

MORATORIUM DURING LIQUIDATION: SCOPE AND EFFECT

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Editor's Note: "Moratorium", as is discussed earlier, entails 'calm period' during which parties can negotiate. The sweep of moratorium is far-reaching during resolution as it prohibits even secured creditors to initiate enforcement actions against the assets of the corporate debtor. Section 33 contains provisions similar to section 14, envisaging stay on suits/proceedings during liquidation. However, the reach of 'stay' during section 33 is different from the effect of section 14.

In this article, the author has made an effort to discuss the idea of moratorium, its ambit and effect on the liquidation proceedings under the Code.

What is a moratorium?

The term has been defined in Merriam Webster Dictionary to mean "legally authorized period of delay in the performance of a legal obligation or the payment of a debt; a waiting period set by an authority; or a suspension of activity.

In Cambridge Dictionary, moratorium refers to period of time during which a particular activity is stopped.

In the Code, Section 33(5) of the Insolvency and Bankruptcy Code, 2016 ("IBC") stipulates "Subject to section 52, when a liquidation order has been passed, no suit or other legal proceeding shall be instituted by or against the corporate debtor:

Provided that a suit or other legal proceeding may be instituted by the liquidator, on behalf of the corporate debtor, with the prior approval of the Adjudicating Authority."

It is a general notion that moratorium exists only at the time of corporate insolvency resolution process, the article discusses whether moratorium exists during liquidation as well. Further, based on precedents, the author has also tried to explain the exclusions and inclusions in the term "other legal proceedings" as mentioned in Section 33(5) of IBC.

Moratorium on Institution or Continuation of Suits?

1. The understanding, based on the interpretation of Section 33, is that there is no moratorium on continuation of suits. In case the liquidator wants to institute a fresh suit or legal proceeding, he will require specific permission from the adjudicating authority, in accordance with Section 33(5) of IBC, however, the liquidator can continue to pursue or defend an already existing proceeding, without seeking any permission from the adjudicating authority, pursuant to the powers conferred upon him under Section 35(1)(k) of IBC. Here, it will be relevant to draw reference from the parent Companies Act which puts a stay not only on institution of "suit or other legal proceeding", but also on its continuation.

In fact, in the parent Companies Act, 1956, Section 446(2) conferred an exclusive jurisdiction on the winding up court in all matters pertaining to the company before the court. Section 60(5) of IBC is akin to the provisions contained in Section 446(2)(d). The relevant extract is reproduced below:

“Notwithstanding anything contained in any other law for the time being in force, NCLT have jurisdiction to entertain, or dispose of: (a) any application or proceeding by or against the corporate debtor;... (c) any question of priorities... arising out of or in relation to the insolvency resolution or liquidation proceedings of the corporate debtor”.

There are several court rulings which have analyzed the relevance of this provision— that the winding up court has **holistic powers** in respect of the company under winding up, so that all matters that may affect the company under liquidation may be dealt with by the court. It can thus, be contended that age old laws have been developed with an intention to prohibit institution as **well as continuation** of suits or legal proceedings during liquidation.

In the book **Law Relating to Insolvency & Bankruptcy Code, 2016**⁵⁴, this issue was discussed and it has been clarified that:

Unlike clause (a) of sub-section (1) of section 14, sub-section (5) of section 33 does not include the word ‘continued’, which apparently implies that suits or proceedings that were instituted prior to the insolvency commencement date may be continued during the liquidation proceedings. However, the [notes to clauses](#) clearly state that the “liquidation order shall result in a moratorium on the initiation **or continuation** of any suit or legal proceeding by or against the corporate debtor”. In view of the author, absence of the word ‘continued’ is merely a drafting glitch- since allowing the continuation of pending suits or proceedings will hamper smooth conduct of liquidation proceedings. Hence, the provision shall be read as, “. . . no suit or other legal proceeding shall be instituted **or continued** by or against the corporate debtor:”

In Companies Act, 1956 and 2013, approval of court was required for suits by or against the corporate debtor, but under the IBC, there is no provision for seeking leave by the other party and only the liquidator can institute legal proceedings on behalf of the corporate debtor by seeking prior approval of the adjudicating authority. The very object of Section 60(5) of IBC is to prevent multiplicity of suits in multiple fora, and therefore, it will be quite illogical to have several forums determining matters which may impinge on the assets or liabilities of the company under liquidation. There are several rulings which have discussed the intent of the moratorium. One significant ruling is *Central Bank of India v. Elmot Engineering Co.*, 1994 AIR 2358; 1994 SCC (4) 159, wherein the Hon’ble Supreme Court cited the following para from Palmer’s Company Precedents, Part 11, 17thEdn., page 302:

Central Bank of India v. Elmot Engineering Co

“When a winding-up order is made, the Court, acting by its officer the Official Receiver lays its hand upon the assets and says, no creditor or claimant must touch these assets or take proceedings by way of action, execution or attachment pending the distribution by the Court in due course of administration. This protection is indispensable equally in winding-up and in bankruptcy to prevent a scramble for the assets, but it is not always enough. “

⁵⁴2016 Edition, by Sikha Bansal and Vinod Kothari.

Moratorium During Liquidation:

Scope & Effect

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The Apex Court, thus, explained the intent of the section:

“This section aims at safeguarding the assets of a company in winding-up against wasteful or expensive litigation as far as matters which could be expeditiously and cheaply decided by the company court are concerned. In granting leave under this section, the court always takes into consideration whether the company is likely to be exposed to unnecessary litigation and cost.”

Proceedings not covered under the ambit of moratorium:

– Tax proceedings:

Tax proceedings will have to be classified into two categories: pre-assessment and post-assessment proceedings. While assessment proceedings are considered to be outside the purview of moratorium, proceedings for recovery of tax would fall within the ambit of moratorium. This distinction may seem to be unfair, however, in the proceedings under the [income tax act](#) and some other analogous acts, for example under sales tax, excise etc., the proceedings for determination of the rights and liabilities of the companies and the other persons may have to be determined initially by authorities which have been specially created under the specific statute, and when it comes to recovery of dues, the winding up court should come into picture. The reason is that the legislature intended that the assets of the company in liquidation should be dealt with at one place by the NCLT who would be in the best position to distribute the funds of the companies equitably.

See [Life Insurance Corporation of India v. Asia Udyog \(P\) Ltd., 1984 55 CompCas 187 Delhi, 1984 145 ITR 520 Delhi](#) and in *Official Liquidator, Golcha Properties Private Ltd. (In Liquidation) v. Income-Tax Officer and Ors.* [1974] 44 CompCas 144 (Raj); [1974] 94 ITR 11 (Raj); 1972 WLN 563.

While the tax authorities may continue the assessment proceedings to determine the quantum of their claim, however, they cannot proceed with execution, distress or recovery. Statutory authorities are included under the definition of “operational creditors” [Section 5(20) of IBC], and accordingly, they will have to file their claim with the liquidator for recovery of their dues in the requisite form. The liquidator will verify their claim, and make payment only in accordance with the priority laid down under Section 53 of IBC.

For pre-assessment proceedings, the liquidator has to continue to represent the company. In this regard, it is relevant to cite the case of [Tika Ram and Sons \(Private\) Ltd. v. Commissioner of Income-Tax](#) [1964] 51 ITR 403 (All), where Allahabad High Court made the following observations:

“Income-tax proceedings are certainly not such proceedings which the High Court under [Section 446](#) could possibly entertain and make the assessment itself nor could it transfer any such assessment pending before the Income-tax Officer to its own record.

.....For these reasons I would hold that assessment proceedings do not fall within the scope of “other legal proceedings” and do not automatically come to a stop the moment the company goes into liquidation.....

.....the company in liquidation is still an assessee, and income-tax proceedings up to the stage of assessment do not fall within the scope of the words “other legal proceedings” as used in [Section 446](#) of the Companies Act, 1956.”

For recovery of dues, the exclusive jurisdiction vests with the NCLT, and statutory authorities cannot encroach upon the same. See [DamjiValji Shah v. Life Insurance Corporation of India](#), [1965] 35 Comp. Cas. 755; [1965] 3 S.C.R. 665, 673 (S.C.), [S. V. Kondaskar, Official Liquidator, and Liquidator of the Colaba Land and Mills Co. Ltd. v. V. M. Deshpande, Income-tax Officer](#), [1972] 83 I.T.R. 685, 699; 42 Comp.Cas. 168, 181 (S.C.).

In this regard, reference may be drawn to [Circular No. 1053/02/2017-CX](#) issued by Central Board of Excise and Customs dated 10th March 2017, which clearly lays down that the dues under IBC shall have priority over Central Excise dues. Also, it is mentioned that when cases are pending before BIFR/ OL/ appropriate authority under IBC, then recovery measures shall not be resorted to and further, in such cases public counsel should be advised to file affidavits for first charge under Section 11E of Central Excise Act, 1944 informing the quantum of confirmed demand to BIFR/ OL/DRT/IBC Authorities.

– **Jurisdiction of Writ Courts:**

On perusal of the provisions contained in the earlier act, it may be noted that an exemption was granted to cases pending before High Courts or Supreme Court, but no such exemption has been provided for under the IBC. The issue was discussed in [Canara Bank v. Deccan Chronicle Holdings Limited, \[CA \(AT\) Insol No. 147 of 2017\]](#). The appellant (i.e. the creditor) submitted that the adjudicating authority cannot exclude any court from the purview of moratorium for the purpose of recovery of amount or execution of any judgement or decree, including the proceeding, if any, pending before the High Courts and the Supreme Court of India against a corporate debtor.

The NCLAT acknowledged that clause (a) of Section 14(1) specifically does not exclude any Court, including the High Courts or even the Apex Court. However, the Hon’ble Bench there are certain constitutional provisions which must be considered. There is no provision to file any money suit or suit for recovery before the Supreme Court except under Article 131 of the Constitution; some High Courts have original jurisdiction to entertain the suits, which may include money suit or suit for recovery of money. However, the writ jurisdiction conferred on the Supreme Court and the High Court under Article 32 and Article 226 of Constitution of India, being a constitutional power, cannot be curtailed by any provision of an Act or court. Therefore, ‘moratorium’ will not affect any suit or case pending under Article 32 or 226. However, so far as suit, if filed before any High Court under original jurisdiction which is a money suit or suit for recovery, against the corporate debtor such suit will be covered by the bar imposed under Section 33(5).

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– **Criminal Proceedings:**

In criminal proceedings, particularly in the proceedings under Section 138 of the Negotiable Instruments Act, 1881, the directors or officers in default, as the case may be, are generally held personally liable, as against the civil liability of the company. The company and its directors cannot shirk their criminal liability merely on the ground that the company was already wound up and the liquidator had taken charge of the affairs of the company.

Upholding the principle laid down by the Kerala High Court in [*Jose Antony Kakkad v. Official Liquidator 2000 Comp Cas 811*](#), in [*Counter Point Advt. P. Ltd., Rep. by its Director, Mr. Naresh Purushotham v. Harita Finance Limited, Rep. by its Special Legal Assistant, Miss. Gulzar Sayeeda \[2006\] 133 CompCas 435 \(Mad\); 2006 Cri LJ 2289; 2006 \(2\) CTC 501*](#), the Madras High Court observed that:

“Though the words ‘legal proceedings’ in Section 446 of the Companies Act is wide enough to be taken in criminal proceedings also, such criminal proceedings must be in relation to the assets of the company. Criminal proceedings which are not in respect of the assets of the company but which end in the conviction or acquittal of the accused, cannot be stayed under Section 446 of the Companies Act. Proceedings under Section 138 of the Negotiable Instruments Act, 1881, can end only in the conviction or acquittal of the accused in the case and no recovery of any amount covered by the dishonoured cheques can be made in the criminal proceedings. As the proceedings under Section 138 of the Negotiable Instruments Act are not in respect of the assets of the company, the proceedings pending in the criminal Courts cannot be stayed under Section 446 of the Companies Act.”

Again, in *M/s. Indorama Synthetics (I) Ltd v. State of Maharashtra and Anr.*, having regard to the earlier decisions, and in consonance with the spirit, purpose and object of the provisions of Section 446(1) of the Companies Act and Section 138 of the Negotiable Instruments Act, similar view was taken by the Bombay High Court. Applying the ratio, it can be safely concluded that the expression “suit or other proceedings” does not include criminal complaints filed under Section 138 of the Negotiable Instruments Act.

• **Proceedings notified by the Central Government:**

Section 35(6) stipulates that the provisions of sub-section (5) shall not apply to legal proceedings in relation to such transactions as may be notified by the Central Government in consultation with any financial sector regulator, however, no such legal proceedings has been notified till date.
