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Unscrupulous promoters may defraud creditors taking advantage of the suspension of the Insolvency and Bankruptcy Code

No justification for prohibiting an insolvent company from filing a voluntary insolvency petition

Gandhinagar, June 10, 2020: Gujarat National Law University (GNLU) organized a webinar on Moratorium under the Insolvency & Bankruptcy Code, 2016 (IBC) and its impact on proceedings under the Negotiable Instruments Act, 1881 (N.I. Act). The webinar was delivered by Mr Jeet Jayant Bhatt, an alumnus of GNLU and a practising advocate in the High Court of Gujarat.

Mr Bhatt discussed the background of insolvency laws in India as well as the scheme of IBC. He said that section 14 of IBC provides for the declaration of a moratorium on the commencement of insolvency resolution process. This moratorium prohibits, among other things, the institutions of suits and proceedings against the corporate debtor in any court as well as the transfer of or, creation of encumbrance on, the assets of the debtor. The primary objective of this moratorium is to keep the assets of the corporate debtor intact during the insolvency resolution process. Gujarat High Court has held that proceedings under section 138 of the N.I. Act (for the dishonour of cheque) also get stayed once the moratorium is declared under section 14 the IBC while Bombay High Court has taken a contradictory view in the matter. Mr Bhatt said that, in his opinion, keeping in view the purpose of moratorium under IBC, all proceedings which are in the nature of recovery of debt are liable to be stayed and this would also include proceedings under section 138 of the N.I. Act.

In reply to a question on the IBC Amendment Ordinance dated June 05, 2020, Mr Bhatt said that the ordinance suspends initiation of fresh insolvency proceedings for six months which can be extended for further six months. It is a welcome step for several companies which are adversely impacted by Covid-19. However, it might lead to several companies committing fraud. If creditors cannot exercise the option of initiating insolvency proceedings and if there would be no declaration of the moratorium as per section 13 and 14 of the IBC, then the unscrupulous promoters might start transferring the assets and properties of the company to defraud the creditors. They can also manipulate the books and siphon off cash flows and exit business. “This defeats the very purpose of IBC,” Mr Bhatt said.

The ordinance grants protection to company directors and partners with the same terms of suspension on Section 66 of IBC, which relates to fraudulent transactions done with intent to defraud creditors or for a fraudulent purpose where a company law court can order the accused to pay up any amount it sees fit if the claims are substantiated.



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Mr Bhatt added that the ordinance not only suspends the right of financial creditors or operational creditors of initiating insolvency proceedings but also the right of corporate debtors to file for insolvency proceedings. He said, “There appears to be no justification to prohibit a company that is insolvent — and likely to continue to be so — from filing a voluntary insolvency petition as early as possible”.

The webinar was inaugurated by GNLU Director Dr Shanthakumar and was attended by students, faculty and practitioners.

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