

## Supreme Court Clarifies Interplay Between IBC Moratorium and Section 138 NI Act Proceedings

4 June 2026

### Introduction

The Hon'ble Supreme Court of India, in *Dineshchand Surana v UCO Bank*, 2026 INSC 579 (*Surana*) acting through a Bench comprising Justice J.B. Pardiwala and Justice K.V. Viswanathan, examined the interplay between the moratorium provisions under Part III of the Insolvency and Bankruptcy Code, 2016 (IBC) and proceedings for dishonour of cheque under Section 138 of the Negotiable Instruments Act, 1881 (NI Act). The judgment arose from a challenge to the order passed by the Hon'ble High Court of Madras, which had dismissed the appellant's plea to quash a complaint under Section 138 of the NI Act for dishonour of cheque on the grounds that the Appellant was undergoing personal insolvency proceedings. The Court passed a common judgment and order in a group of two appeals.

The judgment is significant because it revisits the observations of a three-Judge Bench of the Hon'ble Supreme Court in *P. Mohanraj v Shah Bros. Ispat (P) Ltd.* [(2021) 6 SCC 258] (*P. Mohanraj*), which had characterized Section 138 proceedings as a "civil sheep in a criminal wolf's clothing". Further, the judgment offers a nuanced framework for understanding how moratorium provisions under the IBC interact with proceedings for dishonour of cheque under the provisions of NI Act. Notably, the two-Judge Bench has referred the matter to a larger Bench for final determination of the questions framed.

### Factual Matrix

The appellant, Dineshchand Surana, was the former Managing Director of M/s. Surana Power Ltd. (SPL), which was undergoing liquidation pursuant to an order dated 19 February 2018 passed by the NCLT, Chennai. The appellant had availed financial and credit facilities from the respondent bank, UCO Bank, including an Inland Letter of Credit Facility in favour of SPL amounting to Rs. 5.03 crores. Upon devolvement of the Letter of Credit, the appellant issued a cheque as security with the understanding that the bank would be at liberty to encash the cheque if the liability accrued on the appellant upon devolvement of the Letter of Credit was not discharged within a period of 90 days. UCO Bank attempted to encash the cheque to settle the dues of the appellant as per the agreed terms, which was dishonoured with the endorsement "Funds Insufficient." The respondent bank filed a complaint under Section 138 of the NI Act before the XIV Metropolitan Magistrate, Egmore, Chennai.

In 2022, during the pendency of the cheque dishonour proceedings, the NCLT, Chennai admitted an insolvency application against the appellant for personal insolvency under Section 95 of the IBC triggering the interim moratorium under Section 96. Subsequently, the personal insolvency application was admitted in 2024, triggering the moratorium under Section 101. Thereafter, a bankruptcy order was passed in 2025, and the moratorium under Section 128 was operative when the Supreme Court heard the matter.

### Contentions of the Appellant

The appellant's central contention was that Section 138 proceedings ought to be stayed in view of the moratorium provisions under Part III of the IBC. Relying on *P. Mohanraj*, the appellant submitted that the expression "legal action or proceeding in respect of any debt" in Sections 96 and 101 is wide enough to include Section 138 proceedings, as the moratorium extends to any legal proceeding relatable to recovery

of debt. The appellant further contended that the objective of the moratorium under Part II and Part III is the same i.e. to prevent depletion of assets and provide breathing space and accordingly the reasoning in *P. Mohanraj* should equally apply to personal insolvency. The appellant also argued that the two-Judge Bench decision in *Rakesh Bhanot v Gurdas Agro Private Limited* [(2025) 6 SCC 781] was in the teeth of the larger Bench's decision in *P. Mohanraj*.

## Issues for Determination

The Hon'ble Supreme Court framed three core issues: (a) Whether Section 138 proceedings are initiated with the object of recovering money from the debtor? (b) Whether Section 138 proceedings are protected during the moratorium period under Part III of the IBC? (c) Whether the Moratorium provisions in Part III extend to Section 138 proceedings initiated against directors who are vicariously liable under Section 141 in cases of personal insolvency or bankruptcy?

## Re-Characterization of the Nature of Section 138 Proceedings

In *P. Mohanraj*, the Hon'ble Supreme Court had described Section 138 proceedings as "*civil sheep in a criminal wolf's clothing*" on the ground that the nature of Section 138 proceedings is recovery of debt aimed at protecting the victim's interest, with the State's interest subsumed within that object.

However, in *Dineshchand Surana*, the Court departed from this characterisation. While acknowledging the civil features highlighted in *P. Mohanraj*, it observed that the three-Judge Bench's attention was not drawn to the predominantly criminal aspects of Chapter XVII of the NI Act, particularly the objective of deterrence underlying Section 138. The Court observed that both the origin of the wrongful act — breach of trust in cheque as a negotiable instrument — and the injury caused — breach of contract for payment — are inherently civil; however, Section 138 makes this wrongful act a criminal offence with penal consequences. Where the injury remains civil but the act has intentionally been made criminal by statute, it is difficult to accept the offence is merely a "*civil sheep in criminal wolf's clothing*."

The Court placed reliance on the definition of "*excluded debt*" under Section 79(15) of the IBC, which expressly excludes "*liability to pay fine imposed by a court or tribunal*" from debts entitled to the protection of moratorium.

## Scope and Ambit of the Phrase "Legal Action or Proceeding in Respect of any Debt"

The Court addressed whether Section 138 proceedings fall within the expression "*legal action or proceeding in respect of any debt*" in Sections 96 and 101. It acknowledged that a bare textual reading would include Section 138 proceedings, and the qualifier "*in respect of any debt*" would also not exclude such proceedings, considering the dishonoured cheque must be drawn for payment of a legally enforceable debt. However, the Court held that despite this plain reading, Section 138 proceedings should not receive moratorium protection as the predominant nature of the offence is criminal. Making moratorium applicable solely because of the civil nature of the underlying injury would render Section 138 equivalent to a debt recovery mechanism, which was never the legislative intent.

## Depletion of Assets during Moratorium

The Court engaged with the fundamental objective of the moratorium — prevention of depletion of the debtor's assets during insolvency. The purpose under both Part II and Part III is to provide breathing space to restructure assets and liabilities. Relying on *P. Mohanraj*, the Court observed that staying legal actions in respect of "*any debts*" would enable implementation of a resolution plan more beneficial for creditors than bankruptcy. However, the Court was conscious that certain liabilities are not protected by the moratorium even though their consequence might deplete the debtor's assets; the rationale, especially for "*excluded debts*" under Section 79(15), is rooted in public policy, and errant persons ought not to be afforded moratorium protection in respect of violations discouraged in the interest of social or economic policy.

## The Tiered Framework: Criminal and Compensatory Aspects

The Court introduced an innovative tiered framework premised on three distinct concepts arising in Section 138 proceedings:

**Imprisonment** is the quintessential criminal sanction imposing personal criminal liability on the drawer. Section 138 provides for imprisonment extending to two years, a penal consequence that cannot be equated with a debt or monetary obligation.

**Fine** is the monetary penalty imposed as part of the criminal sentence, extending to twice the cheque amount. Though monetary, the Court emphasized it is fundamentally a punitive measure – an exemplary penalty to deter the drawer. Critically, Section 79(15)(a) of the IBC defines “excluded debt” to include “liability to pay fine imposed by a court or tribunal,” meaning fines cannot enjoy moratorium protection.

**Compensation** is the discretionary civil remedy awardable under Section 395 of the Bharatiya Nagarik Suraksha Sanhita (BNSS), whereby a court may award the whole or part of the fine amount as compensation to the victim. Unlike fine, compensation is inherently civil – it aims to make the complainant whole for the loss suffered.

Applying these distinctions, the Court held that imprisonment and fine are essentially criminal in nature and remain outside moratorium protection. Allowing moratorium to stay imprisonment would cause violence to the avowed object of Section 138 of NI Act, while the express exclusion of fines under Section 79(15)(a) precludes their protection. As regards payment of compensation, the Court held it is inherently civil in nature, causing an inevitable overlap between criminal and civil actions demanding nuanced treatment.

The Court thus formulated the following framework:

**Tier I – The Mandatory Criminal Aspect:** The initial adjudication must determine whether the offence of cheque dishonour is made out; if convicted, the drawer must discharge personal criminal liability by serving imprisonment or paying fine. The moratorium provides no shelter against these consequences.

**Tier II – The Discretionary Compensatory Aspect:** The compensatory power arising under Section 395 of the BNSS, being inherently civil, should be protected by moratorium. The Court reasoned that keeping it outside moratorium would create an inequitable distinction between debts paid by cheque and other modes – if moratorium protects a debt of Rs. 10,000/- payable by internet banking, there is no justification for denying the same protection merely because the debt was sought to be discharged by cheque. Any such differential treatment would amount to treating Section 138 as an alternative debt recovery mechanism, which was never the legislative intent.

In view of the tiered framework above, the Court opined that a moratorium neither bars the initiation of a complaint under Section 138 nor interdicts the criminal consequences of conviction. A convicted drawer remains obligated to serve imprisonment or pay the fine imposed, notwithstanding any operative moratorium. However, the moratorium’s protective reach does extend to the recovery of compensation ordered under Section 395 of the BNSS. In essence, the debtor faces the full rigour of criminal prosecution; only the civil enforcement of compensation is temporarily stayed.

## Applicability of Moratorium to Directors Vicariously Liable Under Section 141

The Court addressed whether directors vicariously liable under Section 141 would enjoy moratorium during personal insolvency. Drawing upon *Dilip B. Jiwrajka v Union of India* [(2024) 5 SCC 435], the Court observed that the moratorium under Section 96 operates in respect of “debt” as opposed to Section 14 which operates in relation to the “corporate debtor”. The Court held that “any debt” in Sections 96 and 101 is broad enough to include debts not personally incurred by a director but the responsibility of which falls upon the director because of Section 141. This was contrasted with the narrower expression “any of his debts” in Section 124, which relates to the bankruptcy stage. The Court concluded that moratorium under Sections 96 and 101 stays recovery of compensation ordered under Section 395 of the BNSS during Section 138 proceedings, while the criminal aspect remains unaffected.

## Determination and Reference to Larger Bench

The Court answered the three issues as follows:

**Issue I:** Proceedings under Section 138 are not in the nature of a legal action for recovery of money.

**Issue II:** The applicability of moratorium depends upon the stage of the Section 138 proceeding – the criminal aspect (Tier I) is not protected, while the compensatory aspect (Tier II) is protected to prevent depletion of assets during insolvency.

**Issue III:** Directors vicariously liable under Section 141 enjoy the benefit of moratorium, but only in respect of the compensatory aspect.

Recognizing that its observations are potentially at variance with the views of the three-Judge Bench decision in *P. Mohanraj*, the Court referred the following questions to a larger Bench:

- (i) Whether the provisions of Section 138 and the objective underlying its enactment indicate that it is quasi-criminal in nature with a tilt towards the criminal side?
- (ii) Whether the moratorium provisions under Part III of the IBC should be made applicable on the entire proceedings under Section 138 or only to the compensatory aspect thereof?

## Comments

The judgment in *Dineshchand Surana* represents a significant recalibration of the jurisprudence at the intersection of the IBC and the NI Act. By introducing the tiered framework i.e. distinguishing the mandatory criminal aspect (Tier I) from the discretionary compensatory aspect (Tier II), the Court has attempted to reconcile two competing legislative objectives: the deterrent effect of criminal sanctions for cheque dishonour and the rehabilitative objective of providing breathing space to debtors undergoing insolvency. The Bench differed from the broad proposition in *P. Mohanraj* that Section 138 proceedings in their entirety are covered by the moratorium, and instead carves out a nuanced middle path.

From the perspective of a creditor, the judgment is reassuring insofar as it preserves the criminal teeth of Section 138 proceedings. For a debtor undergoing personal insolvency, the protection of the compensatory aspect ensures that the debtor's assets are not depleted by enforcement of compensation orders during the moratorium period.

However, considering the differing views of the Court in *P. Mohanraj* and *Dineshchand Surana*, the issue remains effectively open and will be settled by the larger bench of the SC. It will be interesting to see if the larger bench recognizes and gives primacy to action on the criminality aspects of Section 138 of NI Act even during pendency of insolvency proceedings or takes the earlier approach of stopping such proceedings with a view to preserve the assets of the bankrupt for an orderly resolution.

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