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SUPREMACY OF IBC OVER PMLA: A MYTH OR REALITY

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ABSTRACT

This paper talks about the overlap in the provisions of the PMLA, 2002 and the IBC, 2016 with regards to attachment of property of the Corporate Debtor by the authorities under PMLA during the pendency of insolvency proceedings. The NCLAT took cognisance of this issue in the landmark case of JSW Steel Ltd. vs. Mahendra Kumar Khandelwal & Ors. The matter is currently sub judice before the Super Court. The researcher then talks about the Ordinance of 2019 which brought about a massive amendment in the IBC by adding Section 32A to the Code, and the paper discusses the implications of this amendment on the issue at hand. Further, several additional judicial views are talked about, which establish the primacy of one enactment over the other in essence. The research critically analyses this stance and makes suggestions for a better and more holistic approach that can be adopted in order to tackle this menace.

Keywords - insolvency, money laundering, enforcement directorate, cororate debtor, attachment of assets, ordinance, NCLAT

INTRODUCTION TO THE SUBJECT MATTER

This paper is going to analyze the overlap between the contours of the Prevention of Money Laundering Act, 2002 (hereinafter referred to as "PMLA") and the Insolvency and Bankruptcy Code, 2016, (hereinafter referred to as "IBC") in view of the current strife for primacy between the two monumental legislations. The PMLA was instituted and modeled after various International Covenants with the main objective of combating the evil of money laundering and preventing it by prosecuting those who commit the act and thereby seizing and recovering the various properties that may have been acquired through these means. However, the Act being a special legislation, it has been known to contradict and disrupt the smooth functioning of various other legislations for the time being in force, and the primary dispute that this paper aims to elucidate is the hindrance it has caused with respect to the IBC. The IBC was enacted to consolidate the laws relating to restructuring of a corporate entity after it commits defaults on due payments, and also lays down provisions which clearly showcase its underlying intent of value maximization

of the assets of the Corporate Debtor so as to garner maximum benefit for the creditors and other stakeholders. The Code calls for a time- bound insolvency proceeding mechanism for the entity in question, and it can consequently be seen that the aim of the IBC is not to push companies into liquidation, but in fact to prevent the corporate from reaching that stage in its functioning. The problem between the two acts arises when the property of the Corporate Debtor is tainted by acts of money- laundering, which brings to the forefront questions about coexistence of moratorium and attachment of property by the Directorate of Enforcement under the PMLA once the resolution process beings. Different Courts have put forth different interpretations on this issue, which is why it is imperative for the Apex Court to consider the fallacy and provide an interpretation which is beneficial for all the parties involved and effected herewith.

ATTACHMENT UNDER PMLA

The PMLA envisages attachment of the proceeds of crime by the authorities authorized under the Act and its eventual adjudication and confirmation by a quasi- judicial authority, namely, the Adjudicating Authority (hereinafter referred to as "AA"). The provisions under sections 3, 5, 8, 17, 18, 20, 21 and 23 as well as the definitions of money laundering, proceeds of crime, property and value, are all intertwined, delineate the provisions of each other and in tandem operate to effectuate one of the two substantial purposes of the Act *viz*., attachment for the purposes of eventual confiscation, of proceeds of crime involved in money- laundering, whether in the ownership, control or possession of a person accused of the offence under S.3 or not.[1]

The offence of money- laundering as defined in S.3 comprises of direct and indirect attempt to indulge, knowingly assist, and knowingly be a party to or actual involvement in any process or activity connected with the proceeds of crime and projecting it as untainted property. Proceeds of a crime or any property derived or obtained directly or indirectly by any person as a result of a criminal activity relating to a scheduled offence or the value of any such property qua the provisions of Chapter III of the Act, the process of provisional attachment, confirmation of such attachment by the AA and confiscation of the property attached, is operative against property

[1] Dr. M. C. Mehanathan, *Law on Prevention of Money Laundering in India* 140-143 (LexisNexis, Haryana, 2nd edn., reprint 2018)

constituting the proceeds of crime involved in money laundering whether in ownership, control or possession of a person who has committed an offence under S.3 or otherwise.[2]

Section 5 of the PMLA provides for attachment of property. It is very clear from the wording of the section that initiation of action under this section is on the basis of reason to believe that any person is in possession of any proceeds of crime, and such proceeds of crime are likely to be concealed, transferred or dealt with in any manner which may result in frustrating any proceedings relating to confiscation of such proceeds of crime. Such action is independent from any inquiry or investigation of any predicate offence.[3]

Once a complaint has been made to the AA under S.5, 17 or 18, and if it has reason to believe that the person in question has committed an offence under S.3 of the Act, or is in possession of proceeds of crime, it initiates the process of adjudication. This process involves two stages: (i) confirmation of the order of attachment/retention/freezing of property/record; and (ii) recording a finding that any or all of the properties referred to in the notice under S.8 are involved in money laundering.

Only when the AA comes to a conclusion that the property in question is involved in money laundering, as distinct from proceeds of crime which is liable for attachment under S.5 of the Act, it can order further retention of the property/record seized or frozen or frozen and further declare it to be the property involved in money laundering. The final order of confiscation will be issued by the Special Court under S.8 of the Act. [4]

CORPORATE INSOLVENCY RESOLUTION PROCESS UNDER THE IBC

The IBC comes into play when a person (as defined by the Code in S.3(23)) who has taken a loan commits a default, and subsequently, an application for the same can be preferred to the National Company Law Tribunal (hereinafter referred to as "NCLT"). The Code further defines 'debt' and 'default' as well. An application for insolvency can be filed by a financial creditor, an operational

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[2] *B. Rama Raju v. Union of India, Ministry of Finance, Department of Revenue*, represented by its Secretary [Revenue], New Delhi, 2011 (3) ALT 443.

[3] *Binod Kumar v. State of Jharkhand*, (2011) 11 SCC 463.

[4] Ibid at 1.

creditor, or the corporate debtor himself as well. After the filing of the application, the AA has a period of fourteen days to ascertain the existence of default. If all the essentials have been fulfilled, i.e., there is ascertainment of existence of default, there is no disciplinary proceeding against the insolvency professional and the application is otherwise complete in every respect, it is then admitted by the AA. In case there is any mistake in the application, the applicant is given a seven-day window to rectify the error, and is he fails to do so in the stipulated time period, the application is returned.

On the admission of the application, the AA, by an order, can declare "moratorium" under S.14 of the IBC. Once the IRP is appointed, the creditors, as per S.15 of the Code, are supposed to submit their claims within 14 days, and those who fail to do so, can make the submission within 90 days from the commencement of the insolvency, as per the amendment in S.12(2). Before the amendment, the creditors were at liberty to submit their claims before the approval of the resolution plan. The amendment was thus brought into effect keeping in the mind the time bound nature of an insolvency proceeding. It is imperative to dispose off these applications at the earliest as a lapse in time leads to depreciation of the value of the assets of the corporate debtor, which would reduce the availability of credit for the creditors, and would thus harm the corporate as well as its stakeholders.

Once moratorium is imposed, several restrictions are placed on any simultaneous action with regard to the subject matter of the proceedings under IBC. No pending suit is allowed to continue, and no fresh suit can be initiated. Moreover, there can be no enforcement of a decree of a court of law, and most importantly, no recovery action under SARFAESI or any other law is permissible. Hence, this period is supposed to be a neutral period wherein the creditors and the debtors come together to negotiate with each other and give way to a successful insolvency, which ends with a viably restructured corporate, dodging the bullet of liquidation of the entity on the whole.

THE PROBLEM

The dichotomy in this entire scheme of affairs arises on account of the fact that, during the resolution process, prospective resolution applicants, after conducting their necessary diligence, ascribe an enterprise value to the assets of the financially distressed corporate and propose a

resolution plan keeping in mind that value. Such assets, however, may, without the knowledge of the prospective resolution applicants, include assets that have been created using proceeds of a crime, and hence, are potentially capable of being attached under the PMLA.

Under IBC, the Resolution Applicant plays an important role in revival of the Corporate that is undergoing CIRP. The Resolution Applicant after submitting resolution plan to the COC, and after obtaining their approval, seeks the approval of the AA to take over the assets and liabilities of the CD, so as to dispose off its debts as per the resolution plan. The RA takes over the insolvent corporate with a *bonafide* intention. Now, if there is a looming threat of attachment of property or pending proceedings by investigating agencies for wrong doings of the previous management, the Resolution Applicant will not come forward to put his hard earned money for acquiring the assets of the Corporate Debtor. The resolution applicant, while bidding for a financially distressed asset, ought to be assured of the safety of these assets, and it is only with such legitimate expectation that any prospective applicant would step up to acquire the enterprise. In absence of such assurance, the resolution of distressed assets under the code is simply impractical.

The Code aims at ensuring that a person acquiring the assets of the corporate debtor is not subjected to any harassment by any agency. This objective will be defeated if the Resolution Applicant, after placing his credit for the acquisition of the assets of the CD, is put to harassment by any investigating agency. The Resolution Applicant will come forward to invest in the assets of the CD only if there is an assurance that the assets of the CD are safe. Once this assurance is provided, the value of the asset will also go up.[5]

If we look at the rationale behind the IBC, it is abundantly clear that the main aim of the Code is to ensure the that insolvency of a corporate person is conducted uniformly, in a time bound manner, thereby protecting the interests of all the parties involved by ensuring the maximum possible return to them that can be garnered from the assets at hand, and also keeping the business up and running. However, this objective will be defeated if the ED attaches the property of the CD as a proceed of crime, or retains it for being involved in money laundering activities.

[5] Lakkaraju Srinivas, "*Conflict Between IBC and PMLA*", accessed on 10.11.2020 at 23:10 hrs., https://taxguru.in/corporate-law/conflict-ibc-pmla.html

THE JSW STEEL CASE: A LANDMARK JUDGEMENT

This conflict came to the fore in the resolution proceedings of Bhushan Power & Steel Limited (hereinafter referred to as "BPSL"), where, subsequent to the approval of the resolution plan submitted by JSW Steel (hereinafter referred to as "JSW"), the enforcement directorate under the PMLA proceeded to attach the assets of BPSL.

While the NCLT approved the resolution Plan of JSW with certain modifications/amendments on September 5, 2019, the Directorate of Enforcement of Central Government attached assets of BPSL under S.5 of the PMLA vide its order of October 14, 2019.

JSW, faced with the anomalous situation of having committed to pay a significant value to acquire the assets of BPSL, only for that to be lost in attachment under the PMLA, refused to implement the resolution plan until there was some clarity on this aspect.[6]

JSW in the matter of *JSW Steel Ltd Vs. Mahender Kumar Khandelwal & Ors*[7]*.,* before National Company Law Appellate Tribunal (hereinafter referred to as "NCLAT") inter alia objected and challenged the jurisdiction of ED to attach the properties of BPSL. During the pendency of the appeal, the Ordinance relating to introduction of S.32A was promulgated and therefore, the same has been taken into consideration by the NCLAT while deciding the appeal. NCLAT sought from ED and Union of India to report whether JSW is covered by the newly inserted Section 32A of the IBC.

ED took a contrary stand from Union of India and stated that the proposed Section 32 A will not be applicable to JSW, being a related party as also the amendment being prospective in nature and thus the benefit of provisions of Section 32 A sub clause (2) is not available to the properties attached of BPSL by ED.

NCLAT vide its judgment dated February 17, 2020 rejected the contentions of ED and held that the benefits of proposed Section 32 A are very much applicable in the present case and the

[6] Misha, Siddhant Kant, *"PMLA v. IBC: The Battle for Primacy*", accessed on 10.11.2020 at 12:38 hrs., https://law.asia/pmla-v-ibc-battle-primacy/

[7] Company Appeal (AT) (Insolvency) No. 957 of 2019.

attachment of assets of BPSL under PMLA by the ED after the approval of resolution plan is illegal and without jurisdiction. However, the said order is *sub-judice* before the Supreme Court of India.[8]

THE ORDINANCE OF 2019: INTRODUCTION OF S.32A IN THE IBC

Section 32A can be said to be the most powerful and overriding amendment made to the IBC. As read with Section 238, it may be invoked to stop any or all prosecutions, attachments and seizures against the corporate debtor authorized by any law for the time being in force including those brought under the PMLA. The newly introduced provision can be boiled down under three major categories namely:[9]

a) ***Cessation of any Liability:*** On perusal of the said Section it is clear that Section 32A (1) is a non-obstante provision that appears to give blanket immunity to the new set of directors of the Resolution Applicant who replaces the old directors to take over the corporate debtor as against all the offences done by the promoters/directors of the corporate debtor prior to being put into Corporate Insolvency Resolution Process, from the date of approval of the Resolution Plan by the Adjudicating Authority.

b) ***Prohibition of action against the Property of the Corporate Debtor:*** On perusal of Section 32A (2) it is clear that the said clause prohibits all actions that can be taken against any property of the corporate entity undergoing Corporate Insolvency Resolution Process that is covered under a Resolution Plan approved by the Adjudicating Authority. This clause categorically denies all the claims of attachment by the Government agencies on the properties of the Corporate Debtor, provided the same was considered and covered under the Resolution Plan approved by the Adjudicating Authority. However, it is to be noted that this sub clause does not bar any or all action against property of other third parties, namely the guarantors.

c) *Offering Assistance and Cooperation for investigation:* On perusal of Section 32A (3) it can be understood that notwithstanding anything contained in the clauses (1) and (2) of the

[8] Swet Skikha, *"Ring- fencing Under IBC, and Open Issues"*, accessed on 09.11.2020 at 00:30 hrs., https://www.mondaq.com/india/insolvencybankruptcy/922190/ring-fencing-under-ibc-and-open-issues

[9] Anant Merathia, Rishi Srinivas, Ranghasayee, "*The IBC vs. PMLA- A Critical Study"*, accessed on 10.11.2020 at 16:27 hrs., https://ibclaw.in/the-ibc-vs-pmla-a-critical-study/

Section 32(A), the Corporate Debtor and any person, shall extend all assistance and co-operation to any authority investigating an offence committed prior to the commencement of the Corporate Insolvency Resolution Process.

This was yet another instance of swift governmental intervention to ensure success in the working of the code. Subsequently, the legislature approved the amendment to the code in the same terms as the ordinance, indicating the clear intent of the legislature to give primacy to the object of resolution under the code.

PRIMACY OF IBC OVER PMLA: THE JUDICIAL STANCE[10]

The obvious question that arises at the outset is which provision will get supremacy in the eyes of the law. The courts have had conflicting views on this proposition, but the popular opinion does seem to edge towards the primacy of IBC, and this view was strengthened by the Ordinance as well.

Both, PMLA (under S.71) and IBC (under S.238) contain non-obstante clauses. However, the Supreme Court of India, in *Solidaire India Ltd. v. Fairgrowth Financial Services Private Limited*[11], upheld the Latin maxim '*leges posteriores priores contraries abrogant*', i.e., where two special statutes contain non-obstante clauses, the later statute would prevail over the former since the legislature, at the time of drafting the later law, is aware of the non-obstante clause in the earlier law - the inclusion of a non-obstante clause in the later law implies that it intends to override the earlier law. Since IBC was enacted in 2016 and PMLA in 2002, the issue comes to a logical end with the former overriding the latter.

The Delhi High Court, in *Deputy Director, ED v. Axis Bank*[12], held that neither PMLA nor IBC overrides the other because there is no inconsistency between them. It reasoned that since the objectives of PMLA were distinct from that of IBC, the latter could not prevail over the former

[10] Shivani Shenoy, Yashwardhan Rajawat, *"Applicability of Moratorium to Attachment Proceedings: Reverse Engineering Section 32A at the Backdr"*, accessed on 09.11.2020 at 02:18 hrs., https://www.irccl.in/single-post/2020/02/20/applicability-of-moratorium-to-attachment-proceedings-reverse-engineering-section-32a-at

[11] (2001) 3 SCC 71

[12] 2019 SCC Online Del 7854.

and proceedings under both statutes could run simultaneously. This view taken by the High Court is myopic on two counts.

In order for any legislation to override the other, inconsistency among them is a condition precedent[13]. IBC requires that operations of the corporate-debtor be managed as a going concern. However, once a property is provisionally attached, it cannot be transferred, converted, disposed or moved. In the *Sanjay Gupta*[14] case, it was held that a successful resolution applicant could not manage the affairs of the corporate debtor as a going concern without possession of its assets. Further, in *JSW Steel* (supra), the CIRP of the corporate debtor i.e. Bhushan Power and Steel Limited came to a standstill due to the property of the corporate debtor having been attached by the ED. Therefore, IBC and PMLA can be said to have fundamental inconsistencies, thereby fulfilling the test.

The Axis Bank case failed to effectively employ the doctrine of harmonious construction. The criterion for the applicability of this doctrine is apparent inconsistency between two statutes, not actual inconsistency[15]. However, an interpretation that renders one provision useless is not harmonious construction. The judgment, despite setting aside the order for release of provisionally attached property of the corporate debtor does not harmonize Section 14 of IBC with Sections 5 and 8 of PMLA; rather, it defeats the former at the altar of the latter.

There also exists a lot of confusion regarding the forum to approach to adjudicate upon issues where IBC and PMLA overlap. However, in the view of the researcher, mechanisms under IBC will be considered in preference to those under PMLA because the ED can be deemed as an operational creditor.

In *Axis Bank* (supra), it was held that when the government attaches and confiscates proceeds of a crime under PMLA, it does not stand as a creditor of the offender, nor does it wish to be perceived to be sharing the loot with the offender. However, PMLA is categorised as “non-tax revenue” in the list of heads of accounts of the Union and the States as per the Government of India Allocation of Business Rules 1961. Further, while directing release of attached assets in *JSW Steel*, the

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[13] *Kamayu Motors Association v. State of Uttar Pradesh*, A.I.R. 1966 S.C. 785.

[14] Company Appeal (AT) (Insolvency) No. 362 of 2019

[15] *CIT v. Hindustan Bulk Carriers*, (2003) 3 S.C.C. 57

NCLAT interpreted ED to be an operational creditor of the corporate debtor who could recover its debts in the order of priority of asset distribution under S.53 of IBC. Therefore, for the ED, the NCLT and other such authorities under IBC ought to adjudicate upon disputes to the exclusion of respective authorities under PMLA.

Moreover, NCLT has exclusive jurisdiction over matters governed by IBC. Under the PMLA, third parties having legitimate interest over the property attached as proceeds of a crime may approach the AA under S.8(2) or the Appellate Tribunal under S.26, which may release the attached property to the claimant. However, when the property of a corporate debtor is attached, the NCLT, by virtue of S.60(5)(c), has exclusive jurisdiction to entertain or dispose off any questions of law or fact arising out of or in connection with the resolution or liquidation process. Therefore, NCLT as opposed to the authorities under PMLA ought to be approached for issues where their subject matters overlap.

In *C. Chellamuthu v. Deputy Director, Prevention of Money Laundering Act, Directorate of Enforcement*[16], while considering the issue whether the property in the hands of subsequent bona fide purchaser without knowledge of crime purchased by legal consideration can be attached and whether property purchased bona fide with legal sale consideration loses the character of proceeds of crime and the sale proceeds in the hand of the vendor only can be attached, the Madras High Court held that once a person proves that his purchase is genuine and the property in his hands is untainted property, the only course open to the respondent is to attach the sale proceeds in the hands of the vendor of the appellants and not the property in the hands of genuine legitimate bona fide purchaser without knowledge. It can be inferred here that a Resolution Applicant is also a purchaser of the assets of the CD, as the transaction even involves legal sale proceeds by virtue of the investment made in restructuring the entity, and hence, after change in management, the assets acquired by the RA become untainted, if at all they were falling within the ambit of PMLA. Similar views were expressed by the Ministry of Corporate Affairs in the JSW Steel case, wherein it said, *"In light of the above, the ED while conducting investigation under PMLA is free to deal with or attach the personal assets of the erstwhile promoters and other accused persons, acquired through crime proceeds and not the assets of the Corporate Debtor which have been financed by creditors and acquired by a bona fide third party Resolution Applicant through the statutory process*

[16] 2016 (2) CTC 90.

supervised and approved by the Adjudicating Authority under the IBC. In so far as a Resolution Applicant is concerned, they would not be in wrongful enjoyment of any proceeds of crime after acquisition of the Corporate Debtor and its assets, as a Resolution Applicant would be a bona fide assets acquired through a legal process."

With respect to the provisions of moratorium, it will apply to attachment proceedings since attachment proceedings are not penal in nature. The moratorium is not applicable only to criminal proceedings or penal action taken pursuant to criminal proceeding or any act having essence of crime or crime proceeds[17]. However, to assume that an order of attachment is penal in nature would be incorrect, because attachment is a civil proceeding, which is done as a measure of security than with punitive intent. The legislative intent behind S.14 of IBC is to keep the assets of a corporate debtor together during CIRP to ensure its continuation as a going concern.[18]

Another important consideration here is that the non-imposition of moratorium would cause undue delay in CIRP. In *Swiss Ribbons Private Limited and Anr. V. Union of India*[19], the Apex Court held that the primary focus of IBC is to ensure revival and continuation of the corporate debtor by protecting it from a corporate death by liquidation and advised that liquidation ought to be the last resort only if all attempts at resolution fail. Proceedings for release of attached property of the corporate debtor under the PMLA are not required to be time bound or speedy. This would make it difficult to conclude CIRP within the 330-day timeline. The longer the delay, the more likely it is that liquidation would be the only answer. Further, since most assets are subject to a high rate of depreciation, the liquidation value tends to decrease with time, leading to a loss of value of the corporate-debtor.

[17] *Rotomac Global Pvt. Ltd. v. Deputy Director, Directorate of Enforcement*, Company Appeal (AT) (Insolvency) No. 140 of 2019; *Varssana Ispat Ltd. v. Deputy Director, Directorate of Enforcement,* Company Appeal (AT) (Insolvency) No. 493 of 2018.

[18] Report of the Insolvency Law Committee, Ministry of Corporate Affairs, Govt. of India, March 2018.

[19] Writ Petition (Civil) No. 99 of 2018.

CONCLUDING ANALYSIS AND SUGGESTIONS

The researcher feels that there are too many unanswered questions regarding the proposition at hand. With the insertion of S.32A in the IBC, which ceases liability of and prosecution against the corporate debtor for offences committed prior to the commencement of CIRP from the date of approval of the resolution plan by the Adjudicating Authority, judicial interpretation will now be more straightforward, but the mechanics of the newly inducted rather unconventional provision, remains to be seen with respect to those CIRPs which end neither in a resolution plan nor in liquidation but rather in a settlement.

Moreover, the position that the IBC has an overriding effect on the PMLA is a hypothesis that can be criticised. It is clear that both the acts are created for separate purposes, i.e., the IBC to serve the interests of the creditors and aid the restructuring of the CD, as opposed to the PMLA, which is a punitive legislation meant to curb the malpractice of money laundering. Therefore, in a case where both the acts need to be applied, it has to be ensured that both these purposes are being fulfilled, rather than taking care of one and completely ignoring the other. There is serious need for adequate caution to be exercised against abuse of the immunity under S.32A, lest the erstwhile promoters of the corporate debtor use the corporate debtor as a conduit to collude with resolution applicants to evade criminal liability and dilute the robust mechanisms of PMLA.

We cannot ignore the fact that money laundering is a criminal activity, and has an effect on the economy of the country as a whole, and therefore is against public policy. Having an accused person go scot-free, with no repercussions for his laundering acts, due to the sole reason that he entered into insolvency, is not a healthy precedent to set. The researcher suggests that a balance needs to be struck between the two provisions, and this can only be possible if both the legislations are kept in mind while making a decision regarding this. For this, it is suggested that a limited time period be set out before the approval is sought for the resolution plan by the IRP, wherein the assets of the CD can be scrutinised by any authority under the PMLA, so as to ensure that neither of the assets are involved in any active investigation under the latter Act, and once the authority approves, it cannot later on claim to attach these assets after the approval of the resolution plan. In order to avoid any additional time for this, these objections can be asked to be submitted in the 14 day period wherein the creditors are supposed to make their claims as well. Since the authorities involved are separate, there will be no overlap, and hence both the claims can come in

simultaneously, before the RA invests his money in the restructuring. This would give both the provisions a fair chance to fulfil their objectives.

It is expected that the Supreme Court verdict pending in the JSW Steel case will give the requisite clarity in this issue.