

Insolvency and Bankruptcy Law in India

Dr. A. Sridhar

NALSAR University of Law, Hyderabad

Week 04

Lecture 19

Welcome to all.

As part of the course on Insolvency and Bankruptcy Law in India, today, we will discuss the commencement of CIRP and the moratorium. So, before discussing today's concept, let us recap what we have discussed in the previous session. In the previous session, we also discussed the moratorium concept, including its objectives, why we are fixing it, and the provisions of sections 13 and 14. Then we discussed the purpose of the moratorium. Then we have discussed that once the moratorium is announced, it is going to stay the proceedings; the automatic stay of the proceedings means all the cases against the company will be stayed, and the moratorium does not extend to the subsidiary company.

So, one question is whether, if the moratorium is announced in favor of one corporate debtor or if the moratorium is announced in the case of one corporate debtor, it also extends to the subsidiary company. So, we have learned that the moratorium does not extend to subsidiary companies. Does the moratorium prevent the proceedings that are for the benefit of the corporate debtor? We learned that a moratorium does not prevent proceedings that benefit the corporate debtor. That means if any proceedings benefit the corporate debtor, they will continue even during the moratorium period.

Next, can Section 138 proceedings against the promoter continue even during the moratorium? Another question is whether, if you observe Section 138 of the Negotiable Instruments Act, which speaks about dishonor of a check, that is, check bounce cases, the opposite person—who is entitled to receive the payment and holds the check—has the right to file a case against the corporate debtor or any other person who issued the check, that is, against the drawer. So, the payee has the right to file a case against the drawer. As we already know, there are three parties in the case of a check: the drawer, the drawee, and the payee. The payee is the person who has the check, the drawer is the person who gave the check, and the drawee is always a banking institution that is liable to make the payment. In the case of a cheque, if the drawer gives the cheque to the payee and the payee presents the cheque to the banking institution, and the cheque is dishonoured because of the non-availability of funds, then the payee can file a case against the drawer.

So, this is the provision under Section 138. So please remember that section 138 is considered to be criminal proceedings. So, because it is considered to be an offense, and the person there is liable for imprisonment under section 138, read with other sections that follow, he is also liable for imprisonment. It is considered to be a criminal proceeding. Now, the question is whether these section 138 proceedings can continue against the promoter or not.

The Supreme Court, in the case of P Mohan Raj versus Shah Brothers Ispat Pvt. Ltd., held that the proceedings under Section 138 can continue against the directors. Because if the company is giving the cheque, in this case, the drawer happens to be the corporate debtor, which is the company. If the company gives a cheque to someone else, that someone else is a payee.

The payee can file a case against the drawer. So, on behalf of the company, the directors are the people who are actually liable. If the company is sued under section 138, you will make both the director and the company the opposite parties. That's why, in this case, the Supreme Court, in the case of P. Mohanraj v. Shah Brothers, Ispat Private Limited, held that you can continue the proceedings against the director but not against the company. In the Section 138 case, both parties will be present: the director and the company. So, the above judgment is once again reiterated by the Supreme Court. In another case, Gimpex Pvt. Ltd. vs. Manoj Goyal. In another case, Naag Leathers Pvt. Ltd. vs. Dynamic Marketing Partnership.

The case of P. Mohanraj versus Shah Brothers is part of Pvt. Ltd. Where it was held that criminal proceedings, that is, section 138 proceedings, can continue against the promoter during the moratorium period, the Supreme Court held that yes, you can continue. The same thing is reiterated that is reconfirmed by the Supreme Court in the case of Gimpex Pvt. Ltd. versus Manoj Goyal and in another case, Naag Leather Private Limited vs. Dynamic Marketing Partnership. In both cases, the Supreme Court supported the judgment or reiterated the judgment in Mohanraj's case. So, is the moratorium terminated? Does the moratorium terminate or nullify existing contracts of CD? When the moratorium is implemented, will it terminate or nullify existing contracts? No. The Kolkata High Court in the case of Gauri Shankar Jain versus Punjab National Bank.

The effect of the moratorium is only temporary. Please remember. Though we are imposing restrictions on filing the cases or initiating any proceedings and transferring the property, it is only temporary in nature because the moratorium will be enforced from the date of initiation of CIRP till, maybe under section 31, maybe under section 33, when the court, that is, the NCLT, is passing the order. So that's why in the case of Gowri Shankar Jain versus Punjab National Bank, the Kolkata High Court held that the effect of the moratorium is temporary in nature. The rights remain unaffected and intact, so we are not going to affect the rights, but such rights are suspended for a temporary period.

So, we are not totally canceling the rights; we are only suspending the rights. So, there is an impact of the moratorium. So, what is barred by the law of limitation is the right to remedy, not the right itself. So, it does not mean that when I impose the moratorium, I don't have the right. I have the right, but now I cannot enforce my right against the company.

Subsequently, once the moratorium is completed or has lapsed, I can once again exercise the rights against the company. So, my right is not violated; my right is not suspended; it is only the right to remedy that is suspended during the moratorium period. Then the moratorium and CIRP do not improve or enhance the rights of the CD. Please remember, so here, the rights of the financial creditor and operational creditor are suspended, but this does not mean that the rights of this CD are going to improve. The CIRP process does not improve and enhance the rights of the corporate debtor, so the rights of the corporate debtor are not going to be improved.

So, the Supreme Court, in the case of Embassy Property Developments Private Limited versus State of Karnataka, held that the moratorium should not be considered a panacea for all that is wrong done by the corporate debtor and should not be considered an escape route to evade any action by the statutory authority. In this case, the Supreme Court clearly held that, please remember, if the corporate debtor does any wrong, the corporate debtor shall be liable; thus, the concept of a moratorium cannot be considered an escape route. So, to evade the action by the statutory authority, why? Statutory authorities always have rights against the corporate debtor. So, they can file a case against the corporate debtor at any point in time, but during the moratorium period, they cannot file; this does not mean that they don't have the right. The right is suspended for a temporary period.

So, the moratorium can never be used as an escape route to evade any action by the statutory authority. Statutory dues cannot be recovered or are not recoverable in the exercise of statutory powers by the statutory authority. Statutory dues are there like taxes; we are supposed to pay the taxes, municipal taxes, income tax, GST, etc., so these are all various liabilities or amounts that I am supposed to pay as a corporate debtor. I am supposed to pay, so here, these rights cannot be recovered in the exercise of the statutory powers by the statutory authority.

So, during the moratorium period, you cannot recover any money. It was held in the case of Principal CIT versus Monnet Ispat and Energy Limited. In this case, the Supreme Court held that the moratorium bars any coercive action taken by the statutory authority to recover its dues. Once the moratorium is implemented or comes into enforcement, no statutory authority can coerce. Coerce means to force, so they cannot coerce the corporate debtor to recover the money.

They cannot file any case; they cannot influence the corporate debtor to recover the money. Then, in another case, Anju Agarwal versus Bombay Stock Exchange, the NCLAT, National Company Law Appellate Tribunal, held that there was a moratorium on the outstanding amount payable to SEBI. If any amount is payable to SEBI, maybe SEBI has imposed some penalty, or maybe there is a violation of insider trading, or maybe some regulations were violated. In such cases, if SEBI has imposed any penalty or if you are liable to pay some amount to SEBI, then whether a moratorium is applicable or whether a moratorium is applied on the outstanding amount or not yes, a moratorium on the outstanding amount payable to SEBI is applied, so you are not liable to pay immediately. Then, can the attachment of property by a statutory authority continue? No, it cannot continue.

Suppose we take the example of a statutory authority; imagine the corporate debtor fails to pay some amount, maybe some taxes. As a statutory authority, you have the right to attach the property of the corporate debtor as if you were recovering the money. To recover the money, you are having the attachment, and subsequently, you are going to give notice if the corporate debtor fails to make the payment; then you are going to sell the property. So that is the general process. You have the power to recover under the revenue legislation.

So, as a revenue collector, you can recover the property; that is a general process. But whether the attachment is affected if a moratorium is imposed, then can you attach the property? In *B. Parameshwara Udpa v. Assistant Provident Fund Commissioner*, the NCLAT held that the EPFO's attachment of the CD's bank account cannot be continued; therefore, you cannot attach the property. Once the moratorium is enforced, even you cannot attach the property that belongs to the corporate debtor.

Attachment under the Prevention of Money Laundering, so can you attach the property under the Prevention of Money Laundering? Generally, whenever any offenses happen, okay, under the Prevention of Money Laundering Act, if money laundering is involved, then in such cases, the Directorate, generally under the Prevention of Money Laundering Act, which is called the PMLA Act, what they are going to do is attach the property first. They are going to attach the property; subsequently, once the case is decided, they are going to sell the property. And please remember, anything that happens under the Prevention of Money Laundering Act is generally considered to be an offense. Please remember, when someone is doing money laundering, it is considered an offense. That's why the offenses under the Prevention of Money Laundering Act are criminal in nature.

When I use the word "offense," it obviously denotes criminality. Now, the general principle is that criminal proceedings cannot be stalled because of the moratorium; criminal proceedings cannot be stalled. The question is that under the Money Laundering

Act, whenever you attach the property, it is a property. So, whenever you are attaching the property of the accused.

Can they attach the property or not? There is no unanimous opinion; contrary views are present. Different courts have given different opinions. Let us look at that in the case of Varsana Ispat Limited versus Deputy Director General of the Directorate of Enforcement. NCLAT, in this case, held that section 14 is not applicable to the criminal proceedings because the proceedings under the Money Laundering Act are in the nature of criminal proceedings; therefore, section 14 is not applicable. This is the decision given by the NCLAT, but contrary to that, in the case of Rajiv Chakraborty, Resolution Professional of EIEL, versus the Directorate of Enforcement.

In this case, the Delhi High Court held that the legislature thus chose to embargo the continuation of criminal proceedings, including the action of attachment under the PMLA. So, when the Delhi High Court interprets the IBC legislation, it goes to its basic purpose—the basic purpose of why the legislation was enacted. The Delhi High Court is of the opinion that when the legislature is making the section 14 legislation, they know that there is another legislation, the PMLA Act. So, under the PMLA Act, property can be attached.

They are well aware of that. Even after knowing that under the PMLA Act, the directorate and the authorities can attach the property. Section 14 specifically provides that you cannot attach, alienate, or transfer any property of the corporate debtor. When the legislature knows that there is another piece of legislation in place where you can attach property, now under this IBC, you are saying that you cannot attach any property, so they are well aware of other legislation. That's why the Delhi High Court held that the legislative intention is that Section 14 must be implemented, even in the case of the Money Laundering Act. Accordingly, the Delhi High Court held that Section 14 can be enforced.

If there are so many judgments on this issue. There are so many judgments. The Delhi High Court, Calcutta High Court, and many NCLTs have given various judgments, expressing different opinions. We have contrary views. However, by looking at all these judgments, we can understand that prior to the approval of the resolution plan, the pendency of the moratorium is not a bar.

Let us now discuss another concept: the power of contempt. The question is whether, under section 14, when you implement the moratorium or when the moratorium comes into effect, the court can issue an order for contempt of court against the company. Why? Whenever an issue fails to follow court orders, the court generally will issue an order for contempt of court. Then, against whom is the contempt of court order given? They are liable. Now, can you create the liability like this? In the case of Ved Prakash Abbott

versus Kishore K Avarsekar, the Delhi High Court held that the power of contempt is a constitutional power because under the Constitution of India, the High Courts and Supreme Court have the power to punish any person for contempt of court, which is a constitutional right.

That's why the constitutional rights, as we have already discussed previously in the previous class. The next concept is whether the court has the power to punish under the constitutional provisions. Under the Constitution of India, both the High Court and the Supreme Court have the power to punish any person for contempt of court. If they fail to follow orders given by the court, in such cases, the High Court and the Supreme Court, under the Constitution of India, have the power to punish any person for contempt of court. Now, the question is whether the High Court can punish the CD when the moratorium is implemented or when Section 14 comes into effect.

In the case of Ved Prakash Abbott versus Kishore K. Avarsekar, the Delhi High Court held that the power of contempt is a constitutional power. As we have discussed previously, constitutional powers are not barred. Constitutional rights and constitutional powers are not barred by the moratorium; therefore, there is no bar, and it is not barred by the declaration of moratorium. The court can always issue an order for contempt of court.

Whether a set-off of an adjustment of monies for pre-CIRP dues during the moratorium is barred or not. So, some adjustments were there before CIRP. During the moratorium, can you make such adjustments or set off? Is it possible or not? In State Bank of India versus Debashish Nanda, the NCLAT held that the bank cannot set off or adjust the amount from the CD account during the moratorium period. Though, as per the law, the bank has a general lien, the banking company can have a general lien. We are going to discuss how this concept is actually discussed under contract law.

A banking company can have a general lien on the bank account. But when a moratorium is in place during the moratorium period, the bank cannot set off or adjust amounts from the bank account, nor can it adjust from the CD account. So, a set-off of an adjustment of money that belongs to the pre-CIRP cannot be adjusted during the moratorium period; that is barred. Whether you can encash the cheque, suppose we take the example of the CD corporate debtor; they have given the cheque to another person, an opposite person, or a third party. Whether the third party can encash it depends on the fact that when you encash, you are creating a liability.

You are withdrawing the money, whereby corporate data is paying the money. That is the basic meaning of encashing the cheque. Can you encash the cheque or not? No, you cannot encash the cheque. In Sri Equipment Finance Limited versus Amit Gupta, the NCLAT held that post-dated cheques cannot be encashed during the moratorium period.

Therefore, this possibility exists. The corporate debtor has already given one cheque, which is a post-dated cheque. If the customer or any creditor wanted to encash it, is it possible? No, even though it is post-dated, it is not possible to encash the cheque. So, it was held in the case of Sri Equipment Finance Limited versus Amit Gupta. Another question mark is there under the section itself: essential services cannot be terminated. So, if you observe what is considered to be essential services, if you observe Regulation 32 of IBBI Insolvency Resolution Process for Corporate Persons Regulations 2016, the following are considered to be essential services: electricity, water, telecommunication services, and information technology services.

So, these four are considered to be essential services, and please remember that to the extent these are not a direct input to the output produced or supplied by the corporation. That means if I am using this electricity, water, and telecommunication to manufacture or render the services. So, if electricity is an input, I am using it to carry out the manufacturing process. It is not considered to be an essential service for the going concern, human consumption. If electricity, water, telecommunication services, and information technology services are provided, then these are all considered to be essential services.

Please remember. The expenses for these services shall be included in the resolution cost. If these things—electricity, water, etc.—are used as a direct input to the output produced or supplied by the corporation, then in such cases, that is not considered acceptable. In the case of ICICI Bank Limited versus Innoventive Industries Limited, the NCLT held that electricity, water, etc., are considered to be essential as long as these services are not a requirement of the output produced or supplied by the CD.

When electricity and water are considered essential, they are deemed necessary as long as they are not used as a requirement for the output. I'm not engaging in any manufacturing activity. For the regular day-to-day activities essential to human existence, electricity, water, etc., are all considered to be essential services. In another case, RP of Perfect Color Digital Prince Private Limited versus Dakshin Haryana Bijli Vitran Nigam, the NCLAT held that electricity is essential.

And whenever you are providing electricity to the corporate debtor, the cost should be included in the resolution cost. As I already told you, the amount spent on essentials such as electricity, water, telecommunication, etc., must be included in the resolution cost. There is a moratorium in another case, Dakshin Gujarat Vij Company Limited versus ABG Shipyard Limited. So, in this case, NCLAT already held that the moratorium does not prohibit payments to essentials suppliers.

It is accounted for the resolution cost, so please remember that when a moratorium is in place, as we have already discussed, essentials are an exception to that. Generally, you

cannot make any payment, but essentials are an exception to that. So, what we are going to do is that we may not pay immediately, but it is accounted for in the resolution cost. Then subsequently, when the resolution process is completed, we are going to make the payment to the result. As we are going to discuss in the subsequent lessons about the waterfall mechanism, in the waterfall mechanism, we are supposed to pay the resolution cost first.

So, these essentials are accounted for in the resolution cost. Now, what are all the transactions that are exempt from the moratorium? Section 14, subsection 3 speaks about the transactions; such transactions, agreements, or other arrangements as may be notified by the central government in consultation with any financial sector regulator or other authority. Under section 14, subsection 3, the central government has the power to notify such transactions and agreements as exempted. Under subsection 3, a surety in a contract of guarantee to a corporate debtor means that if any individual is a surety to the corporate debtor, then the moratorium is not applicable.

You can always exercise. A right against the surety. So, this transaction is specifically exempted under the legislation. Then let us discuss some other sections that are relevant. So, in the case of the moratorium, section 31, subsection 3 provides that after the order of approval under subsection 1, the moratorium order passed by the adjudicating authority under section 14 shall cease to have effect. As we have already discussed, sections 31 and 33. So, under section 31, once the resolution plan is approved, the adjudicating authority will approve it because it has to be approved by the COC.

Once the COC approves it, it will be placed before the adjudicating authority. In the subsequent lessons, we are going to discuss the procedure, okay? So, once the adjudicating authority approves the resolution plan, the moratorium given under the section automatically ceases to have effect. On that day, the moratorium lapses. It has expired. So, the moratorium ceases as soon as the resolution plan is approved by the adjudicating authority; this is section 31.

Then, another section, section 74, speaks about the punishment. Section 74 states the punishment for contravention of a moratorium or resolution plan. where the corporate debtor or any of its officers violates the provisions of section 14. So, as we have already discussed, section 14 provides for a moratorium. So, during the moratorium, you are not supposed to transact anything as corporate data; officers of the corporate debtor are not supposed to do any transactions. If any officer violates the provisions of section 14, any such officer who knowingly or willfully commits, authorizes, or permits such contravention shall be punishable with imprisonment.

So, there is a punishment, which shall not be less than three years and may extend to five years, or with a fine that shall not be less than one lakh rupees but may extend to three

lakh rupees. So now, when you are violating section 14 as an officer of the company, you are also punishable, and that is provided under section 74. Then it further provides that, where any creditor violates the provisions of Section 14, any person who knowingly and willfully authorizes or permits such contravention by the creditor shall be punishable. Any person who authorizes the creditor to do so is in violation of Section 14. Then such a person shall be liable to imprisonment for not less than one lakh to one year, which may extend to five years, and a fine of not less than one lakh rupees, which may extend to one crore rupees.

So, imprisonment can be from one year to five years, and the penalty can be from one lakh to one crore rupees, or both. Both are possible. So, there is a possibility that the adjudicating authority may impose imprisonment as well as a penalty. Depending on the circumstances, another subsection, section 74, only applies under the subsection where the corporate debtor, any of its officers, or creditors, or any person on whom the approved resolution plan is binding under section 31. So, as we have already discussed, the Section 31 resolution plan is approved by the NCLT.

Where the corporate debtor or any of its officers or creditors or any person on whom the resolution plan is binding under section 31 knowingly and willfully contravenes any of the provisions of the terms of the resolution plan, or abates such contravention, such corporate debtor, officer, creditor, or person, whether a corporate debtor, officer, creditor, or any other person, who is abating or contravening the provisions, shall be liable to pay a penalty of imprisonment not less than one year, which may extend to five years, and a penalty of 1 lakh rupees, which may extend to 1 crore rupees. So, we are imposing the penalty on the corporate debtor and the company's officers or creditors. You can understand that the imposition of the moratorium is to be considered serious enough to warrant punishment if not followed. So, you can understand from section 74 that failing to follow the moratorium is considered very serious, and punishment can also be imposed on the persons who are violating it.

So let us discuss what we have discussed. Let us recap what we have discussed so far. So, in these classes. We have discussed what a moratorium is, and then, subsequently, we have discussed when the moratorium is applicable, as we have already discussed under Section 14. So, when the CIRP process starts, that is, when the application made by the financial creditor, operational creditor, or corporate debtor is admitted by the NCLT, then the moratorium will be applicable.

So, here we have discussed what the meaning of moratorium is, etc., etc. Then, subsequently, we have discussed transactions where the moratorium is not applicable. We have discussed when the moratorium is applicable; we have also discussed where the moratorium is not applicable. Then subsequently, we discussed punishment in case of non-compliance. So, under section 74, we discussed that whenever there is a moratorium,

if any creditor, company, etc., or officers of the company violate it, then imprisonment as well as a penalty is applicable.

So, in these lessons, we discussed what a moratorium is, when a moratorium is applicable, and the transactions where a moratorium is not applicable, along with punishment in case of non-compliance.

Thank you.