



BANKING AND FINANCE

# Unravelling the Conflict: Insolvency Proceedings and Dishonoured Cheques

**AUTHOR** Aditya Suryavanshi

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## Facts

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This case involves a criminal writ petition filed by Ortho Relief Hospital and Research Centre against M/s. Anand Distilleries and its Directors. The petitioner, a hospital, had extended a short-term loan of Rs. 15,00,000/- to the respondents in October 2015. Towards security, the respondents issued a post-dated cheque for the same amount. The petitioner claims to have received periodic interest payments until January 2018, after which the respondents stopped making payments.

In February 2018, the petitioner learned about insolvency proceedings initiated against M/s. Anand Distilleries under the Insolvency and Bankruptcy Code, 2016 (IB Code). The National Company Law Tribunal (NCLT) admitted the insolvency petition and appointed an Interim Resolution Professional (IRP). The petitioner lodged a claim with the IRP but received no communication regarding its status.

Despite the insolvency proceedings, the respondents assured the petitioner that the company would resume normal operations and asked to present the cheque. Upon presentation on December 14, 2018, the cheque was dishonoured with the remark "insufficient funds." A legal notice was issued, followed by a complaint filed under Section 138 of the Negotiable Instruments Act, 1881 (NI Act), and Sections 406 and 420 of the Indian Penal Code.

The respondents filed an application (Exh. 39) seeking discharge from the Section 138 NI Act offense, citing the ongoing insolvency proceedings. The trial court allowed this application, discharging the respondents, and consequently dismissed the complaint against the company (accused no. 1). The petitioner has challenged this discharge order.

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## Analysis

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The core issue before the Bombay High Court was whether the initiation of insolvency proceedings under the IB Code prior to the filing of a complaint under Section 138 of the NI Act frustrates the latter proceedings.

### Petitioner's Arguments

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- Proceedings under the NI Act and IB Code are distinct and operate in different spheres.
- The NI Act is penal in nature, not for recovery, thus unaffected by IB Code proceedings.
- Even with an approved resolution plan under the IB Code, respondents are not absolved of penal liability under Section 138 NI Act.
- The liability of respondents (Directors) is personal, and the moratorium under IB Code ends with liquidation, removing any impediment to recovery.
- A company is a separate legal entity, and its directors remain liable under Section 138 NI Act.
- Reliance was placed on Supreme Court judgments like P. Mohanraj, Ajay Kumar Radheyshyam Goenka, Narinder Garg, Shashankbhai Jayantibhai Shah, and Rakesh Bhanot.

### Respondents' Arguments

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- Proceedings under the IB Code were initiated prior to the Section 138 NI Act proceedings.
- The moratorium under Section 14 of the IB Code bars institution of suits or proceedings against a corporate debtor.
- The cause of action for the present case arose after the imposition of the moratorium.
- Section 32A of the IB Code provides for liability for prior offenses, and the second proviso clarifies that individuals involved in the offense remain liable.

- Reliance was placed on Vishnoo Mittal case, stating that the moratorium bars prosecution if the cause of action arose after its imposition.

## Court's Reasoning and Observations

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The High Court considered the relevant Supreme Court judgments to address the issue.

- **Distinction between IB Code and NI Act:** The Court reiterated that Section 138 NI Act proceedings are penal, not recovery-oriented, and are aimed at maintaining commercial integrity. The IB Code, conversely, focuses on corporate debt resolution and rehabilitation.
- **Moratorium and Natural Persons:** While Section 14 of the IB Code imposes a moratorium on proceedings against the corporate debtor, Supreme Court rulings (particularly P. Mohanraj and Ajay Kumar Goenka) clarify that this moratorium applies only to the corporate debtor. Natural persons (directors, signatories) remain statutorily liable under Chapter XVII of the NI Act.
- **Section 32A of IB Code:** This section bars prosecution of the corporate debtor for prior offenses once a resolution plan is approved under specific conditions. However, the second proviso explicitly states that individuals who were in charge of or responsible for the company's business and involved in the offense continue to be liable.
- **Prior vs. Subsequent Initiation of Proceedings:** The Court noted that while the respondents emphasized the prior initiation of IB Code proceedings, the Supreme Court judgments (P. Mohanraj, Ajay Kumar Goenka, Rakesh Bhanot) established that the distinction between prior or subsequent initiation of proceedings under the IB Code and Section 138 NI Act does not absolve natural persons of their liability. The core principle is that the IB Code's moratorium protects the corporate entity, not the personal penal liability of individuals.
- **Vishnoo Mittal Case:** The Court distinguished Vishnoo Mittal, stating that the reliance on it was misplaced as it did not consider the Three Judges Bench rulings of P. Mohanraj and Ajay Kumar Goenka. These later judgments clarified that the nature of proceedings under the IB Code and NI Act are different, and the moratorium under Section 14 does not include criminal proceedings like those under Section 138 NI Act.

The Court summarized key takeaways from the Supreme Court judgments:

1. Section 138 NI Act proceedings are not recovery proceedings.
2. Directors remain liable under Section 138 NI Act even if the company's debt is resolved under IB Code.
3. A resolution plan under IB Code does not automatically extinguish Directors' criminal liability under Section 138 NI Act.
4. Section 138 NI Act proceedings are penal and aim to maintain commercial integrity.
5. Approval of a resolution plan under IB Code does not automatically discharge signatories/Directors from Section 138 NI Act liability.
6. Section 32A protects the corporate debtor, not individuals responsible for the company's conduct.
7. The IB Code and NI Act serve different purposes and do not conflict.

## Conclusion

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The Bombay High Court concluded that the trial court had erred by discharging the respondents (accused nos. 2 and 3) under Section 138 of the NI Act. The Court found that the trial court overlooked the settled legal position established by the Supreme Court, which clearly distinguishes between the moratorium for corporate debtors under the IB Code and the personal criminal liability of directors and individuals under the NI Act.

The Court held that the prior initiation of IB Code proceedings does not prevent prosecution under Section 138 of the NI Act for natural persons. The personal penal liability of directors continues irrespective of any moratorium or resolution plan affecting the corporate debtor.

Therefore, the Criminal Writ Petition was allowed, the impugned orders of the trial court discharging the respondents and dismissing the complaint were quashed and set aside, and the Rule was made absolute. The Court rejected the respondents' prayer for a stay on the judgment.

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