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The Inherent Fallacy: Examining the Scope of Interim Moratorium and Its Impact on Proceedings Under the Negotiable Instruments Act, 1881

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ABSTRACT

This paper examines the applicability of the interim moratorium under Section 96 of the Insolvency and Bankruptcy Code, 2016 to proceedings initiated under Section 138 of the Negotiable Instruments Act, 1881 for dishonour of cheques. While it is settled that the moratorium under Section 14 of the Code suspends such proceedings against corporate debtors, there is a judicial divide regarding the effect of the interim moratorium on personal guarantors of a corporate debtor, particularly those who are also directors and are vicariously liable under the Negotiable Instruments Act when such an offence is committed by the corporate debtor. This paper critiques the reasoning adopted by various High Courts in declining to suspend proceedings under the Act in view of the interim moratorium under Section 96 of the Code and, in particular, the inherent fallacy identified by the Delhi High Court in Sandeep Gupta v Shree Ram Traders. The author, through an analysis of the statutory framework, attempts to highlight the interpretative differences in the moratoriums under Sections 14 and 96 of the Code

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and argues that proceedings under the Act shall stand suspended once the interim moratorium is invoked.

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I. INTRODUCTION

The Insolvency & Bankruptcy Code, 2016 (Code) was introduced to harmonize and consolidate the legislative framework surrounding the rehabilitation of insolvents and recovery of the debts owed by them. Initially, only the provisions regarding the insolvency of corporate debtors were enforced. Subsequently, major portions of Part III of the Code came to be enforced, including provisions relating to the insolvency of individuals, particularly personal guarantors to corporate debtors.[1]

The provisions that deal with corporate persons under Part I of the Code are similar to the ones that apply to individuals under Part III. In particular, both implement a moratorium on proceedings with respect to

[1] Ministry of Corporate Affairs Notification S.O. 4126(E) [2019]. <https://www.mca.gov.in/Ministry/pdf/Notification_18112019.pdf>.

debt for which steps have been taken under the Code. This is done so that the companies, firms, or natural persons undergoing the resolution process are "given breathing space to recuperate for a successful resolution".[2]

It is now settled law that the moratorium under Part I of the Code suspends proceedings initiated for dishonour of cheques under the Negotiable Instruments Act, 1881 (Act), qua the corporate debtor.[3] However, judicial opinion is divided as to whether the interim moratorium, as applicable to individuals under Part III of the Code, would suspend these proceedings against the personal guarantors of a corporate debtor, who are also most often its directors. This is due to the fact that, on one hand, the Act imposes statutory liability on directors for the offence under Section 138, arising from their role as officers in charge of the company. On the other hand, they also bear a separate yet coextensive liability for the debt owed by the company as they often stand as surety for the said debts.[4] As such, these directors find themselves in a precarious position, ensnared by overlapping legal obligations amidst conflicting judicial interpretations.

II. LIABILITY UNDER THE ACT

In 1989, the Negotiable Instruments Act, 1881 was amended to introduce Chapter XVII.[5] The objective behind the amendment was to uphold the sanctity of financial instruments and reinforce businesses' trust in

[2] *P Mohanraj v Shah Bros. Ispat (P) Ltd* [2021] 6 SCC 258 [47].
[3] ibid.
[4] Indian Contract Act 1872, s 128.
[5] Act 66 of 1988, S. 4 (w.e.f. 1-4-1989 vide S.O. 240(E), dt. 29-3-1989).

transacting through cheques. Thus, dishonour of cheques came to be deemed as a penal offence in order to increase its acceptability as a mode of payment for commerce.[6]

In particular, Section 138 deems dishonour of cheques as an offence by the drawer, provided that the cheque was issued for discharge, in whole or in part, of legally enforceable debt or other liability.[7] The punishment prescribed is either imprisonment for a maximum period of two years, or fine which may extend to twice the amount of the dishonoured cheque, or both. However, its penal nature is limited as many of the procedural aspects of the Criminal Code[8] are not required to be followed.[9] In fact, divergence from standard criminal procedure is so pronounced that the offence may more aptly be described as a civil remedy masquerading as a criminal sanction.[10]

In cases where the drawer is a company, the Act fastens vicarious liability on every person who, at the time of the offence, was in charge of and responsible to the company for the conduct of its business, in addition to the liability of the company itself.[11] The directors, who are often the signing authority for cheques issued by their company, are thus made liable as a 'natural person' along with the company. However, this does not mean that only because a person is a director, he would be held

[6] *Electronics Trade & Technology Development Corpn. Ltd. v Indian Technologists & Engineers (Electronics) (P) Ltd* [1996] 2 SCC 739.
[7] Negotiable Instruments Act 1881, s 138.
[8] Bharatiya Nagarik Suraksha Sanhita 2024.
[9] See: Negotiable Instruments Act 1881, s 142, 143 and 147.
[10] *Ajay Kumar Radheshyam Goenka v Tourism Finance Corp. of India Ltd* [2023] 10 SCC 545 [17].
[11] Negotiable Instruments Act 1881, s 141.

vicariously liable. The Supreme Court of India, in *S.M.S. Pharmaceuticals Ltd. v Neeta Bhalla*[12], noted that the concept of vicarious liability represents a significant deviation from the established principles of criminal law. Accordingly, it was held that only the signatory of a cheque is clearly responsible while directors of a company cannot be held vicariously liable merely on the ground that they are directors. Instead, the complainant has to clearly show how that person was responsible for the conduct of the company at the time of the offence.[13]

III. MORATORIUMS UNDER THE CODE

The moratorium under Section 14 of Part I of the Code, as applicable to corporate debtors, is initiated by the Adjudicating Authority when it admits an application for initiation of insolvency and prohibits *inter alia* institution or continuation of suits or proceedings against the corporate debtor in any court of law or other authority and alienation of assets.

Part III of the Code provides for moratoriums at two different stages of the insolvency process. The interim moratorium under Section 96 commences, in relation to all debts, on the date an application for initiating insolvency is filed and prohibits initiation and continuation of any legal action or proceeding pending in respect of any debt.[14] This part also provides for a moratorium under Section 101, which commences after the application gets admitted by the Adjudicating Authority.[15] In addition to the restrictions imposed under the interim moratorium, this

[12] *S.M.S. Pharmaceuticals Ltd. v. Neeta Bhalla* [2005] 8 SCC 89.
[13] *Ashoke Mal Bafna v Upper India Steel Mfg & Engg Co Ltd* [2018] 14 SCC 202 [10].
[14] Insolvency & Bankruptcy Code 2016, s 96.
[15] Insolvency & Bankruptcy Code 2016, s 101.

moratorium also prohibits the debtor from alienating or encumbering his assets.

Upon perusal of the provisions on moratorium under the Code, one clear distinction comes to the fore. Although the objective of the moratorium is the same under both parts of the Code, there is a fundamental difference in their scope. The moratorium under Part I prohibits continuation or initiation of proceedings only 'against the corporate debtor' and does not extend to its guarantors.[16] Whereas the interim moratorium under Section 96 and the moratorium under Section 101 prohibit continuation or initiation of proceedings 'in respect of any debt', so that guarantors who may be entirely unrelated to the debtors would stand covered.[17] Thus, the moratoriums in Part III cover not just the debtor but 'any debt' and reflect its broader protective scope.

When Part III of the Code came to be enforced, its validity was questioned before the Supreme Court in *Dilip B. Jiwrajka v Union of India*.[18] A three-judge bench of the Supreme Court, while dismissing the challenge, noted the aforesaid difference and observed as follows:

> "57… The impact of the interim moratorium under Section 96 is that a legal action or proceeding pending in respect of any debt is deemed to have been stayed, and the creditors or the debtors shall not initiate any legal action or proceedings in respect of any debt. The crucial words which are used both in clause (b)(i) and

[16] *P. Mohanraj v Shah Bros Ispat (P) Ltd* [2021] 6 SCC 258.
[17] *SBI v V Ramakrishnan* [2018] 17 SCC 394.
[18] *Dilip B Jiwrajka v Union of India* [2024] 5 SCC 435.

> clause (b)(ii) of sub-section (1) of Section 96 are "in respect of any debt". These words indicate that the interim moratorium which is intended to operate by the legislature is primarily in respect of a debt as opposed to a debtor.
>
> 58. This must be contra-distinguished from the provisions for moratorium which are contained in Section 14 in relation to CIRP under Part II. Section 14(1)(a) provides that on the insolvency commencement date, the institution of suits or continuation of pending suits or proceedings against the corporate debtor… The purpose of the moratorium under Section 96 is protective. The object of the moratorium is to insulate the corporate debtor from the institution of legal actions or the continuation of legal actions or proceedings in respect of the debt."

Thus, once a creditor's claim against the corporate debtor is admitted, the creditor or the personal guarantor himself can invoke insolvency so as to prohibit initiation or continuation of proceedings or legal action in respect of any debt.[19]

IV. RECONCILING LIABILITY AS A 'NATURAL PERSON' & THE INTERIM MORATORIUM

As seen from the discussion above, the interim moratorium under Section 96 of the Code would prohibit initiation or continuation of

[19] Insolvency & Bankruptcy Code 2016, s 94 and 95.

proceedings in respect of any debt. However, the Madhya Pradesh High Court in *Anurodh Mittal v Rehat Trading Company*[20], the Punjab & Haryana High Court in *Charanbir Singh Sethi v Pooja Sharma*[21] and the Delhi High Court in *Sandeep Gupta v Shree Ram Traders*[22] (collectively referred to as High Court Cases) have held that a director cannot escape statutory liability under the Act merely because the interim moratorium has been invoked due to the filing of an application for initiating insolvency proceedings under Part III of the Code.

The High Courts primarily relied on *P. Mohanraj v Shah Bros. Ispat (P) Ltd.* (P. Mohanraj),[23] wherein a three-judge bench of the Supreme Court, after analysing the scheme of the Act and relevant precedents, held that proceedings under Section 138 of the Act are quasi-criminal in nature (similar to civil contempt proceedings) and therefore subject to the moratorium under Section 14 of the Code. It was concluded as under:

> "102. Since the corporate debtor would be covered by the moratorium provision contained in Section 14 IBC, by which continuation of Sections 138/141 proceedings against the corporate debtor and initiation of Sections 138/141 proceedings against the said debtor during the corporate insolvency resolution process are interdicted, what is stated in paras 51 and 59 in Aneeta Hada

[20] *Anurodh Mittal v Rehat Trading Company* [2024] (High Court of Madhya Pradesh). MCRC No.17782/2024.
[21] *Charanbir Singh Sethi v Pooja Sharma,* [2023] (High Court of Punjab & Haryana) PHHC:057793.
[22] *Sandeep Gupta v Shree Ram Traders,* MANU/DE/3189/2023
[23] *P Mohanraj v Shah Bros Ispat (P) Ltd* [2021] 6 SCC 258.

> *[Aneeta Hada v Godfather Travels & Tours (P) Ltd., (2012) 5 SCC 661]* would then become applicable. The legal impediment contained in Section 14 IBC would make it impossible for such proceeding to continue or be instituted against the corporate debtor. Thus, for the period of moratorium, since no Sections 138/141 proceeding can continue or be initiated against the corporate debtor because of a statutory bar, such proceedings can be initiated or continued against the persons mentioned in Sections 141(1) and (2) of the Negotiable Instruments Act. This being the case, it is clear that the moratorium provision contained in Section 14 IBC would apply only to the corporate debtor, the natural persons mentioned in Section 141 continuing to be statutorily liable under Chapter XVII of the Negotiable Instruments Act."

Additionally, the High Courts placed reliance on *Ajay Kumar Radheshyam Goenka v Tourism Finance Corp. of India Ltd.* (Ajay),[24] a subsequent decision by a coordinate bench of the Supreme Court, where the following conclusion was reached:

> "17. We have no hesitation in coming to the conclusion that the scope of nature of proceedings under the two Acts is quite different and would not intercede each other. In fact, a bare reading of Section 14 IBC would

[24] *Ajay Kumar Radheshyam Goenka v Tourism Finance Corp of India Ltd* [2023] 10 SCC 545.

> make it clear that the nature of proceedings which have to be kept in abeyance do not include criminal proceedings, which is the nature of proceedings under Section 138 of the NI Act. We are unable to appreciate the plea of the learned counsel for the appellant that because Section 138 of the NI Act proceedings arise from a default in financial debt, the proceedings under Section 138 should be taken as akin to civil proceedings rather than criminal proceedings. We cannot lose sight of the fact that Section 138 of the NI Act are not recovery proceedings. They are penal in character. A person may face imprisonment or fine or both under Section 138 of the NI Act. It is not a recovery of the amount with interest as a debt recovery proceedings would be. They are not akin to suit proceedings."

The High Court's reliance on *Ajay* and *P. Mohanraj* is misplaced. In *Ajay*, the central question before the Supreme Court was whether proceedings under the Act could be terminated against such directors, following the resolution or liquidation of the corporate debtor. The Court answered in the negative, noting that under the proviso to Section 32-A(1) of the Code, only the corporate debtor's liability is extinguished, while directors remain vicariously liable under the Act. Furthermore, the purposes underlying Sections 32-A and 14 of the Code are fundamentally distinct and cannot inform one another's interpretation. The former addresses the extinguishment of criminal liability for the corporate debtor, while the latter merely suspends proceedings. Accordingly, the

issue in the High Court Cases is categorically distinct from that considered by the Supreme Court in *Ajay*.

Notwithstanding the aforesaid, by holding that Section 14 of the Code would not suspend proceedings under Section 138 of the Act, the conclusion in *Ajay* directly conflicts with the Supreme Court's earlier decision in *P. Mohanraj* where such proceedings were held to be quasi-criminal and therefore prohibited by the application of the moratorium. A natural corollary to the decision in *P. Mohanraj* is that such directors would continue to be statutorily liable, for the reason that they were never the subject of the moratorium under Section 14 of the Code.[25] As such, the facts in *P. Mohanraj* are distinguishable from those in the High Court Cases, where the petitioners were not seeking a suspension of proceedings under Section 14 but rather under the interim moratorium provided under Section 96 of the Code. Therefore, neither *Ajay* nor *P. Mohanraj* provides a definitive answer to the issue at hand.

However, the Delhi High Court in *Sandeep Gupta*[26] took a more nuanced approach, observing that the argument for suspension of proceedings, under the Act, due to the interim moratorium suffers from an *"inherent fallacy"*. The single judge noted that such directors face trial as a 'Natural Person' for the company's liabilities, whereas the interim moratorium is triggered in relation to their personal liability as a guarantor. In other words, such directors are facing trial for the dishonour of a cheque issued

[25] *P Mohanraj v Shah Bros Ispat (P) Ltd* [2021] 6 SCC 258.
[26] *Sandeep Gupta v Shree Ram Traders,* MANU/DE/3189/2023.

in discharge of the company's debt and not for their own personal debt so as to bring it within the scope of the interim moratorium.

The author submits that the Delhi High Court has misconstrued the scope of Section 96. As discussed previously, the criteria for application of the interim moratorium to a proceeding is that it shall be in respect of a debt and not the debtor. Thus, whether the debtor was made liable for the debt statutorily or otherwise should not be of any concern because, at its core, the proceedings under the Act are 'in respect of' a debt. The essential requirement for the offence to be made out is that the dishonoured cheque was issued to discharge a legally enforceable debt.[27] The Supreme Court in *P. Mohanraj* itself noted that:

> "A legal action or proceeding in respect of any debt would, on its plain language, include a Section 138 proceeding. This is for the reason that a Section 138 proceeding would be a legal proceeding "in respect of" a debt. "In respect of" is a phrase which is wide and includes anything done directly or indirectly — see *Macquarie Bank Ltd. v Shilpi Cable Technologies Ltd.* (at p. 709) and *Giriraj Garg v Coal India Ltd.* (at pp. 202-203). This, coupled with the fact that the section is not limited to "recovery" of any debt, would indicate that any legal proceeding even indirectly relatable to recovery of any debt would be covered."

[27] *P Mohanraj v Shah Bros Ispat (P) Ltd* [2021] 6 SCC 258 [45]-[47].

The judgement in *P. Mohanraj* also reproduced and affirmed the following observations made by a Division Bench of the Supreme Court in *SBI v V Ramakrishnan*,[28] where the reason behind the incorporation of 'any debt' in the provision was discussed:

> "26.1. Section 14 refers only to debts due by corporate debtors, who are limited liability companies, and it is clear that in the vast majority of cases, personal guarantees are given by Directors who are in management of the companies. The object of the Code is not to allow such guarantors to escape from an independent and co-extensive liability to pay off the entire outstanding debt, which is why Section 14 is not applied to them. However, insofar as firms and individuals are concerned, guarantees are given in respect of individual debts by persons who have unlimited liability to pay them. And such guarantors may be complete strangers to the debtor — often it could be a personal friend. It is for this reason that the moratorium mentioned in Section 101 would cover such persons, as such moratorium is in relation to the debt and not the debtor."

Relying on the aforesaid observations, a coordinate bench of the Punjab & Haryana High Court in *Vijay Kumar Ghai v Pritpal Singh Babbar*

[28] *SBI v V Ramakrishnan* [2018] 17 SCC 394.

directed suspension of proceedings under Section 138 NI Act due to the application of the interim moratorium and held as follows:[29]

> "82… this court would have to interpret the terms "all the debts" and "any legal action or proceedings pending in respect of any debt" as occur in Section 96 of the Code, to mean that it would cover all such debts including any debt not pertaining to a corporate debtor for whom the accused in such a complaint under Section 138 stood as a personal guarantor to, even in his capacity as a Director of such corporate debtor.
>
> 83. This would be further so in the opinion of this court, because a "debt" has been defined in the absolutely generic meaning of the word, in Section 3(11) of the Code (falling in the preliminary Part-I thereof); and further, as admitted by learned counsel for the respondent, a debt as is subject matter of proceedings under Section 138 of the Act, has not been prescribed to be an "excluded debt" in terms of Section 79(e) of the Code."

Thus, the author asserts that the interim moratorium extends to proceedings under Section 138 of the Act, even when the debt does not arise from the debtor's personal capacity, but rather from their role as a director of the company that issued the dishonoured cheque.

[29] *Vijay Kumar Ghai v Pritpal Singh Babbar* (2023) 23 Comp Cas-OL 1032.

V. CONCLUSION

Through an in-depth analysis of statutory provisions and judicial decisions, this paper has attempted to highlight the divergent approaches adopted by various High Courts in interpreting the scope of the interim moratorium. The analysis has demonstrated that the judicial reluctance to suspend proceedings under the Act stems from a misconstrued interpretation of Section 96's language, which upon a plain reading covers proceedings and legal actions "in respect of any debt".

One possible reason for this reluctance could be the potential misuse of the interim moratorium, as it can be invoked by the personal guarantors themselves merely upon filing an application under Section 94 of the Code. Even the Ministry of Corporate Affairs has recognised this concern and suggested an amendment to make the interim moratorium inapplicable to personal guarantors.[30] Although no specific details regarding misuse have been mentioned, data released by them shows that out of the 1465 applications filed for initiation of insolvency under Part III of the Code, as of September 2022, over 90% have been filed by creditors of personal guarantors, with the remaining filed by the personal guarantors themselves.[31]

However, until the interim moratorium provision is amended, it is clear that cheque dishonour proceedings under the Act would have to be suspended once the interim moratorium is invoked. The "inherent fallacy" identified by the High Court of Delhi overlooks the broader

[30]Ministry of Corporate Affairs Insolvency Notice File No. 30/38/2021 [2023]. <7f55e29ae9c0023184a3895f849cd2ef.pdf>.
[31] ibid.

protective intent of the interim moratorium, which is designed to shield debtors from proceedings that could undermine the insolvency resolution process.