

# UPDATE

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## **The Interplay Between IBC Moratorium and Criminal Liability Under Section 138 of the NI Act: In light of Recent Judgement Passed In ‘Rakesh Bhanot Vs. Gurdas Agro Pvt. Ltd.**

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### ***A. Introduction***

The Supreme Court of India, in its landmark ruling *Rakesh Bhanot v. Gurdas Agro Pvt Ltd*<sup>1</sup>, delivered on 01 April 2025, clarified the relationship between insolvency moratoriums and criminal liability for dishonoured cheques. The judgment clarifies a key legal conflict between the Negotiable Instruments Act, 1881 (“NI Act”) and the Insolvency and Bankruptcy Code, 2016 (“IBC”), specifically addressing whether the initiation of personal insolvency proceedings under the IBC triggers the temporary moratorium under Section 96, thereby pausing criminal prosecution under Section 138 of the NI Act.

In this matter, the appellants, who were charged with dishonour of cheque under Sections 138 and 141 of the NI Act, contended that criminal cases should be put on hold because of the temporary moratorium under Section 96 of the IBC. While rejecting such argument, the Supreme Court highlighted the divergent objectives of the two laws- on one hand, Section 138 of the NI Act protects business trust by making cheque defaults illegal, whereas on the other hand, the IBC seeks to address insolvency through a common procedure. As the Court emphasized, under the NI Act, criminal liability is personal and arises from statutory violations, not merely from civil debt obligations. Therefore, directors, signatories, or guarantors cannot invoke insolvency proceedings as a shield against prosecution.

This ruling strikes a balance between the deterrent function of the NI Act and the debtor protection framework under the IBC. By preventing the misuse of insolvency proceedings to evade criminal liability, it reinforces the integrity of the legal process. For creditors, the decision enhances legal certainty by clearly distinguishing between civil enforcement under IBC and criminal prosecution under the NI Act, affirming their right to pursue criminal remedies even during insolvency moratoriums.

### ***B. Factual Matrix***

The ruling by the Supreme Court stemmed from multiple criminal appeals challenging decisions made by several High Courts, which had denied requests to stay proceedings under Section 138 of the NI Act in light of the interim moratorium imposed under Section 96 of the IBC.

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<sup>1</sup> 2025 SCC OnLine SC 728

The petitioners/ appellants were being prosecuted under Section 138 and 141 for cheque dishonour, following which these individuals' filed petitions under Section 94 of the IBC to begin personal insolvency resolution procedures, which automatically resulted in an interim moratorium under Section 96 of IBC. They argued that the current criminal proceedings against them under the NI Act should be halted by this moratorium. These applications were denied by the lower courts and high courts, which led to numerous appeals before the Supreme Court.<sup>2</sup>

The question of law that was determined by the Supreme Court was whether criminal proceedings against individuals under Section 138 (dishonored cheques) and Section 141 (liability of company officers) of the NI Act should be stayed when an application under Section 94 of the IBC is filed, thereby triggering an interim moratorium under Section 96 of the IBC.<sup>3</sup>

### ***C. The Intersection of Criminal Liability and Insolvency: Understanding the NI Act and IBC***

The purpose of the NI Act was to regulate negotiable instruments, including cheques, bills of exchange, and promissory notes, in order to promote financial certainty and ease business transactions. Section 138 of the NI Act outlines the legal repercussions of dishonouring a cheque. This section holds the drawer criminally liable if payment is not made within the stipulated time after notice. Serving as an effective tool for maintaining trust in financial dealings, it penalizes default and deters misuse of cheques. It reinforces the credibility of negotiable instruments and safeguards the interests of recipients, ensuring that business transactions proceed with greater legal and financial assurance as well as accountability.

On the other hand, IBC brought a major shift in India's insolvency regime by consolidating laws governing both individuals and corporate entities. It aims to streamline resolution, promote entrepreneurship, and balance debtor-creditor interests. For corporate entities, the Corporate Insolvency Resolution Process (CIRP) offers a structured mechanism, and importantly, its initiation triggers an automatic moratorium, effectively staying all proceedings against the corporate debtor. For corporate entities, the IBC provides a comprehensive framework known as the Corporate Insolvency Resolution Process (CIRP). However, this case specifically pertains to partnership firms and is governed by Sections 94, 95, and 96 of the IBC.

Under Section 94 of the IBC, a defaulting debtor can apply to the Adjudicating Authority to initiate insolvency resolution process, either directly or through a resolution professional, by submitting an application.<sup>4</sup> Whereas, Section 95 of the IBC entitles a creditor to apply for initiating insolvency resolution process against a debtor, in the prescribed format. The creditor has three options for applying: independently, jointly with other creditors, or via a resolution professional.<sup>5</sup>

Once an application is filed under Section 94 or 95, Section 96 provides for an interim moratorium. During this time, creditors are prohibited from bringing new legal actions against the debtor and any pending debt-related lawsuits are stayed. This temporarily halts all legal actions or proceedings

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<sup>2</sup> Supra note 1

<sup>3</sup> Ibid

<sup>4</sup> Insolvency and Bankruptcy Code, 2016, s. 94

<sup>5</sup> Id. S.95

relating to debts, including those already in progress, and applies to all partners in the case of a partnership firm. The goal is to maintain status quo and prevent creditor action while the application is under scrutiny before the Adjudicating Authority. Nonetheless, certain transactions which are notified by the Central Government, after consulting with financial regulators, shall be exempted from interim moratorium and Section 96 per se.<sup>6</sup>

#### ***D. Navigating Inconsistencies in the Legal Framework***

Section 138 of the NI Act penalises cheque dishonour resulting from insufficient money in the drawer's account and Section 141 creates vicarious culpability for those in charge of the company's operations including directors and signatories.<sup>7</sup>

Under Section 138, criminal charges are brought after:

- a) When a cheque gets dishonoured.
- b) Inability to pay the dishonoured sum within 15 days after being served with a demand notice.
- c) Complaint filing within a month of the cause of action emerging.<sup>8</sup>

When a debtor files an application under Section 94 or a creditor files an application under Section 95 to begin the insolvency resolution process, interim moratorium under Section 96 of the IBC gets triggered. The filing of "any legal action or proceedings" for "any debt" against the debtor is prohibited during this time, as is "any legal action or legal proceeding pending in respect of any debt," according to Section 96(1)(b).<sup>9</sup>

In order to facilitate an orderly resolution of debts without the burden of concurrent legal processes, this moratorium is intended to give the debtor going through insolvency resolution some breathing room.<sup>10</sup> However, there has been legal dispute over the scope and extent of this protection, especially with reference to criminal prosecutions under the NI Act.

While Section 138 of the NI Act rightly penalises cheque dishonour to uphold financial discipline and protect the interests of payees, its enforcement comes into conflict with the automatic moratorium imposed by Section 96 of the IBC. The punitive and compensatory objectives of Section 138 appear to conflict with the IBC's intent to suspend all legal proceedings, including criminal actions, during the insolvency resolution process. This has led to ambiguity over whether criminal liability under Section 138 of the NI Act should also be stayed during the operation of moratorium in personal insolvency proceedings.

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<sup>6</sup> Id. S.95

<sup>7</sup> Negotiable Instruments Act 1881. S. 141

<sup>8</sup> Id. s.138

<sup>9</sup> *Saranga Anilkumar Aggarwal v. Bhavesh Dhirajlal Sheth*, 2025 SCC OnLine SC 493

<sup>10</sup> *Supra* note 1

## ***E. Analysing The Relationship Between the IBC's Moratorium Provisions and Criminal Liability Under the NI Act***

In this case, the Supreme Court undertook a detailed examination of the interplay between criminal liability under the NI Act and the moratorium provisions of the IBC. The Court ruled that criminal procedures are not covered by the moratorium under Section 96 of the IBC, which is limited to protection against civil claims. The Court's earlier decisions concerning the corporate moratorium under Section 14 of the IBC are consistent with this approach. The judgement makes a distinction between a civil suit for debt recovery and a criminal action that upholds business integrity and address statutory infractions. The Court also underlined that although the IBC seeks to protect people from civil lawsuits pertaining to debt, it does not intend to absolve people of criminal responsibility for crimes they have committed in their individual capacities.

The Court's interpretation of the term "any legal action or proceedings" in Section 96 of the IBC was a crucial component of the ruling. When read in conjunction with "in respect of any debt," the Court determined that this phrase relates to civil procedures for debt collection rather than criminal prosecutions. The statutory interpretation done by the Court rules to determine that the primary goal of criminal proceedings under Section 138 of the NI Act is to punish the statutory offense of issuing dishonoured cheques and not to recover debt. The fundamental goal goes beyond simply recovering the debt; it is to preserve the integrity of negotiable instruments in business dealings.

The Court observed that, "For the foregoing discussion, we are of the opinion that the object of moratorium or for that purpose, the provision enabling the debtor to approach the Tribunal under Section 94 is not to stall the criminal prosecution, but to only postpone any civil actions to recover any debt. The deterrent effect of Section 138 is critical to maintain the trust in the use of negotiable instruments like cheques in business dealings. Criminal liability for dishonoring cheques ensures that 35 individuals who engage in commercial transactions are held accountable for their actions, however subject to satisfaction of other conditions in the N.I. Act, 1881. Therefore, allowing the respective appellants / petitioners to evade prosecution under Section 138 by invoking the moratorium would undermine the very purpose of the N.I. Act, 1881, which is to preserve the integrity and credibility of commercial transactions and the personal responsibility persists, regardless of the insolvency proceedings and its outcome."<sup>11</sup>

The Court reiterated that, regardless of any moratorium that may be in effect for a corporate debtor, statutory obligation against directors and signatories under Section 138 read with Section 141 of the NI Act is personal in nature and still binds natural individuals. Their position and function within the organization at the time of the offense give rise to this liability. The ruling makes it clear that these people cannot avoid criminal responsibility by later filing for personal bankruptcy. The Court underlined that permitting such an escape route would encourage misconduct in business interactions and weaken Section 138's deterrent effect.

The Court made it clear that prosecutions under Section 138 of the NI Act would not be impacted by the adoption of a Resolution Professional's Report under Section 100 or the approval of a Resolution Plan under Section 31 of the IBC. This implies that even if insolvency processes are successfully concluded, criminal liability endures.<sup>12</sup>

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<sup>11</sup> Supra note 1 at Para 17

<sup>12</sup> Id. Para 13

The integrity of the criminal justice system and the insolvency code is preserved by this aspect of the decision, which guarantees that the conclusion of insolvency procedures cannot retroactively justify actions that were illegal at the time they were performed.

## ***F. Conclusion: Impact on Insolvency and Commerce***

The judgment provides much-needed clarity on the scope and limitations of the IBC's moratorium provisions for both for corporate debtors under Section 14 and for individuals under Section 96. This judicial interpretation enhances the predictability of insolvency proceedings and enables stakeholders to make more informed decisions. By drawing a clear distinction between civil and criminal proceedings in the context of the moratorium, the Court has laid down a more nuanced framework for understanding the protective mechanisms embedded within the IBC.

- a) Balancing Conflicting Legal Objectives:** The ruling carefully balances two conflicting legal objectives. The IBC's primary goal is to provide debtors facing financial distress with an opportunity for recovery, granting them a temporary reprieve from legal proceedings.
- b) Preserving Business Integrity:** In contrast, the NI Act aims to uphold the integrity and legitimacy of negotiable instruments in commercial transactions, ensuring that violations such as cheque dishonour are effectively addressed.

For both sets of rules to operate well, this balance is essential. The ruling preserves the deterrent effect of criminal penalties for cheque dishonour while guaranteeing that the insolvency resolution process can continue without being hampered by civil claims. It strengthens the standing of creditors who possess dishonoured cheques from debtors who subsequently file for bankruptcy. Regardless of the moratorium imposed by Section 96 of the IBC, these creditors may now pursue criminal remedies under Section 138 of the NI Act. In their interactions with possible debtors, creditors benefit from this dual-track strategy, which permits bankruptcy settlement to take place concurrently with criminal prosecution.

In conclusion, by emphasizing the serious consequences of issuing dishonoured cheques, the ruling is likely to influence business practices significantly. Given that insolvency processes cannot protect them from criminal liability for dishonoured cheques, businesses and their directors will need to exercise greater caution when it comes to their payment practices. This improved deterrence may reduce the number of cheques that bounce and increase the trustworthiness of cheque as a payment method in business dealings.

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