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Section 138 NI Act versus Moratorium in IBC



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In recent times of increasing economic fraud and cheating, Section 138 of Negotiable Instruments Act, 1881 which prescribe liability of the drawer of cheque in the event the cheque is dishonoured, provides safeguard to holder of cheque. However, due to multiplicity of litigation in various legislations cause delay in disposal of complaints under Section 138 and thereby diluting the effect and application of the provision.

The moratorium initiated under Section 14 of the Insolvency and Bankruptcy Code 2016 (**IBC**) is a mechanism to secure the assets of the corporate debtor, once the corporate insolvency resolution process has been initiated, in order to ensure the concept of going-concern and also protect the interest of the new management and control of the corporate debtor. The provision read as follow:-

"(1) Subject to provisions of sub-sections (2) and (3), on the insolvency commencement date, the Adjudicating Authority shall by order declare moratorium for prohibiting all of the following, namely:--

- (a) ***the institution of suits or continuation of pending suits or proceedings against the corporate debtor including execution of any judgment, decree or order in any court of law, tribunal, arbitration panel or other authority;***
- (b) *transferring, encumbering, alienating or disposing of by the corporate debtor any of its assets or any legal right or beneficial interest therein;*
- (c) *any action to foreclose, recover or enforce any security interest created by the corporate debtor in respect of its property including any action under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002);*
- (d) *the recovery of any property by an owner or less or where such property is occupied by or in the possession of the corporate debtor.*

Explanation.--For the purposes of this sub-section, it is hereby clarified that notwithstanding anything contained in any other law for the time being in force, a license, permit, registration, quota, concession, clearances or a similar grant or right given by the Central Government, State Government, local authority, sectoral regulator or any other authority constituted under any other law for the time being in force, shall not be suspended or terminated on the grounds of insolvency, subject to the condition that there is no default in payment of current dues arising for the use or continuation of the license, permit, registration, quota, concession, clearances or a similar grant or right during the moratorium period;

(2) *The supply of essential goods or services to the corporate debtor as may be specified shall not be terminated or suspended or interrupted during moratorium period.*

(2A) *Where the interim resolution professional or resolution professional, as the case may be, considers the supply of goods or services critical to protect and preserve the value of the corporate debtor and manage the operations of such corporate debtor as a going concern, then the supply of such goods or services shall not be terminated, suspended or interrupted during the period of moratorium, except where*

such corporate debtor has not paid dues arising from such supply during the moratorium period or in such circumstances as may be specified;

- (3) *The provisions of sub-section (1) shall not apply to--*
- (a) *such transactions, agreements or other arrangements as may be notified by the Central Government in consultation with any financial sector regulator or any other authority;*
 - (b) *a surety in a contract of guarantee to a corporate debtor.*
- (4) *The order of moratorium shall have effect from the date of such order till the completion of the corporate insolvency resolution process:*

Provided that where at any time during the corporate insolvency resolution process period, if the Adjudicating Authority approves the resolution plan under sub-section (1) of section 31 or passes an order for liquidation of corporate debtor under section 33, the moratorium shall cease to have effect from the date of such approval or liquidation order, as the case may be."

The application of Section 14 under IBC and its effect on the simultaneous litigation proceedings under various legislation whether general or special in nature has been moot question on multiple occasion before the learned Court, which has resulted in different approach and multiple viewpoint on the same issue.

The present article discusses a similar interplay between moratorium under Section 14 IBC and pending trial under Section 138 read with 141 of the Negotiable Instruments Act 1881. The provision under Section 141 NI Act reads as:-

- "(1) If the person committing an offence under section 138 is a company, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly:*

Provided that nothing contained in this sub-section shall

render any person liable to punishment if he proves that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent the commission of such offence:

Provided further that where a person is nominated as a Director of a company by virtue of his holding any office or employment in the Central Government or State Government or a financial corporation owned or controlled by the Central Government or the State Government, as the case may be, he shall not be liable for prosecution under this Chapter.

- (2) *Notwithstanding anything contained in sub-section (1), where any offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to, any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.*

Explanation.-- For the purposes of this section, --

- (a) *"company" means any body corporate and includes a firm or other association of individuals; and*
- (b) *"director", in relation to a firm, means a partner in the firm."*

On this issue various High Courts present diverging opinions which got resolved by the Hon'ble Supreme Court through its judgment in ***P. Mohanraj v. Shah Brothers Ispat Private Ltd.***¹ whereby the Hon'ble Court concluded that:

"103. In conclusion, disagreeing with the Bombay High Court and the Calcutta High Court judgments in Tayal Cotton (P) Ltd. v. State of Maharashtra, [2018] 97 taxmann.com 12 / 149 SCL 453 (Bom.) : (2019) 1 Mah LJ 312 and MBL Infrastructure Ltd. v. Manik Chand Somani C.R.R. 3456 of 2018 with C.R.A.N. 679 of 2019 (extension) with C.R.A.N. 771 of 2019, dated 16-4-2019 respectively, we hold that a Sections 138/141 proceeding against a corporate debtor is covered by Section 14(1)(a) IBC

104. Resultantly, the civil appeal is allowed and the judgment under appeal is set aside. However, the Sections 138/141 proceedings in

this case will continue both against the Company as well as the appellants (the directors of the Company) for the reason given by us in paras 101 and 102 above as well as the fact that the insolvency resolution process does not involve a new management taking over. We may also note that the moratorium period has come to an end in this case."

The Hon'ble Court vide the aforesaid judgment has explicitly stated that the moratorium caused on account of initiation of corporate insolvency resolution process in terms of IBC shall fall within the purview of Section 14(1)(a) of IBC. The Hon'ble Court carved out exception to the above rule if the new management taking over the corporate debtor is not different from the old management. Further, the Hon'ble Court also drew another exception whereby the corporate debtor is secured in terms of Section 14, however, proceedings shall continue against the persons accused in the complaint under Section 138 of NI Act, who were in-charge of and responsible for the affairs of the corporate debtor.

The decision of ***P. Mohanraj*** (supra) was followed by the Hon'ble Supreme Court in ***Gimpex Private Ltd. v. Manoj Goel***² and ***M/s. Nag Leathers Pvt. Ltd. v. M/s. Dynamic Marketing Partnership***³.

LIABILITY OF NOMINATED DIRECTOR

The second proviso of Section 141 NI Act provides immunity to the nominated director from the prosecution liability of offence of the company under Section 138 NI Act. The proviso provides the definition of nominated director which includes person appointed by the Central Government or State Government or financial institution owned and controlled by the Government.

LIABILITY OF NON-SIGNATORY DIRECTOR

The judgment of ***P. Mohanraj*** (supra) explicitly held that the liability of the directors and other persons in-charge of the affairs of the company shall not extinguish on the pretext of application of Section 14 IBC. However, the viable query arises is the role and liability of a director who is not a signatory on the dishonoured cheque(s).

In regard to the non-signatory director, the Hon'ble Supreme Court in ***S.M.S. Pharmaceuticals Ltd. v. Neeta Bhalla***⁴ has opined:-

"5. ... a complaint must contain material to enable the Magistrate to make up his mind for issuing process. If this were not the requirement, consequences could be far reaching. If a Magistrate had to issue process in every case, the burden of work before Magistrates as well as harassment caused to the respondents to whom process is issued would be tremendous. Even Section 204 of the Code starts with the words "if in the opinion of the Magistrate taking cognizance of an offence there is sufficient ground for proceeding". The words "sufficient ground for proceeding" again suggest that ground should be made out in the complaint for proceeding against the respondent. It is settled law that at the time of issuing of the process the Magistrate is required to see only the allegations in the complaint and where allegations in the complaint or the charge sheet do not constitute an offence against a person, the complaint is liable to be dismissed.

19(a) It is necessary to specifically aver in a complaint under Section 141 that at the time the offence was committed, the person accused was in charge of, and responsible for the conduct of business of the company. This averment is an essential requirement of Section 141 and has to be made in a complaint. Without this averment being made in a complaint, the requirements of Section 141 cannot be said to be satisfied.

(b) The answer to question posed in sub-para (b) has to be in negative. Merely being a director of a company is not sufficient to make the person liable under Section 141 of the Act. A director in a company cannot be deemed to be in charge of and responsible to the company for conduct of its business. The requirement of Section 141 is that the person sought to be made liable should be in charge of and responsible for the conduct of the business of the company at the relevant time. This has to be averred as a fact as there is no deemed liability of a director in such cases.

(c) The answer to question (c) has to be in affirmative. The question notes that the Managing Director or Joint Managing Director would be admittedly in charge of the company and responsible to the company for conduct of its business. When that is so, holders of such positions in a company become liable under Section 141 of the Act. By virtue of the office they hold as Managing Director or Joint Managing Director, these persons are in charge of and responsible for the conduct of business of the company. Therefore, they get covered under Section 141. So far as signatory of a cheque which is dishonoured is concerned, he is clearly responsible for the

incriminating act and will be covered under sub-section (2) of Section 141."

The aforesaid principle was relied and reiterated by the Hon'ble Supreme Court in ***S.K. Alagh v. State of Uttar Pradesh***⁵; ***Maharashtra State Electricity Distribution Co. Ltd. v. Datar Switchgear Ltd.***⁶ and ***GHCL Employees Stock Option Trust v. India Infoline Limited***⁷.

The Hon'ble Supreme Court in ***Ashutosh Ashok Parasrampuriya v. M/s. Gharrkul Industries Pvt. Ltd.***⁸ has held that:-

"23. In the light of the ratio in S.M.S. Pharmaceuticals Ltd. (supra) and later judgments of which a reference has been made what is to be looked into is whether in the complaint, in addition to asserting that the appellants are the Directors of the Company and they are incharge of and responsible to the Company for the conduct of the business of the Company and if statutory compliance of Section 141 of the NI Act has been made, it may not open for the High Court to interfere under Section 482 Cr. PC unless it comes across some unimpeachable, incontrovertible evidence which is beyond suspicion or doubt or totally acceptable circumstances which may clearly indicate that the Director could not have been concerned with the issuance of cheques and asking him to stand the trial would be abuse of process of Court. Despite the presence of basic averment, it may come to a conclusion that no case is made out against the particular Director for which there could be various reasons.

24. The issue for determination before us is whether the role of the appellants in the capacity of the Director of the defaulter company makes them vicariously liable for the activities of the defaulter Company as defined under Section 141 of the NI Act? In that perception, whether the appellant had committed the offence chargeable under Section 138 of the NI Act?

25. We are concerned in this case with Directors who are not signatories to the cheques. So far as Directors who are not the signatories to the cheques or who are not Managing Directors or Joint Managing Directors are concerned, it is clear from the conclusions drawn in the aforestated judgment that it is necessary to aver in the complaint filed under Section 138 read with Section 141 of the NI Act that at the relevant time when the offence was committed, the

Directors were in charge of and were responsible for the conduct of the business of the company.

26. This averment assumes importance because it is the basic and essential averment which persuades the Magistrate to issue process against the Director. That is why this Court in S.M.S. Pharmaceuticals Ltd. (supra) observed that the question of requirement of averments in a complaint has to be considered on the basis of provisions contained in Sections 138 and 141 of the NI Act read in the light of the powers of a Magistrate referred to in Sections 200 to 204 Cr. PC which recognise the Magistrate's discretion to take action in accordance with law. Thus, it is imperative that if this basic averment is missing, the Magistrate is legally justified in not issuing process."

Further the protection from liability under Section 138/141 of NI Act has been provided under Section 141, whereby as per the proviso, the due-diligence on part of the director shall act as a defence which needs to be proved by the accused director.

Thereby, on account of the aforesaid judgments and provisions it may be averted that the burden of proof of asserting liability on a non-signatory director or other natural person in terms of Section 138/141 of NI Act shall be on the complainant through his complaint which needs to be examined by the Magistrate before issuing notice.

CONCLUSION

In light of the abovementioned *ratio decidendi*, the issue is not *res integra* and has been settled stating that the proceedings initiated on account of cheque dishonourment shall fall within the scope of Section 14(1)(a) of IBC, however the protection is not extended to the natural persons who were in-charge or responsible to the affairs of the corporate debtor.

The role of managing director ought not be blindly equated to the position of other directors or persons and prosecuting such other directors under Section 138/141 of NI Act shall be abuse of process of law on account of vicarious liability, as such persons may not be actively participating in the affairs of the Company. Thereby, the Magistrate while examining a complaint under Section 200 of Cr. PC requires to assert the facts which establishes that all the natural persons named as accused are participating in the management and

affairs of the company at the time of signing of the cheque(s).



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1. [2021] 125 taxmann.com 39 / 167 SCL 327 (SC)
 2. Criminal Appeal Nos. 1069-1075 of 2021, 8-10-2021
 3. SLP (Crl.) No. 9077/2019, decided on 18.11.2021
 4. [2007] 74 SCL 187 (SC)
 5. [2008] 142 COMP CASE 228 (SC)
 6. [2010] 8 taxmann.com 223 / 105 SCL 253 (SC)
 7. [2013] 36 taxmann.com 434 (SC)
 8. [2021] 132 taxmann.com 189 / [2022] 169 SCL 1 (SC)