

# INTERNATIONAL JOURNAL OF LAW MANAGEMENT & HUMANITIES

[ISSN 2581-5369]

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Volume 6 | Issue 2

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2023

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# A Comment on Ajay Kumar Radheyshyam Goenka vs Tourism Finance Corporation of India Limited

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## ABSTRACT

*The Insolvency and Bankruptcy Code, 2016 (hereinafter referred to as the “IBC”) prescribes a procedure for Corporate Insolvency. The state of insolvency of a company is associated with its inability to pay off its debts. In certain circumstances even before the insolvency proceedings have begun, the effort to discharge a debt may result in dishonour of negotiable instruments entailing a liability of the insolvent company as well as the officials involved in such dishonour under the Negotiable Instruments Act, 1881 (hereinafter referred to as “NI Act”). The effect of subsequent insolvency proceedings upon pending criminal proceedings under the NI Act was the subject matter of the dispute in Ajay Kumar Radheyshyam Goenka vs Tourism Finance Corporation Of India Limited . The judgment throws light on various aspects of the liability of a corporate debtor and its officials for offences committed under NI Act prior to the commencement of corporate insolvency proceedings under the IBC. Many questions revolving around such liability, the continuation of it and its nature have been categorically answered in this judgment. In addition to setting the record straight in the issue, the judgment also has implications on the Clean Slate Theory, Theory of Corporate Veil and the principle of estoppel against creditors that participate in the Corporate Insolvency Resolution Process. The present comment is an attempt to analyse the judgments on all these points.*

**Keywords:** Criminal Liability of Corporate Debtor, Section 138, IBC, Cheque dishonour.

## I. BRIEF FACTS

In March 31, 2012, the Tourism Finance Corporation of India Limited (Respondent in the present appeal) being a public finance institution, advanced, upon application, a loan of Rs. 30,00,00,000/- to the Rainbow Papers Limited (hereinafter referred to as “RPL”) after entering into a loan agreement dated 27.03.2012. Mr. Ajay Kumar Radheyshyam Goenka was a the managing director and the authorised signatory of Rainbow Papers Limited at that time. For the purpose of repayment of debt, RPL issued post-dated cheques to the Respondent. The debt

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was partly discharged to the tune of Rs.10,88,00,000 by RPL before the disputes arose between the parties. To pay one of the installments, RPL issued a post-dated cheque of Rs. 25,47,945/- dated 15.02.2016 to the Respondent. Upon presentation, the cheque was returned for the reason “Account Closed”. On 19.04.2016, the Respondent company issued a demand-cum-legal notice under Section 138 of Negotiable Instruments Act, 1881. In the notice, the Respondent called upon RPL, as Accused no.1 and Mr. Goenka (the Appellant herein), as Accused no. 2 to settle the debt advanced by way of corporate loan. In their reply to demand notice, the accused acknowledged their liability to repay the debt. In the absence of any payment being made, on 16.05.2016 the Respondent filed a criminal complaint before the Court of Chief Metropolitan Magistrate for dishonour of cheque under sections 138 , 141 and 142 of the NI Act.

During the pendency of NI act proceedings, in 2017, one of the operational creditors of RPL filed an application under Section 9 of the IBC before the National Company Law Tribunal (hereinafter referred to NCLT), Ahmedabad for initiation of Corporate Insolvency Resolution Process (hereinafter referred to as ‘CIRP’) with respect to the RPL. The same was admitted by NCLT. In October 2017, the Respondent filed a claim of Rs. 22,50,00,000 before the Interim Resolution Professional (for short, ‘the IRP’). On 05.06.2018, the Committee of Creditors (hereinafter referred to as the “CoC”) approved the resolution plan proposed by the resolution applicant. The complainant was also a part of the CoC. Under the resolution plan approved by the CoC, the position of Respondent was changed from a secured creditor to an unsecured creditor. The Respondent filed an objection to this before the NCLT in July 2018. In February 2019, the resolution plan was approved by the NCLT.

Thereafter, in July in the same year, present Appellant, who was the second accused in cheque dishonour proceedings before the Metropolitan Magistrate, filed an application for discharge from 138 NI Act proceedings. The application was rejected by the Metropolitan Magistrate. The Appellant filed a Criminal Revision Application before the Additional Sessions Court challenging the order of the Metropolitan Magistrate. The same was also rejected by an order of the Additional Judge dated 23.11.2019. Mr. Goenka filed an appeal against this order which resulted in the present matter.

## **II. ISSUE**

- a. whether during the pendency of the proceedings under the Insolvency and Bankruptcy Code, 2016, which have been admitted, the proceedings under the N.I. Act can continue simultaneously against the corporate debtor and it’s authorised signatory or not?
- b. Whether participation of Respondent in insolvency proceedings under IBC by putting

forward its claim and accepting some share as a creditor along with approval of resolution plan under section 31 of IBC would lead to discharge of penal liability under section 138 of NI Act of Appellant herein.

### **III. ARGUMENTS IN FAVOUR OF APPELLANT**

1. It was asserted on behalf of the Appellant that Section 138 of the NI Act is primarily compensatory in nature. The punitive element of the section (being fine and imprisonment) is provided for the purpose of enforcing the compensatory aspect.
2. Section 14(1)(a) of the IBC prohibits institution or continuation of ongoing suits or proceeding, including execution proceedings, against corporate debtor after the Adjudicating authority declares the beginning of a moratorium period. Since Section 138 NI Act proceedings are primarily for the recovery of a financial debt, it should be considered to be a civil proceeding and hence should be prohibited from continuing after the declaration of moratorium period by NCLT.
3. The liability of the Appellant was arising out of his position of Managing director and authorised signatory of the RPL. The debt was taken by the company as a corporate loan. Therefore, once the proceedings against the company have gone into abeyance under section 14 of IBC, the liability of the Appellant also stands discharged.
4. In cases where the insolvency proceedings have travelled beyond Section 14 (moratorium period), the process would either lead to acceptance of a resolution plan by the Adjudicating Authority under Section 31 of the IBC or liquidation of the company after determination of the claims under Chapter III of the IBC. In both the cases, the debt would get extinguished. Since in the present case the insolvency proceedings have entered section 31, the debt stands extinguished. Since the criminal liability under section 138 of the NI Act arises out of liability regarding debt, the same should also be treated as extinguished, thereby leading to termination of proceedings under the NI Act.
5. Allowing section 138 proceedings to continue would subvert the purpose of section 31 or section 53 of the IBC. Section 31 pertains to acceptance of resolution plan by Adjudicating authority, alternatively, section 53 pertains to selling/distribution of assets to meet the claims of creditors. Since the purpose of both these sections is to discharge the financial liability arising out of debt, once a company enters either of these sections during insolvency proceedings, the continuation of 138 proceedings becomes unnecessary.

6. The terms of resolution plan clearly states that all pending legal and other proceedings against the RPL outside of the resolution plan shall stand terminated. In addition, from the appointed date, all negotiable instruments issued by the RPL shall stand terminated and its liability arising therefrom shall stand extinguished. Since the resolution plan has been approved by the CoC of which the Respondent was also a party, the Respondent has agreed to termination of all ongoing proceedings against RPL thereby leading to compounding of the offence punishable under section 138 of NI Act. Therefore, Respondent cannot continue with the proceedings of Section 138 NI Act against the Appellant.

#### **IV. ARGUMENTS ON BEHALF OF RESPONDENT**

1. The criminal proceedings under the NI Act were initiated much before the initiation of insolvency process. Thus, the resolution plan would not automacclly lead to compounding of the offence under section 138 of NI Act retrospectively.
2. The provisions of IBC do not bar the continuation of the criminal prosecution initiated against the corporate debtor or its directors or officials. Dissolution of a corporate debtor during the insolvency can absolve it of its criminal liability. However, the officials of the corporate debtor cannot be allowed to take an advantage of this situation by escaping their personal liability.
3. Under section 32A, ongoing criminal proceedings against the person being a ‘designated partner’ or an ‘officer who is in default’ or was in any manner in charge of/responsible to the corporate debtor for the conduct of its business or was directly or indirectly involved in the commission of such offence shall be continued even if the corporate debtor’s liability is discharged.

#### **V. DECISION BY THE APEX COURT**

After analysing the relevant provisions of IBC, 2016 and their implication on proceedings under section 138 of NI Act, the hon’ble Supreme Court dismissed the appeal and upheld the order of hon’ble Delhi High Court judge on following grounds:

1. The proceeding under section 138 of NI Act is not a recovery proceeding. It is penal in character. It prescribes fine and imprisonment and not recovery of amount. Therefore, initiation of insolvency proceedings under IBC do not discharge the liability of appellant under section 138 of NI Act.
2. Section 32A of IBC categorically discharges a corporate debtor of its pre-existing civil

and criminal liabilities after the initiation of CIRP. It also categorically states that the officials of corporate debtor having a direct or indirect role in commission of an offence prior to initiation of CIRP shall continue to be liable for prosecution for those offences. Consequently, the appellant's liability under section 138 of NI act would not be discharged.

3. The participation of Respondent in CIRP by filing its claim and being a member of CoC for approval of resolution plan does not lead to compounding of the offence under Section 138 of NI Act thereby not leading to discharge of the Appellant.

## **VI. ANALYSIS**

The analysis of the judgment has been done through following points:

1. Nature of NI Act proceedings viz-a-viz insolvency proceedings under the IBC.

The court has categorically held that proceedings under section 138 of the NI Act are not in the nature of recovery or civil proceedings. It is a penal provision the liability under which arises out of the act of dishonouring the negotiable instrument (cheque in the present case). The nature of liability under this section is in addition to the financial liability arising out of non payment of a debt under any other provision of law.

It is worthy to note that the apex court has rightly categorised the nature of Section 138 proceedings as penal in nature. The understanding is also supported by the term "offence" used for dishonouring of a cheque under the section. In addition, the legislative intent to treat section 138 proceedings as criminal proceedings is also apparent from the fact that the Magistrate (and not the civil courts) has been empowered to try cases arising out of dishonour of a cheque.

2. Analysis of Clean Slate Theory viz-a-viz Section 32A of IBC and Section 138 of NIA proceedings

The theory of clean slate means that the prospective resolution applicant of a corporate debtor should get to manage a company which is free from any liabilities. The theory has been recognised in *Ghanashyam Mishra & Sons (P) Ltd. v. Edelweiss Asset Reconstruction Co. Ltd.*<sup>2</sup>. The apex court observed that if past liabilities are allowed to be carried forward in the working of corporate debtor after the appointment of a resolution applicant and approval of the plan, it would render the whole plan unworkable. The resolution applicant cannot be burdened with surprise debts and liabilities which were never a part of his resolution plan as doing so would introduce so much uncertainty in the CIRP that potential resolution applicants would be

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<sup>2</sup> (2021) 9 SCC 657).

disincentivised to come forward thereby defeating the whole purpose of IBC. The theory is reflected in Section 32A of the IBC. Section 32A of the IBC deals with liability of corporate debtor and its officials for offences committed prior to initiation of CIRP. Sub-Section (1) states that the liability of a corporate debtor for an offence committed prior to the commencement of the corporate insolvency resolution process shall cease, and the corporate debtor shall not be prosecuted for such an offence after the resolution plan has been approved by the Adjudicating Authority under section 31. However, the second proviso to the section says that the liability of certain persons to be prosecuted and punished for an offence continues even after the liability of the corporate debtor has extinguished by virtue of sub-section (1). For the liability of such person to continue, he or she should satisfy the following two conditions. Firstly, he or she should be a “designated partner” in case of a Limited Liability Partnership under the Limited Liability Partnership Act, 2008 or an “officer who is in default” as per section 2(60) of the Companies Act, 2013 or should be in charge of the affairs of the corporate debtor. Secondly, he or she should be directly or indirectly involved in the commission of such an offence.

Relying on its judgment in the case of *Manish Kumar v. Union of India and Another*<sup>3</sup>, the apex court observed that if the argument of allowing the signatory/director to be discharged of his liability after the approval of the resolution plan is accepted, the same would run contrary to the legislative intent of Section 32A since the said section is designed to prevent the wrong-doer to get away.

The court further relied on another judgment, *P. Mohanraj and Others Vs. Shah Brothers Ispat Private Limited*<sup>4</sup> to hold that Section 32A only relieves the corporate debtor and not the signatories/directors etc thereof. The prosecution against the signatories/directors will continue even after the corporate debtor is discharged.

### 3. Analysis viz-a-viz Compounding of offence under section 138 of NI Act by participating in CIRP

A very important question before the court in this case was whether the participation of the respondent in the CIRP by submitting its claim and approving the resolution plan as a member of CoC would amount to compounding the offence under section 138 of NI Act. It was asserted that as soon as the resolution plan was approved, the Respondent, being one of the members of CoC was bound by its terms, which in turn led to the acceptance of the amount in resolution plan as full and final settlement of the debt. It was further asserted that the acceptance of the

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<sup>3</sup> (2021) 5 SCC 1.

<sup>4</sup> (2021) 6 SCC 258.

amount led to discharge of the Appellant from the criminal liability of debt under NI Act. In this regard, the court, while having differentiated between the meaning of compromise and compounding has held that the terms of the resolution plan only discharge the corporate debtor from its liability.

The reasoning from which this decision is branching out is based on the nature of acceptance of the resolution plan. Once the resolution plan is approved, all the creditors are bound by it. The acceptance of the terms of resolution is thus an involuntary act and such acceptance is not more than an outcome of the procedure of law. Therefore, a resolution plan, being a result of the operation of a law (IBC), cannot, even through express terms, over ride section 32A of the same law.

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