methodology
- The Nature of Insolvency Laws and Social Welfare
  - Workmen and Employees in International Soft-law Discourse
  - Assessing Insolvency Regimes: Theorising data about social welfare
- Workmen and Employees and Insolvency Laws- Comparing select Asian Jurisdictions
- Conclusion and Way forward



# Sale Complete

**ABG Shipyard** went into liquidation after lenders failed to find a buyer under **IBC**

It is one of **12** entities that **RBI** directed banks to refer to **NCLT**



# Introduction

- Workmen and employees- lost souls of insolvency law
- Law is a function, part of a larger societal whole;
- corporate law has transcended the traditional shareholder- wealth maximisation paradigm;
- espoused a 'heterodox stakeholder' approach
- Broadening corporate social purpose- gauge the viability (sustainability) of an enterprise- I and B laws;
- "S" and 'G' in ESG (Environmental, Social, and Governance)- ensuring a debtor's survival;

# Research objectives

- focusses on the human and social dynamics of corporate insolvency laws, in their applicability to the W&E of the distressed companies
- discusses the prevailing normative insolvency policies juxtaposed against the theory of creditors' wealth maximisation and "creditors' bargain"
- foregrounds and assesses how effectively Asian insolvency laws serve the notions of social justice and policy against purely fostering "economic efficiency"
- interplay between social policy and insolvency laws qua the claims/ rights/ entitlements of the W&E as non-consensual "creditors"

# Contribution to the discourse

- Extant literature- emphasizes on the duties of directors qua only the “financial creditors’ of a distressed company;
- This research advances a **novel interpretation** of such a framework.
- It explicates on the ‘**creditor duty’ of directors of an insolvent company qua the W&E as ‘service/ operational/ internal creditors’ of a CD**
- A **change in their legal status *ex post*** during the process of insolvency resolution and liquidation, **from *ex ante*** (pre-insolvency).
- This aspect has largely bypassed the attention of the researchers.

# Nature of Insolvency Laws and Social Welfare

- “freedom to exit” the cycle of failure; creditors’ bargain theory
- The nature, role, and goals of insolvency law in the socio-legal discourse
- Internal v. external aims of insolvency law
- Two competing camps- ‘traditionalists’ and ‘proceduralists’
- Convergence of approaches- various theories underpinning the social welfare character of insolvency laws vis-à-vis the W&E
  - “communitarian vision”
  - ‘multiple values’/ value-based theory
  - ‘explicit value approach’
  - “authentic- consent” model

# Legal sites of protection – W&E- Asia

- Status of a creditor (in countries like India, Singapore, Vietnam)- initiate proceedings for resolution
- Representative(s) of the employees participates in the meetings of the creditors' committee- a pivotal decision-making institution assessing the feasibility and viability of a resolution plan.
- Dues of W&E creditors- accorded a priority reflecting their preferential status in the list of claimants (India, Vietnam, Singapore).
- Employee creditors stand prior to the floating security creditors in beneficial liquidation of a CD.
- In some jurisdictions, specific Insolvency funds- carved out (Hong Kong) to offer relief to the W&E.

# Workmen and Employees in International Soft-law Discourse

- World Bank Report, 2015
- United Nations Commission on International Trade Law (UNCITRAL) in its 2005 Legislative Guide on Insolvency Law
- International Labour Organization's (ILO) approach
  - 1949 adopted the Protection of Wages Convention (C 95)
  - 1992, the Protection of Workers' Claims (Employer's Insolvency) Convention ('C 173')

# Assessing Insolvency Regimes

- Importance of data for evidence-based policy making.
- A data-driven approach to the design, measurement, and implementation of insolvency regimes for gauging the impact on stakeholders has been embraced (IMF, 2019; OECD, 2018)
- Assess the impact of insolvency regimes on W&E as a distinct class of creditors/ stakeholders of a CD.
- Sources of insolvency data in diverse jurisdictions- socio- economic stakeholder data
- No research on stakeholder data captures the phenomenological experience of the W&E beyond the numeric figures.

# Some recent Research

- workers of companies appearing before high-pro-labour courts experience 4.5% lower annual labour earnings in the post-bankruptcy period, relative to the workers of companies appearing before low-pro-labour courts within the same judicial district. (A. Araujo et al., 2023)
- "...bankruptcy is accompanied with large employee costs and in the United States, "an employee's annual earnings decrease by 10% in the year of bankruptcy and 67% over a five-year period after the bankruptcy.". (Graham, 2022)

- Swedish administrative data employed- financially distressed firms lose their most skilled employees, although they did not examine the effect on employee wages. (Ramin P. Baghai et al, 2021)
- Another research focused on entry to entrepreneurship for employees of distressed firms. (Babina, 2020)

# Indian insolvency law

- A recent study on post-resolution performance of the firms, stated
  - “...There is around 50% increase in the average employee expenses in the three years post-resolution- indicating a higher employment intensity in the resolved firms (listed) in the post-resolution period. The total employment across listed firms have also shown a substantial increase in the post-resolution period.”. (Mohan and Gopalakrishnan, 2023)

- Another study which examined, inter alia, “the real effects of IBC in terms of impact on employment”, concluded:
  - “IBC positively impacted industry growth, although this occurred by altering the capital-labour mix in favour of the latter...IBC has tilted industry growth towards labour-driven process.” (Ghosh, 2023)

- number of insolvent enterprises in a specific period, the stakeholder(s) initiating the process, the levels of debt, and realisations etc., are well documented
- Little is known about the ex-post consequences of resolutions beyond such numeric points.
- Data about the outcomes realised under the insolvency laws of some of the Asian jurisdictions:
  - Hong Kong
  - India
  - Thailand

# Hong Kong

- Protection of Wages on Insolvency Ordinance (PoWIO)- PoWI Board, PoWIFund/ PoWIF
- PoWIF- makes ex gratia payment to the employees whose employers have become insolvent
- Annual Report, 2022-23 of the PoWIF- makes publicly available the five-year data (2018-19 to 2022-23) pertaining to the number of applications received from the employees whose employer became insolvent during the applicable range.

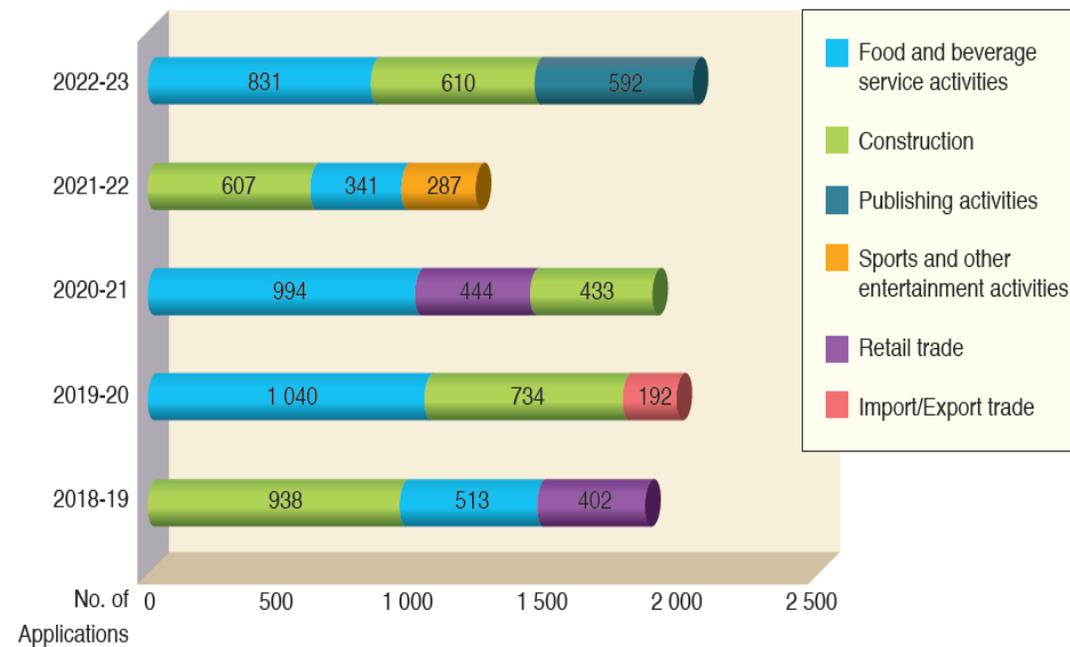
### Number of applications received by the Fund from 2018-19 to 2022-23

(excluding claims for shortfall in ex gratia payment on severance payment)



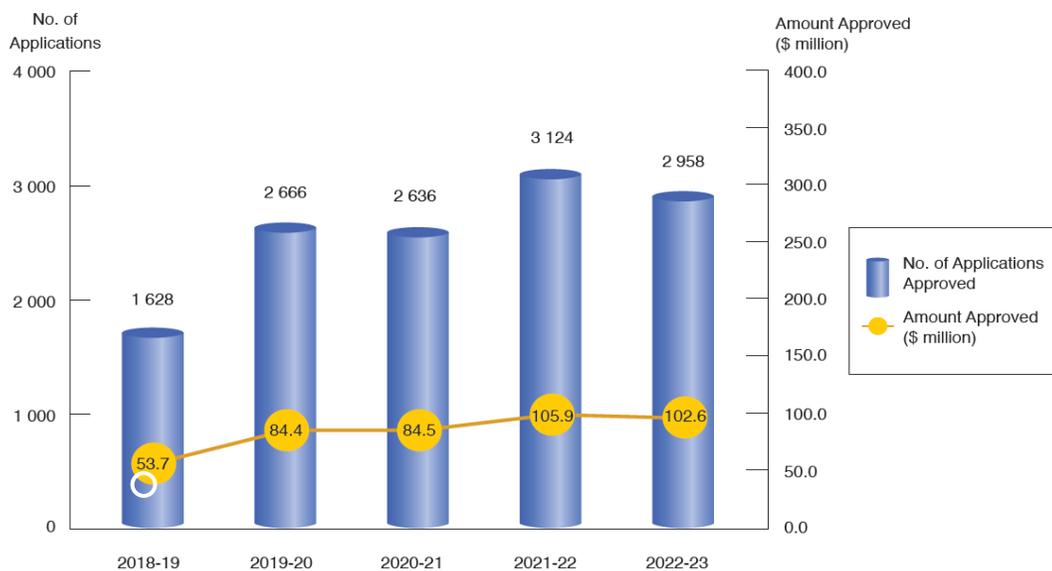
### First three industries with the largest number of applications received from 2018-19 to 2022-23

(excluding claims for shortfall in ex gratia payment on severance payment)



### Number of applications and amount of ex gratia payment approved from 2018-19 to 2022-23

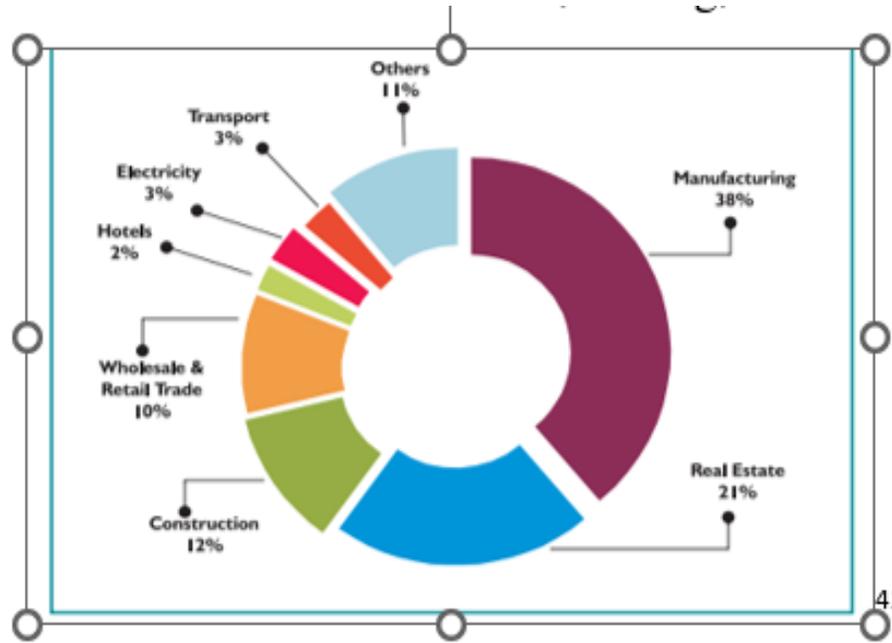
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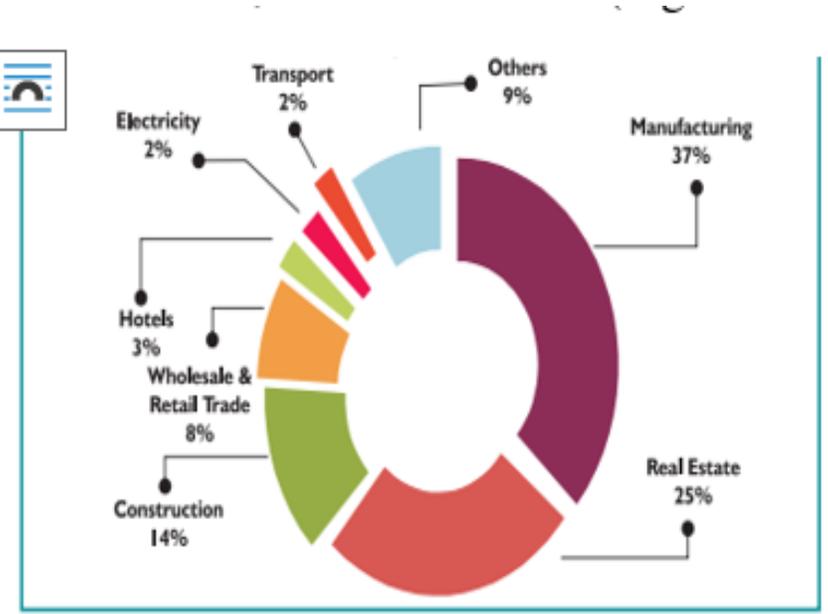
# India

- Insolvency and Bankruptcy Code (IBC)- the dominant mode for financial realisations/ insolvency resolutions
- December 31, 2023, a total of 7325 cases of corporate insolvency resolution were admitted.
  - Out of these, 891 CIRPs yielded resolution plans, resulting in a realisation of INR 3.21 lakh crore.
  - Timeline of the ongoing CIRPs- December 2023, out of the admitted matters, 1899 CIRPs have been ongoing.
- Out of these 1899,
  - 1295 CIRPs have been ongoing for more than the stipulated statutory timeline of 270 days, which totals to approximately 68 per cent

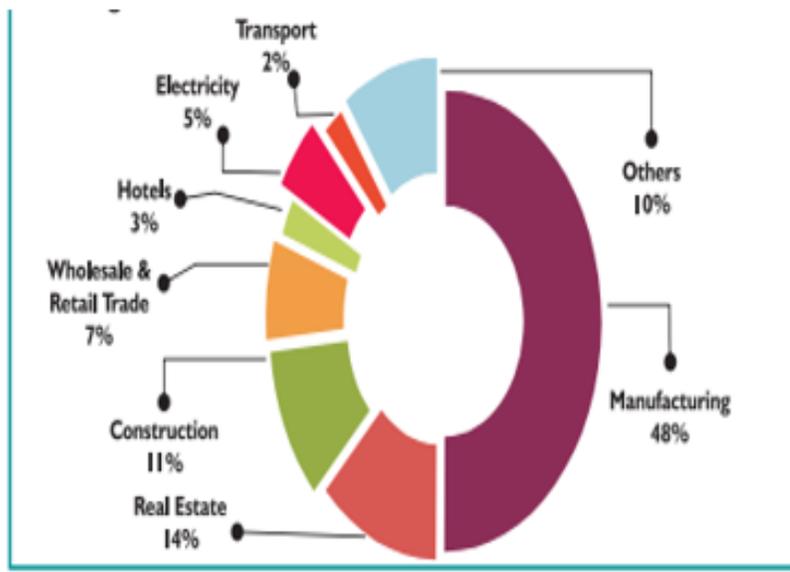
# Sectoral Distribution



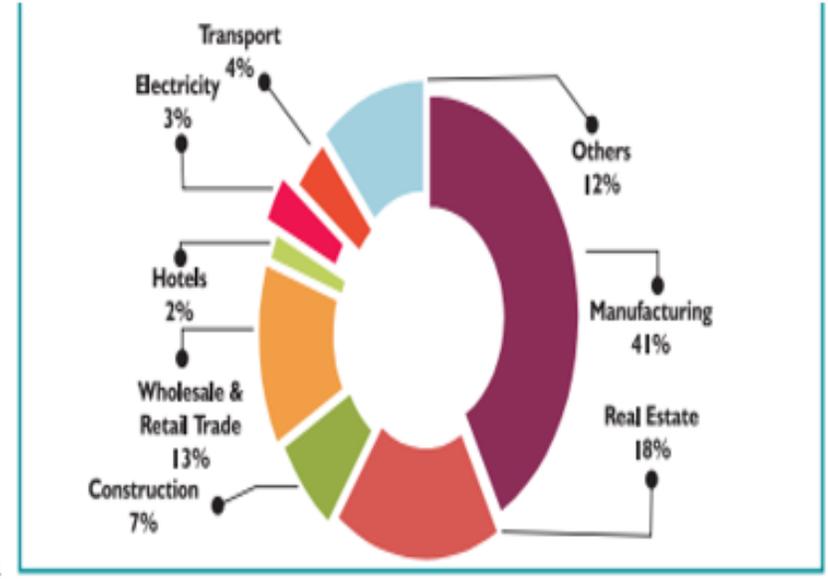
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(Amount in ₹ crore)

Stakeholders under Section	Number of Claimants	Amount of claims Admitted	Liquidation Value	Amount Realised	Amount Distributed
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**830 Liquidations where Final Report Submitted**

Stakeholder- wise data-

Haircuts to W&E?

52	86	10486.45	635.63	622.28	599.31
53 (1) (a)	NA	NA			627.57@
53 (1) (b)	5905	131227.64			5826.39
53 (1) (c)	4235	164.46			10.72
53 (1) (d)	1456	18009.85	7910.63	6754.87#	172.14
53 (1) (e)	946	10619.87			30.50
53 (1) (f)	7422	12049.43			93.48
53 (1) (g)	0	0			0
53 (1) (h)	163	860.22			9.77
<b>Total (A)</b>	<b>20213</b>	<b>183417.92</b>	<b>8546.26</b>	<b>7377.15#</b>	<b>7369.88</b>

# Comparing Select Asian Jurisdictions

- The applicable legal framework
- Workmen and Employees (W&E): Connotation and Standing
- Claims of W&E
  - Service Claims
  - Welfare claims
- Directors Duties vis-à-vis the W&E as Creditors;
- Preserving employment- Sale on a going concern basis in liquidation

India	Singapore	Vietnam	Thailand	Hong Kong
Insolvency and Bankruptcy Code, 2016	Insolvency, Restructuring, and Dissolution Act 2018	Bankruptcy 2014	Bankruptcy Act, 1940 and Civil and Commercial Code	no statutory/ formal insolvency resolution/ corporate rescue
				Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32 of the Laws of Hong Kong) (WUMP) and the Companies (Winding Up) Rules (Cap. 32H)

# Workmen and Employees- Connotation and Standing

- major percentage of the internal stakeholders of a CD across all the compared jurisdictions
- recognised in some jurisdictions as 'internal creditors' or 'service creditors' (in contradistinction to 'money' or financial creditors) of the company;
- empowered to initiate the resolution process for payment of their debts
- IBC creates a class within a class by a differential usage of the terms- "workmen" and the "employees" of a CD.
  - significant consequences with respect to their obligations and protections
  - scheme of classification- not been adopted by the IRDA, the LoB, 2014, and the Thai BA, 1940 which employs the term 'employees'

- Hong Kong WUMP employs five different terms- clerk, servant, labourer, workman, employee.
- Stipulating the preferential payments from the Protection of Wages on Insolvency Fund under section 18 of the Protection of Wages on Insolvency Ordinance (Cap. 380) to the specified stakeholders.

# W&E- as creditors

- Similar to the Indian law, the Vietnamese law, Thai law, and the IRDA- a right on the employees of a company to petition as a “creditor” the respective Courts for commencing insolvency resolution proceeding in respect of an insolvent company.
- “empower the workmen and employees to initiate insolvency proceedings, settle their dues fast and move on to some other job instead of waiting for their dues for years together as is the case under the existing regime. (India- BLRC, 2015)
- trade union/ representatives – Singapore and Vietnam; right of a trade union, representing the W&E of a CD to initiate a CIRP, as an OC in India- J. K. Jute Mill Mazdoor Morcha v. Juggilal Kamalapat Jute Mills Company Limited through its Director, (2019) 11 SCC 332.

- Representation on CoC- the CoC comprises only of all the financial creditors of the CD- India
- Singapore and Vietnam “representatives of employees” form an integral part of the CoC and participate in its meetings as creditors.

# Claims of Workmen

- Service claims
  - arise during the subsistence of employment, for the service rendered, including the salary, wages, bonus dues etc.;
  - jurisdictions like Thailand and Hong Kong, service-related claims are secured by a third party, an institution “wage- guarantee fund’ or a Board which oversees the “Protection of Wages on Insolvency Fund”
- Welfare claims
  - (terminal benefits) which arise after the cessation of the employment- PF, gratuity etc.
- **Preferential status:** some Asian jurisdictions (For example, India) acknowledge the contribution of W&E- ‘pari passu’ status or a position superior than even the secured creditors, on a case-to-case basis.

# Order of Priority of W&E dues/ claims in Resolution

- welfare- orientation of the law qua the service claims of the W&E as OCs.
- debts rank second and third in the waterfall of liabilities enunciated under section 53 (1) (b) and (c) of the IBC, respectively (See also section 296- IRDA).
- However, in Thailand, certain employee payments rank at number six in the order of distribution.
- Unlike India and Singapore where debts, in the nature of interim finance or rescue financing, respectively, if utilised for the purpose of 'business recovery' of the CD, **enjoy a preferential status or super priority (rank first in the waterfall)**, they rank third in Vietnam.

# Directors Duties vis-à-vis the W&E as Creditors

- principal duty of a director of a company is
  - to act in good faith, and “to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community, and for the protection of environment.
- Zone of insolvency- common law jurisdictions- the fiduciary duties of the directors shift towards the creditors of the company.
- W&E of a distressed company- become its ‘creditors’ on its insolvency- leading to a change of their legal status ex post from the one ex ante.
- it forms part of the duty(ies) of the directors to act in the best interests of the W&E, as creditors of the insolvent corporate entity, leading to best outcomes for the community and the society as a whole.

# Beneficial Liquidation- “going concern”

- liquidation order would not operate as an automatic discharge of the CD's employees and workers.
- Company survives and is retained as it was; the ownership of the Company is transferred by the Liquidator to the intended buyer or acquirer.

# Way Forward

- Balance between the rights of W&E and those of other creditors
- More data-centric regulations
- Haircuts be regulated- moderately
- Creditor duty of directors of insolvent firms be expanded
- Voice in resolution- SC judgment in India;

- Thank you