MORATORIUM PERIOD: A CONUNDRUM OF IBC ACT, 2016

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ABSTRACT

IBC is an assimilation of different legislations which has brought a sea change in the economically stressed market. It has facilitated the mechanism and eased out the procedure for going concern without adversely affecting the valuation of its assets. Section 14 read with S. 238 acts as a shield for the bankrupt entities to conclude its insolvency proceeding without any judicial stress.

However, the semantic ambiguity in the application of bar by moratorium has garnered much attention and has become the center piece of conundrum. Addition of section 14 in 2018 has barred institution of any suit or proceeding against the corporate debtor making it completely immune. Section 14 enables the resolution professional to carry out its activity without judicial nemesis.

But a complete bar has affected other stakeholders which has arbitration clause in it. Also section 238 act as a defense mechanism for the corporate debtor to quash any suit against it vis-à-vis criminal proceeding or any act of fraudulent transaction per se.

In this paper, the author(s) will predominantly discuss the effect of the moratorium period, whether it has helped the corporate debtor keeping up the spirit of this act or has impaired different stakeholders per se.

INTRODUCTION

Insolvency is mechanism which facilitates the death and rebirth of entities. These legislations identified the existing problems and came up with a set laws and regulation keeping intact the essence of the company in the market. It made easier for the creditors to recover its debts and lessened the burden of the government to take care of these crumbling companies. The collateral damage reduced heavily as it took care of all its essential and non-essential creditors. Such an act was a necessity particularly when India was heading towards restructuring its financial system. Various committee were formed since 1964 for instance Tiwari Committee, Narshimhaa Committee, L.N.Mittal Committee, Raghuram Rajan Committee. But finally it was Joint Parliamentary Committee brought this Insolvency and Bankruptcy Committee Code in 2016.

The purpose behind enactment of this act was maximization of assets[i] and to promote entrepreneurship. Providing assurance to the financial creditors that they could freely invest their money and can be assured that they can regain their money efficiently in within a year in case the company goes bankrupt. Along with the code it got its own tribunal, appellant tribunal and a board to govern its functioning.

The time bound resolution process under this act marked a historical event in the

Indian legislature. In addition to it, institution of a moratorium period under this act eased the effort of the resolution professional to carry out the resolution process without judicial nemesis.

SCOPE OF MORATORIUM

Moratorium created a clam period wherein negotiations can be made effectively. It enables the creditors and different stakeholders to think clearly over the resolution process and discuss positively the methods of restructuring the going concern. It also helps the corporate debtor to its assets from any downfall. So that the motive behind it i.e. maximization of assets is maintained.

However it does not limits or restricts the institution of any proceeding under Article 32 and 226 of the Constitution of India as stated in section 63 of the Insolvency and Bankruptcy Code, 2016.

THE CONUNDRUM

Sec 14 of the IBC Act, 2019 i.e. moratorium period bars any kind of suit or activity that may affect the assets. But in 2018 an amendment was made which made and exception for the guarantors.[ii] Now under this new amendment the creditors can go after the guarantors to recover their debt. Quite many judgments until then have delivered clarifying whether moratorium period prohibits the creditor to go after the assets of the guarantor or whether CIRP can be initiated against the corporate guarantor even before the same is initiated for corporate debtor.

But the question that looms in the shade is whether the creditors can go after the guarantors after the conclusion of CIRP. Because as of now, after the CIRP is concluded, the corporate debtor is discharged of all the debt and is deemed to be settled as per section 31 which is binding on the corporate debtor, employees, members, creditors, guarantor and stakeholders involved in the resolution plan. Hence no one can initiate any proceeding against the corporate debtor for its previous conduct.

However, the creditors are granted such relief under section 14. Creditors possess the right under the law to go against the guarantors as it is assumed that the liabilities are co-extensive with the borrower. While these are independent in it so the contract of guarantee is assumed to be independent as well.

The guarantors are impaired in such a scenario. The defense which guarantors generally take under the ICA is section 133,134 and 140. But herein section 134, if the creditors discharges the principal debtors voluntarily then the guarantors gets discharged as well. The voluntary discharge of the principal debtors is the fundamental ingredient that discharges the guarantors altogether. But here in IBC the corporate debtor is discharged by operation of law and not voluntarily. Thus the creditors are allowed to go against their recovery of debt.

The defense of section 140 is also of no avail. Guarantors cannot use right of subrogation and sue corporate debtor. In *Lalit Mishra & Ors. V. Sharon Bio Medicine Ltd.* [Company Appeal

Insolvency No. 164 of 2018], it was said that since the resolution process is not a recovery process and thus the guarantors cannot use section 140 to recover the debt.

Hence it is evident that the creditors are quite independent.

APPLICABILITY OF THE MORATORIUM TO PERSONAL GUARANTOR

Moratorium for the corporate debtor is enshrined in section 10 of the IBC whereas for personal guarantor it is in section 101 of the IBC.

To avail the benefit of moratorium for the personal guarantor, separate resolution process is required to be filed. Majorly NCLT is for the corporate persons and DRT for individuals and partnership firms. However, as per section 60(2) when a resolution process is under process or pending before NCLT, then is such a situation the personal guarantor of such corporate debtor must file insolvency before such NCLT.

The benefit from such moratorium can be construed only if the application of insolvency resolution process gets accepted as per section 94-101 of the IBC. But as the provisions of Part III of the IBC has not yet been notified containing section 94-101, so currently this route is not available. However when notified, this route shall be available only the personal guarantors separately files for insolvency resolution process.

If the guarantors fail to pay the guaranteed amount, it would be upon the lender if they want to invoke Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act) or initiate insolvency proceeding under section 95 of the IBC. But in a situation where the moratorium has not been declared, the SARFRAESI proceedings will continue.

Thus it can be construed that the benefit under section 14 is applicable only to the corporate debtor. Hence supreme court in the matter of *Allahabad High Court in the matter of Sanjeev Shriya vs. State Bank of India & Ors*. [Writ – C No. – 30285 of 2017], rightly mentioned the distinction between section 14 and section 101.

CRIMINAL ACTIVITY DURING MORATORIUM

IBC is silent on whether the criminal proceeding during the resolution process is permissible or not. This has brought up another hole in the said act. In the case of *Shah Brothers Ispat Limited V. P Mohanraj & Others*,[iii] the appellant initiated a corporate insolvency resolution process and also sued under section 138 of the Negotiable and Instrument Act, the corporate debtors and its directors because its cheque was dishonored due to insufficient money in the account.

The corporate debtor went on to the tribunal for quashing the criminal suit against them as it can't be instituted during the moratorium period. NCLT accepted the contention made by the corporate debtor and passed the order in favor of the corporate debtor. However, on further appeal NCLAT set aside the order made by the NCLT and ruled that since it is not a recovery claim the suit can be instituted against the corporate debtor. It also said that the criminal proceeding doesn't come under the ambit of the moratorium and a competent court can proceed with the suit.[iv]

THE TUSSLE OF ARBITRATION CLAUSE WITH MORATORIUM

Moratorium created a deadlock situation when any such situation of arbitration came up. Section 14 of the IBC do not allow any kind of proceeding be it arbitration that can be instituted against the corporate debtor. Backed with section 238 it even got stronger and a firm ground to hold its position. But this would impair the stakeholders and would deter them from entering into any such agreement later on. As after the conclusion of corporate insolvency resolution process (CIRP), the corporate debtor is deemed to be discharged of all its debt. Hence, in such a situation no claim could be made against the corporate debtor.

While in a situation where the claims are made by the Corporate Debtor and no counter claims are made against them, section 14(1)(a) do not put bar on such arbitration proceeding. But when claims are made against the corporate debtor, the bar is in operation on such arbitration proceeding. This biased stake of the IBC is in contravention with section 13 and 14 where it invites all the creditors, including parties with arbitration, to file their respective claim. If the act does not want any stakeholder with arbitration clause to file its claim, then it must clearly mention it and provide a proper mechanism to dispose their claims.

This dead silence was broken in *Jharkhand Bijli Vitran Nigam Limited V. IVRCL Ltd (Corporate Debtor)& Anr.* CP (IB) No. 294/7/HDB/2017. In this case it was stated that

arbitration proceeding can be taken up by the corporate debtor and proceed with it provided no counter claim is made against the corporate debtor. However, the NCLT left it open for the arbitration tribunal to segregate the claim made by the corporate debtor and counter claim and whether it can be dealt separately or not.

However, NCLAT in *Jharkhand Bijli Vitran Nigam Limited V. IVRCL Ltd (Corporate Debtor)& Anr.* [Company Appeal (AT)] (Insolvency) No. 285 of 2018] made a remarkable statement that the unless the counter claim are factored in a justice could not be done. Hence it was of the view that arbitration proceeding must continue in the absence of any bar under IBC. But unfortunately if the corporate debtor is held liable to pay then no recovery could be made. As it is the fundamental thing that is insolvency is not a recovery process and if it is allowed the motive of this act which maximization of assets would fail.

So it can be concluded herein that moratorium will come into effect post award of the arbitrational proceeding and would solely depend upon the nature of the award, whether the recovery will be made or not. The court also made a distinction between section 34 and 36 of the Arbitration Act i.e objection and enforceability of the award.

NON-OBSTANTE CLAUSE OF IBC

Supreme Court in *Solidare India Ltd. V. Fairgrowth Fiancial Services Pvt. Ltd.*[v] stated that if there is any dispute between two non-obstante clauses, the later one should prevail. So, here in IBC, section 238 is the non-obstante clause which makes section 14 powerful and in a situation of any inconsistency, it would prevail over other law.

However there is a grey area in IBC regarding moratorium and the question that hangs with it is that, whether moratorium declared will prevail over PMLA (Prevention of Money Laundering Act, 2002).

Delhi High Court in *The Deputy Director Directorate of Enforcement Delhi v. Axis Bank & Ors. [Crl.A 143/2018 & Crl. M.A. 2262/2018]*, held that debt recovery legislations like IBC, RDBA etc. do no prevail over the provisions of PMLA. It clarified that attachment of the properties under PMLA are civil sanction and its investigation run parallel to criminal investigation i.e. offence of money laundering. It was also held that where the property of the

corporate debtor has any criminal connotation, it cannot be used to discharge his civil liabilities towards creditors.

Both the legislation, IBC and PMLA, are debt recovery mechanism. But IBC provides speedy mechanism while PMLA can take years which might not hold the real essence of the assets. PMLA is both time consuming and requires huge money which would altogether defeat the purpose the IBC Code.

SUGGESTIONS

The conundrum that the author discusses is all about the vacuum in this particular act. The lose end in section 14 coupled with strictly written word and shielded by section 238 has all made it harsh and perforated at the same time.

The IBC Act, particularly section 14 tends to bar all proceeding against the corporate debtor during the insolvency proceeding so that it can peacefully complete the insolvency proceeding without any judicial nemesis. However, there are some actions that may need to be addressed which is not specifically mention and which has caused these conundrums.

The moratorium must be extended to the guarantor of the corporate debtor simultaneously. And the guarantor must not be exempted from its right of subrogation once the corporate debtor has filed for insolvency. If such a right is extinguished it will possibly deter future guarantors. In another sense as the corporate debtor is discharged of all its debts once the corporate insolvency is complete, so must be its guarantor; or otherwise the right of subrogation must not be extinguished.

Similarly, in a situation where a claim is made before the resolution professional but if it contains arbitration clause with the corporate debtor then RP must wait until the amount is crystallized by the arbitration tribunal. There must also be a bar on resolution professional not to submit the resolution plan for its approval by CoC. Because once the plan gets approved by the CoC and the creditors fail to submit its claim in time then it will impair the creditor which will be violation of his natural rights.

CONCLUSION

So after discussing the entire aspects of moratorium it can now be concluded that it does has holes in it which needs urgent attention. However the legal body is continuously on their duty to mend it. But the vacuum thus created may hinder a low profile corporate debtor to not attain the perfect degree of justice posited by these remarkable precedents.

The extent of liberty given to these financial creditors is good. As it keep up their spirit and do not deter them to invest in new upcoming startups. If these provisions were not instituted then it might have settled a sense of sense of fear in their mindset over their money. Creating an excepting for the financial creditors has eased them out. Addition of such clause will lure in more investors to invest which is beneficial for the company and also the government doesn't need worry about them.

Also clearing the views on the position of non-obstante laws has eased out the efforts of the judiciary and has made possible for the legal body to initiate proceeding against the corporate debtor despite the moratorium period is in operation. It is only time that will tell if the appropriate court will carves out any exception for the moratorium or there will any amendments to it.

REFERENCES

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