

# Insolvency and Bankruptcy Hotline

June 08, 2023

## DISSECTING THE INSOLVENCY CODE – SCOPE AND IMPACT OF INTERIM MORATORIUM FOR INDIVIDUALS

### INTRODUCTION

Part III of the Insolvency and Bankruptcy Code, 2016 (“**Code**”) deals with the insolvency resolution and bankruptcy process for individuals and partnership firms. Section 96(1) provides that upon the filing of an application to initiate the insolvency resolution process either by a debtor,<sup>1</sup> or a creditor,<sup>2</sup> an interim moratorium comes into effect. During the interim moratorium period:

- (i) any ongoing legal proceedings pertaining to any debt are deemed to have been stayed, and
- (ii) the creditors of the debtor cannot initiate any legal proceedings or take any legal action in respect of any debt.

The interim moratorium ceases on the date on which the insolvency application is admitted or rejected by the Adjudicating Authority.<sup>3</sup> If the insolvency application is admitted, another moratorium commences for a period of 180 days from the date of admission or the date on which the Adjudicating Authority passes an order on the repayment plan under Section 114, whichever is earlier.<sup>4</sup>

In this article, we have discussed the scope of protection provided to individuals during an interim moratorium under Section 96 of the Code.

### SCOPE OF INTERIM-MORATORIUM UNDER SECTION 96

The purpose of a moratorium provided to corporate debtors under Part II is to attract potential acquirers who can revive the corporate debtor.<sup>5</sup> On the other hand, the purpose of a moratorium provided to individuals under Part III is to aid the repayment or resolution of debt.

#### (a) *Wilful defaulter proceedings*

Under the ‘Master Circular on Wilful Defaulters’ published by the Reserve Bank of India in 2015 (“**Master Circular**”), a ‘wilful default’ is deemed to have occurred if any of the conditions listed therein is fulfilled. Therefore, if a borrower has defaulted in its payment obligations despite having the capacity to repay the loan or has diverted funds for purposes other than those for which they were sanctioned, such borrower is deemed to have committed a wilful default.<sup>6</sup> In *Adarsh Jhunjunwala v. State Bank of India & Anr.*,<sup>7</sup> the Calcutta High Court explained that the purpose of a wilful defaulter proceeding is to ensure that credit information regarding the wilful defaulters is widely disseminated so that other lenders are alerted and do not extend further credit to such debtors.<sup>8</sup> The primary object of the circular is to prevent any further fraudulent activities that could result in the loss of public money.

In *Adarsh Jhunjunwala*, the Petitioner cited ongoing interim moratorium under IBC, to obtain a stay on an order passed by the State Bank of India which declared the Petitioner as a ‘wilful defaulter’. The Calcutta High Court noted that if wilful defaulter proceedings, criminal proceedings, or quasi-criminal proceedings are stayed during an interim moratorium under Section 96, the same would defeat the object and purpose of the Code. The Court further stated that allowing interim moratorium under IBC to stall wilful defaulter proceedings would have the effect of promoting impropriety and illegality, by ‘*permitting a wrong doer to commit further wrongs*’.

#### (b) *Quasi-criminal proceedings under the Negotiable Instruments Act.*

The Supreme Court in the case of *P. Mohanraj and Ors. v. Shah Brothers Ispat Private Limited*,<sup>9</sup> while interpreting the scope of interim moratorium under the IBC explained that Section 96 includes the phrase ‘*in respect of any debt*’ which imputes a wider connotation, whereby a legal action/proceedings ‘in respect of any debt’ would include proceedings under Section 138 of the Negotiable Instruments Act, 1881 (“**NI Act**”). Therefore, an interim moratorium under Section 96 extends to all proceedings under Section 138 of the NI Act. As a result, a creditor would be prohibited from initiating legal action/proceedings that is directly or indirectly relatable to the recovery of any debt.

### APPLICABILITY OF INTERIM MORATORIUM TO FUTURE LIABILITIES

The National Company Law Appellate Tribunal (“**NCLAT**”) in *Ashok Mahindru and Ors. v. Vivek Parti*,<sup>10</sup> while explaining the scope of application of interim moratorium under Section 96 of the Code stated that interim moratorium applies for only such proceedings which relate to a liability or obligation which is due on the date of commencement of the interim moratorium. Accordingly, any proceeding in relation to a liability/obligation which arises after the commencement of the interim moratorium cannot be stayed under Section 96. In *Ashok Mahindru*, the Appellant had sought stay on proceedings under Section 19(2),<sup>11</sup> Section 66,<sup>12</sup> and Section 67 of the IBC.<sup>13</sup> Based

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on the aforesaid reasoning, the NCLAT held that such a stay cannot be granted as the same is not contemplated within the scheme of Code.

## WAY FORWARD

When an application is filed under Part III, an interim moratorium is applicable in respect of any debt due from an individual and/or a personal guarantor to a corporate debtor. The Supreme Court, in *State Bank of India v.*

*Ramakrishnan*,<sup>14</sup> had held that the protection of moratorium under Section 96 and Section 101 is far greater than that under Section 14 as a stay under Section 96 implies that all legal proceedings in respect of the 'debt' and not the 'debtor' are stayed.

In the insolvency resolution of a personal guarantor to a corporate debtor, any legal action or proceeding in respect of any debt owed by the personal guarantor is stayed during the interim moratorium. As a result, other creditors of a personal guarantor cannot initiate any legal action in respect of the assets of such a personal guarantor. Therefore, the assets available with the personal guarantor remain protected from a solitary action by creditors, which leaves the creditors in a better position with respect to realization of dues.

Recently, the Ministry of Corporate Affairs ("**MCA**") issued a public notice inviting comments on changes being considered to the Code ("**Notice**").<sup>15</sup> Paragraph 22.2 of the Notice stated that the MCA is considering an amendment to Section 96 so as to remove its applicability to personal guarantors as there has been an apparent 'misuse of initiation of the insolvency application by personal guarantors to take advantage of the interim moratorium'. While the Notice fails to set out any further detail with respect to such misuse, it remains to be seen how the stakeholders respond.

– **Adimesh Lochan, Arjun Gupta & Sahil Kanuga**

You can direct your queries or comments to the authors

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<sup>1</sup>Section 94, Insolvency and Bankruptcy Code, 2016.

<sup>2</sup>Section 95, Insolvency and Bankruptcy Code, 2016.

<sup>3</sup>Section 100, Insolvency and Bankruptcy Code, 2016.

<sup>4</sup>Section 101, Insolvency and Bankruptcy Code, 2016.

<sup>5</sup>*Adarsh Jhunjhunwala v. State Bank of India & Anr.*, 2021 SCC OnLine Cal 3351, 14.

<sup>6</sup>Clause 2.1.3 Wilful Default, Master Circular on Wilful Defaulters

A 'wilful default' would be deemed to have occurred if any of the following events is noted: a. The unit has defaulted in meeting its payment / repayment obligations to the lender even when it has the capacity to honour the said obligations.

b. The unit has defaulted in meeting its payment / repayment obligations to the lender and has not utilised the finance from the lender for the specific purposes for which finance was availed of but has diverted the funds for other purposes.

c. The unit has defaulted in meeting its payment / repayment obligations to the lender and has siphoned off the funds so that the funds have not been utilised for the specific purpose for which finance was availed of, nor are the funds available with the unit in the form of other assets.

d. The unit has defaulted in meeting its payment / repayment obligations to the lender and has also disposed off or removed the movable fixed assets or immovable property given for the purpose of securing a term loan without the knowledge of the bank / lender.

72021 SCC OnLine Cal 3351.

<sup>8</sup>Para 15

<sup>9</sup>(2021) 6 SCC 258, 27.

<sup>10</sup>2022 SCC OnLine NCLAT 460 9.

<sup>11</sup>Personnel to extend cooperation to interim resolution professional

<sup>12</sup>Fraudulent trading or wrongful trading

<sup>13</sup>Proceedings under section 66

<sup>14</sup>(2018) 17 SCC 394, 26, 26.1.

<sup>15</sup>[https://www.mca.gov.in/content/da\\_m/mca/pdf/IBC-2016-20\\_230118.pdf](https://www.mca.gov.in/content/da_m/mca/pdf/IBC-2016-20_230118.pdf)

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