



Critical Analysis of Interim Moratorium Under Section 14 Of IBC, 2016 With Respect to Corporate Debtors

S. Pavan Kalyan

LLM Scholar

Christ University, Delhi NCR

Abstract:

The Interim Moratorium in Section 14 of the Insolvency and Bankruptcy Code (IBC) faces misuse by corporate debtors, delaying payments and legal proceedings, exemplified in *Adarsh Jhunjunwala v. State Bank of India & Anr (2021)*. The Calcutta High Court stressed its misuse against willful defaulters, subverting the legislation's intent. Section 14 has drawn both praise and criticism; it shields struggling companies from aggressive creditor actions during insolvency, aiding asset protection and fairness. However, its misuse impedes justice. Despite offering a crucial shield, the provision requires vigilance to prevent abuse, ensuring its intended purpose of enabling a viable revival plan without enabling wrongful delay or deliberate default.

Nevertheless, its imperfections are evident. The extensive duration of the moratorium, spanning up to 180 days, can protract uncertainty and hinder the resolution process. This has adverse implications for creditors, particularly financial institutions, reliant on punctual repayments. Operational creditors, notably small suppliers, endure hardships in the absence of a clear payment stream, jeopardizing their financial stability. Furthermore, the potential for misuse arises, enabling defaulting promoters to regain control during this period, posing concerns about exploitative practices, and subverting the IBC's primary aim of swift and efficient asset resolution. This research contributes to a nuanced comprehension of the Interim Moratorium's repercussions, guiding policy and practice. It also suggests avenues for future research to refine insolvency frameworks, enhancing both their effectiveness and equity.

Keywords: *Insolvency & Bankruptcy Code, Interim Moratorium, Creditor Behavior, Fraud Detection, operational creditors.*

Introduction:

In the ever-changing landscape of corporate insolvency, the Interim Moratorium, enshrined in Section 14 of the Insolvency and Bankruptcy Code, 2016 (IBC), plays a critical role. This study explores the complexities of the Interim Moratorium, investigating its effects on creditors and its potential as a mechanism for detecting fraudulent behavior by financially distressed corporate debtors. Understanding the nuances of the Interim Moratorium is critical in light of an evolving global economic scenario and the imperatives of effective insolvency proceedings.

Insolvency and bankruptcy, crucial facets of corporate financial landscapes, have witnessed transformative changes with the advent of the Insolvency & Bankruptcy Code, 2016 (IBC) in India. At the core of this legal framework lies Section 14, conferring an Interim Moratorium upon corporate debtors undergoing insolvency proceedings. This provision envisions shielding the debtor from coercive actions, fostering a conducive environment for restructuring and resolution. The Interim Moratorium is a pivotal juncture in the insolvency process, temporarily restricting creditor actions and providing a breathing space for the distressed corporate entity to explore viable resolutions.

Understanding the behavioral dynamics triggered by the Interim Moratorium is critical for understanding its real-world implications. During this critical phase, creditors, both financial and operational, have to deal with a complex interplay of legal, financial, and strategic issues. Exploring these dynamics reveals the complex relationships between stakeholders, as well as the complicated responses to the moratorium's protective umbrella. Furthermore, an examination of comparative jurisdictions, both with and without analogous provisions, provides a broader context for assessing the effectiveness and implications of the Interim Moratorium under Section 14 of the IBC.

Furthermore, incorporating fraud detection mechanisms into the moratorium complicates the insolvency landscape. The interaction of legal safeguards and fraudulent behavior presents both challenges and opportunities for the effective administration of insolvency proceedings. This study delves into the multifaceted nature of the Interim Moratorium, attempting to unravel its behavioral implications and assess its role in detecting and preventing fraudulent activities among corporate debtors in insolvency.

The significance of this study lies in the critical evaluation of how the Interim Moratorium influences the behavior of creditors & its efficacy in averting fraudulent activities during insolvency. As corporate failures & debt distress continue to pose challenges to economic stability, comprehending the nuances of this legal provision becomes imperative for regulators, practitioners, & scholars alike. By shedding light on the behavioral impacts & fraud detection potential, this research contributes to the ongoing discourse surrounding the effectiveness & adaptability of insolvency frameworks.

Theoretical Framework:

Section 14 of the Insolvency & Bankruptcy Code, 2016 (IBC) forms a crucial anchor in the theoretical framework of this study. This section, focusing on the imposition of a moratorium, is pivotal for understanding how legal mechanisms influence the dynamics of insolvency proceedings. It provides a crucial legal shield that suspends any ongoing legal proceedings or enforcement actions against the debtor once the insolvency resolution process begins. This moratorium aims to protect the corporate debtor from undue harassment and preserve its assets during the resolution period.

The theoretical framework underlying Section 14 of the IBC revolves around the principle of providing a breathing space to the debtor, ensuring an orderly and effective insolvency resolution process. This provision intends to prevent any further depletion of the debtor's assets by halting all proceedings or actions against the debtor¹. By doing so, it facilitates the insolvency resolution process, giving the insolvency professional and the creditors an opportunity to formulate and implement a resolution plan without external disruptions².

In the landmark case of *Swiss Ribbons Pvt. Ltd. v. Union of India*³, in the Supreme Court of India upheld the constitutional validity of the IBC while elucidating the importance of the moratorium under Section 14. The court emphasized that the moratorium acts as a crucial tool for the insolvency resolution process, protecting the debtor from coercive measures by creditors. It observed that the moratorium allows for the preservation of the corporate debtor's assets and prevents dissipation, ensuring a fair chance for successful resolution.

Furthermore, the case of *K. Kishan v. Vijay Nirman Company Pvt. Ltd.*⁴ (2017) emphasized that Section 14's moratorium applies not only to pending suits but also to any actions or proceedings against the corporate debtor, providing a wide ambit of protection. The court reiterated the importance of upholding the moratorium's sanctity to maintain the integrity of the insolvency resolution process.

However, judicial decisions have also outlined exceptions to Section 14, clarifying that certain actions such as criminal proceedings, regulatory actions, or actions related to personal guarantors are not barred by the moratorium. The case of *State Bank of India v. V. Ramakrishnan*⁵ (2018) highlighted that the moratorium does not extend to personal guarantors, allowing creditors to initiate actions against them independently.

¹ Meghna Arvind and Dua, A.S. (2023) Read more: IBC laws - decoding the conundrum of interim moratorium under section 14 of IBC - Meghna Arvind and Amarपाल Singh Dua, IBC Laws. Available at: <https://ibclaw.in/decoding-the-conundrum-of-interim-moratorium-under-section-14-of-ibc-meghna-arvind-and-amarपाल-singh-dua/> (Accessed: 10 September 2023).

² (No date a) All about moratorium under section 14 of the insolvency and ... Available at: <https://elischolar.library.yale.edu/cgi/viewcontent.cgi?article=2552&context=yjps-documents2> (Accessed: 15 December 2023).

³ SCC Online SC 73

⁴ CIVIL APPEAL NO. 21825 OF 2017

⁵ Civil Appeal No. 3595 of 2018

Section 14 of the IBC embodies the core principle of providing a protective shield to the corporate debtor, allowing for an unhindered insolvency resolution process. Judicial interpretations and decisions have underscored the significance of the moratorium in preserving the debtor's assets and facilitating an effective resolution while also delineating exceptions to its applicability. This provision plays a pivotal role in maintaining the balance between the interests of creditors and debtors during the insolvency process, ensuring a fair and orderly resolution mechanism.

Fraud Detection Mechanism

The Interim Moratorium provided under Section 14 of the Insolvency & Bankruptcy Code (IBC) assumes a vital role in the prevention of fraudulent behavior by corporate debtors. By imposing a temporary halt on creditor actions, the moratorium creates a conducive environment for a thorough investigation into the financial affairs of the distressed company.

In the realm of corporate insolvency, the identification of fraudulent behavior by corporate debtors is a pivotal concern. During Interim Moratorium, Section 14 of the Insolvency & Bankruptcy Code (IBC) it acts as a protective shield, preventing undue pressures on the debtor & fostering an environment conducive to unbiased scrutiny transactions, assess financial irregularities, & discern any fraudulent conduct. It is a vital role in the prevention of fraudulent behavior by corporate debtors during interim moratorium period corporate debtors wants to delay the legal proceedings or delay in payment to creditors, there are some case where the corporate debtors misuse the proceedings,

for his personal interest or diverging the funds to shell companies in ⁶ *Sidharth Chauhan v. State Govt. of NCT of Delhi* in this case, the petitioner's company/corporate debtor was a real estate company, and CIRP was initiated against it. In response to the foregoing, the petitioner submitted a revival plan/withdrawal proposal for the revival of his company, which was approved by the CoC with 92.85% support.

Meanwhile, an FIR was filed on behalf of certain home buyers in one of the corporate debtor's projects, alleging that the corporate debtor failed to complete the project on time and diverted funds collected from them, committing offenses under sections 406/420/409/120B of the IPC. The petitioner applied for interim anticipatory bail under section 482 of the Cr. PC

Various indicators, such as financial mismanagement, misrepresentation of assets, or diversion of funds, may signal potentially fraudulent activities. By scrutinizing financial records, transaction patterns, and adherence to legal and ethical standards, stakeholders can pinpoint behaviors that deviate from accepted norms. This proactive approach is crucial for maintaining the integrity of moratorium proceedings and ensuring a fair and

⁶TaxmannTaxmann Publications has a dedicated in-house Research & Editorial Team. This team consists of a team of Chartered Accountants (2023) Real estate co.. gets interim protection from HC in funds diversion case as it cooperated with investigation, Taxmann Blog. Available at: <https://www.taxmann.com/post/blog/real-estate-co-gets-interim-protection-from-hc-in-funds-diversion-case-as-it-cooperated-with-investigation/> (Accessed: 10 December 2023).

transparent resolution process. There is a possible way to diverge their funds for their personal interest or to shell companies.

where there are some cases of maliciously filed CIRP by the corporate debtor to delay the payments and escape from legal actions. **Innoventive Industries Ltd. v. ICICI Bank**⁷ the National Company Law Appellate Tribunal (in short NCLAT) held that the NCLT has discretion to reject the debtor's application *under section 10 of IBC on the ground that where the debtor has made an application for CIRP with malicious intention to take advantage of the moratorium provisions of the IBC.*

Unigreen Global Private Ltd⁸, **NCLT, Principal Bench** The corporate debtor filed a petition in the National Company Law Tribunal (NCLT) to initiate a Corporate Insolvency Resolution Process (CIRP) due to its inability to settle outstanding liabilities of Rs 100 Crores⁹. Punjab national bank is the financial creditor in this case where he contested that the Unigreen global Pvt Ltd/Corporate debtor, he suppressed the facts of the case claiming that the company did not disclose full particulars related to assets mortgaged or securities furnished to financial creditors. The NCLT, Principal Bench, rejected Unigreen Global's application for CIRP due to the suppression of facts and imposed a penalty of Rs. Ten Lakhs under Section 65 of the IB Code, 2016.

The detection of fraudulent behavior by corporate debtors during insolvency proceedings is a critical aspect of maintaining the integrity of the resolution process. Various jurisdictions employ distinct mechanisms to identify and prevent fraudulent activities. This includes stringent reporting requirements, forensic audits, and the involvement of regulatory bodies.¹⁰ The Association of Certified Fraud Examiners (ACFE) is a whistleblowing mechanism to identify frauds and the frauds are classified into 3 categories: asset misappropriations, corruption, and financial statements fraud. In the event of voluntary liquidation under section 10 of IBC, 2016 the corporate debtor has to audit his personal account and books accounts of the company by both internal and external auditors, and has to submit before initiating the CIRP process to the insolvency professional, so based on these reports, it can be concluded that the company is truly in distress or has malicious intent to delay the payment to creditors. Understanding the effectiveness of these mechanisms is pivotal in ensuring the robustness of the interim moratorium under Section 14 of the Insolvency & Bankruptcy Code, 2016. By analyzing these fraud detection strategies, the research aims to contribute insights into enhancing the

⁷ Company Appeal (AT) (Insolvency) No. 1 & 2 of 2017],

⁸ Company Petition No. IB-39(PB)/2017

⁹ taxguru_in and Antal, S.K. (2022) Misuse of section 10 of IBC by corporate debtor with intention to defraud stakeholders, TaxGuru. Available at: <https://taxguru.in/corporate-law/misuse-section-10-ibc-corporate-debtor-intention-defraud-stakeholders.html> (Accessed: 12 December 2023).

¹⁰ Gupta, P., & Gupta, S. (2015). Corporate frauds in India – perceptions and emerging issues. Journal of Financial Crime, 22(1), 79–103.

preventive and corrective measures employed during insolvency proceedings¹¹. However, these challenges also present opportunities for innovation in forensic accounting, data analytics, and cross-disciplinary collaboration to enhance fraud detection mechanisms. Integrating advanced technologies and fostering a cooperative ecosystem can amplify the effectiveness of fraud prevention measures during the interim moratorium.

Behavioral Impacts on Creditors

Section 96 of the Insolvency and Bankruptcy Code, 2016, addresses the moratorium period and its implications on creditors. The moratorium period, once initiated under the code, imposes a crucial restriction on creditors from enforcing any claims against the debtor undergoing insolvency proceedings. This moratorium aims to provide the debtor with a breathing space to reorganize or resolve their financial distress without facing aggressive creditor actions.

During this period, creditors are prohibited from initiating or continuing any legal proceedings against the debtor, including the recovery of debts, enforcement of security interests, or the commencement of any lawsuits or arbitration. This suspension ensures that the debtor can focus on the insolvency resolution process without external disruptions.

The impact of this moratorium on creditors is profound and multifaceted. Firstly, creditors must cease all individual actions against the debtor, ensuring a level playing field for all creditors involved. This prevents aggressive or preferential actions by one creditor that might disadvantage others, fostering an equitable resolution process.

Moreover, the moratorium period curtails the power of individual creditors to seize assets or initiate recovery mechanisms, thereby safeguarding the debtor's remaining assets and maintaining the integrity of the insolvency proceedings. This provision helps prevent a situation where one creditor may exhaust the debtor's resources, leaving little for others to claim.

Creditors face limitations on enforcing guarantees or security interests during the moratorium, restricting their ability to seize or sell collateral pledged by the debtor. Consequently, creditors may face delays or challenges in obtaining repayment or reclaiming their investments until the insolvency process resolves.

¹¹Muhammed Beemamol and B Charumathi (2023) ethics and internal audit: Whistleblowing issues. Available at: https://www.researchgate.net/publication/46445762_Ethics_and_internal_audit_whistleblowing_issues (Accessed: 10 November 2023).

However, it's crucial to note that Section 96 of the Insolvency and Bankruptcy Code does provide certain exceptions where creditors can seek relief from the moratorium. Creditors can approach the National Company Law Tribunal (NCLT) to seek permission for specific actions against the debtor during the moratorium period if they can demonstrate sufficient cause and seek the tribunal's approval.

The moratorium period under Section 96 significantly impacts creditors by temporarily restraining their ability to individually pursue claims against the insolvent debtor. This restriction aims to create a conducive environment for a collective resolution process, ensuring fairness among creditors and protecting the debtor's assets from aggressive or unilateral creditor actions. While creditors face limitations during this period, avenues exist for seeking necessary relief through the NCLT under specific circumstances, enabling them to address critical concerns during the insolvency proceedings.

Differential Behavior of Financial Creditors and operational Creditors

Understanding the divergent responses exhibited by financial and operational creditors amid an interim moratorium is pivotal in comprehending the intricacies of insolvency proceedings.¹² A comparative examination of their conduct reveals distinct trends, financial creditors tend to prioritize financial recuperation strategies, leveraging their secured positions to negotiate advantageous terms for debt recovery. In contrast, operational creditors, often lacking secured collateral and reliant on ongoing business operations, typically adopt a more collaborative approach, emphasizing the mutual dependence between their interests and the debtor's operational sustainability in the case of *M/s. PG Advertising Private Limited v. Mahesh Bajaj*,¹³ in this case, the appellant, acting as the resolution professional for PG Advertising Pvt. Ltd., challenged an order from the National Company Law Tribunal (NCLT) that directed the appellant to provide the information memorandum and relevant documents to the respondent, an operational creditor. The NCLT's decision was based on the respondent's application, despite the respondent being only a participant and not a member of the committee of creditors (CoC).

The resolution professional argued, citing Regulation 26(4) of the Insolvency and Bankruptcy Board of India (Insolvency Resolution Process for Corporate Persons) Regulations, 2016, that the respondent lacked the right to access the information memorandum. The National Company Law Appellate Tribunal (NCLAT) ultimately upheld the appeal, setting aside the NCLT order. The NCLAT ruled that operational creditors, as participants in CoC meetings, ***do not have the right to obtain the information memorandum***. The NCLAT emphasized the confidential nature of the document, containing sensitive information about the corporate debtor and its

¹² Muskaan Dagar & Heemanshi Sen, Baffling Conundrum between Financial Creditor and Operational Creditor under Insolvency and Bankruptcy Code, 2016, 2 INDIAN J. INTEGRATED Rsch. L. 1 (2022).

¹³ Comp. App. (AT) (Ins) No. 645 of 2023

assets, and asserted that such information should only be shared with CoC members who have a fiduciary duty to protect stakeholder interests.

The composition of the committee of creditors, exclusively comprising financial creditors, significantly impacts operational creditors. Their exclusion from participation and voting rights during these proceedings, driven by bankruptcy laws favoring financial stability and lending encouragement, results in operational creditors facing substantial losses in insolvency scenarios.

The implications for the resolution process are multifaceted. ¹⁴Differential behaviors of financial and operational creditors introduce complexity and negotiation dynamics that significantly shape the trajectory of insolvency proceedings. While financial creditors may advocate for asset monetization, operational creditors might emphasize the importance of business continuity, potentially influencing the selection of resolution plans. Such varied behaviors contribute to negotiation intricacies, demanding a nuanced approach to balance stakeholder interests and optimize resolution outcomes.

Policy considerations stemming from these observed differences necessitate a comprehensive approach to insolvency frameworks. Regulatory bodies must recognize and address the distinct challenges posed by differing creditor behaviors, tailoring policies to foster cooperation and equitable resolutions. Facilitating communication and transparency among creditors, particularly during the interim moratorium, becomes imperative for fostering productive negotiations. Policymakers ought to explore mechanisms aligning the interests of financial and operational creditors, fostering a collaborative environment conducive to effective insolvency resolution.

The discernible disparities in behavior between financial and operational creditors during insolvency proceedings, particularly within the context of an interim moratorium, significantly influence negotiation dynamics and the overall resolution process. Acknowledging and resolving these differences within a well-designed policy framework is essential for ensuring fair outcomes and the success of insolvency proceedings.

¹⁴ Vidushi Puri (2023) Read more: IBC laws - distinction in treatment of financial creditors vs. operational creditors under IBC - by Vidushi Puri, IBC Laws. Available at: <https://ibclaw.in/distinction-in-treatment-of-financial-creditors-vs-operational-creditors-by-vidushi-puri/> (Accessed: 18 September 2023).

Recommendations

- Strike a balance between debtor protection and creditor rights by imposing reasonable restrictions during the moratorium while ensuring essential operations of the corporate debtor remain uninterrupted.
- Implement a time limit for the moratorium to prevent undue delays and ensure a speedy resolution process, thereby safeguarding the interests of all stakeholders.
- Before initiating proceedings under Section 10 of the Insolvency and Bankruptcy Code, 2016, it is imperative to establish an independent committee responsible for meticulously examining the financial accounts of the company. This committee should also be tasked with gathering comprehensive data about financial creditors. Such a systematic approach aims to invoke Section 14 of the IBC, 2016 to prevent any potential misuse by the corporate debtor to prolong payment obligations and legal procedures.
- In the interim moratorium period, it's crucial to give operational creditors opportunities to participate in the committee of creditors (CoC), prioritize them in resolution plans, share relevant information, and implement provisions to protect essential supplies or services they provide to the corporate debtor.
- Before initiating voluntary liquidation by the corporate debtor under section 10 of IBC,2016 the corporate debtor should file an audit report of his personal account and the books of the company with internal audit and external audit report in order to safeguard the interest of the stakeholders

Conclusion

In summary, the critical analysis of the Interim Moratorium under Section 14 of the Insolvency & Bankruptcy Code, 2016 has yielded crucial insights into its multifaceted impact. Key findings underscore the differential behavior of financial and operational creditors during bankruptcy proceedings, highlighting the need for nuanced policy considerations. Additionally, understanding the intricacies of fraud detection within the moratorium period calls for enhanced collaboration between regulatory bodies, creditors, and insolvency professionals to fortify the integrity of the resolution process.

Looking ahead, future research in this domain should delve deeper into the evolving landscape of insolvency laws and their real-world impact. A nuanced exploration of the behavioral aspects of creditors, coupled with an in-depth examination of fraud detection mechanisms, could further refine our understanding. Shedding light on emerging best practices and potential pitfalls. By embracing these recommendations, scholars and practitioners alike can contribute to the ongoing discourse, enriching the field of insolvency and bankruptcy studies.

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