

Interplay between IBC and PMLA



IRP/ RP of a CD is required to take immediate custody of all its properties which are crucial for value maximization which is aimed at successful resolution of the CD. The authentic information on the status of all the properties of the CD is important for investors/ prospective resolution applicants (PRAs) in preparing their resolution plans. However, the PMLA empowers the Enforcement Directorate to attach properties of the CD in violation of the PMLA Act 2005. Interestingly, both PMLA and IBC have obstante sections which provide them superseding effect over conflicting provisions of the previous enactments. There have been cases wherein ED had attached properties of the CD prior to or during the CIRP. However, in the course of time the judiciary has adjudicated on this issue.

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1. Introduction

The Insolvency & Bankruptcy Code, 2016 (IBC/Code) was introduced in 2016 to bring about a speedy resolution and revival of stressed assets. The core intent of IBC is to maximize the value of assets and keep the Corporate Debtor (CD) as a Going Concern (GC). The provisions of IBC are aimed at speedy resolution in a time bound manner. The erstwhile frameworks of resolution like SARFAESI Act and Debt Recovery Tribunal (DRT) could not be successfully implemented on account of complex and delayed recovery. Besides, their focus was on recovery instead of revival. In the erstwhile frameworks, the custody and control of the assets of the CD used to lie with the corporate debtor/its directors which was a major hindrance and delayed the resolution of the stressed assets. To resolve these issues, IBC was implemented with the concept of “creditors-in-control”.

Under the framework of IBC, an Insolvency Professional (IP) in his/her capacity as Interim Resolution Professional (IRP) or Resolution Professional (RP) is appointed by the Adjudicating Authority (AA) i.e., NCLT, to control the CD and undertake measures to keep it as a GC. As per Section 25 of IBC, the IRP/RP is duty bound to undertake

immediate control and custody of all the assets of the CD. The IRP/RP acts on behalf of the Committee of Creditors (CoC), invites Expression of Interest (EoI) from Prospective Resolution Applicants (PRAs) /bidders that submit their respective resolution plans. These resolution plans are vetted by the RP for its compliance and are presented to the CoC for its approval after ascertaining their feasibility and viability. The final Resolution Plan is approved through minimum 66% voting by the CoC and the same is thereafter presented to the AA, for its approval. The AA further ensures that the plan is in accordance with Section 30(2) of the Code and approves the Resolution Plan. Thereafter, the successful Resolution Applicant takes over the management and control of the CD.

2. Prevention of Money Laundering Act, 2002 (PMLA)

PMLA was introduced to prevent money laundering and ensure that the assets from illegally gained proceeds are attached, seized, or confiscated. The Enforcement Directorate (ED), the enforcement agency under the PMLA has powers to attach/ confiscate properties which are purchased from the proceeds of crime.

3. Understanding the conflict between PMLA and IBC

This article attempts to address the concern, conflicts, and interplay between the provisions of IBC and PMLA. Here, the debatable question is whether provisions of the PMLA need to be applicable to the corporates undergoing through IBC processes. The provisions of PMLA seem to tamper with the intent of IBC and hinders just and fair resolution process since both the legislations are conflicting with each other. The aim of PMLA is to confiscate assets that are derived from money laundering while IBC aims at value maximization and to maintain the GC status of the CD.

Under Section 5 of PMLA, the ED attaches the property of the company and prevents it from transferring, converting, disposing, or moving. However, at the same time upon commencement of CIRP, the IP has to take over the assets of the CD and invite the resolution plans. The attachment done by ED may lead to uncertainty in the entire process and also discourages the PRAs. Any PRA would be inclined to take over a CD only if it is given custody,

control, and possession of all the assets of the CD after making payment under the Resolution Plan. However, both IBC and PMLA seems to have conflicting clauses. In pursuance to the IBC, the NCLTs have exercised their discretion and have differently opined on the same issue thereby creating confusion rather than bringing out clarity on this matter.

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4. If Property of CD is attached during CIRP

The landmark judgement passed under CIRP of *Bhushan Power & Steel Limited*¹ (BPSL) is a classic example of the conflicting provisions of IBC and PMLA. In this case, resolution plan was submitted by M/s JSW Steels in the CIRP of BPSL. While the plan was under consideration, the ED attached the assets worth ₹4,025 crores of BPSL in accordance with provisions of PMLA on the grounds that the assets were acquired from proceeds of crime. The RP knocked the doors of National Company Law Appellate Tribunal (NCLAT) to seek protection from attachment by the ED. NCLAT stayed both - attachment order and approval of resolution plan.

While the NCLAT's final judgement was awaited, there was an amendment in the Code and Section 32A was introduced in IBC. According to Section 32A "*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 from the date the resolution plan has been approved by the Adjudicating Authority under Section 31.*"

Based on the amendment, the NCLAT upheld the Resolution plan submitted by M/s JSW Steels and the proceedings initiated against BSPL were abated including the attachment of assets as per PMLA provisions. This judgement is an example where the assets of the CD under PMLA were attached post initiation of CIRP.

¹ *Bhushan Power & Steel Limited (BPSL)*, NCLAT, New Delhi, Company Appeal (AT) (Insolvency) No. 957 of 2019, Date of order: Feb. 17, 2020.

5. If Property of CD was attached before CIRP Commencement Date

In many cases, the assets are already attached prior to initiation of CIRP. In such scenario also, provisions of IBC will supersede PMLA provisions based on judicial precedents. In the matter of *Sterling SEZ Infrastructure Limited*² and *Sterling International Enterprises Limited*³, the Mumbai NCLT bench directed RP to take custody of the assets which were attached under PMLA provisions prior to commencement of CIRP. An appeal was filed against the NCLT order by the ED. The NCLAT held that even if ED had attached the assets of the CD under PMLA, it must vacate its claim by de-attaching the assets upon commencement of CIRP as IBC has superseding effect on PMLA provisions.

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Another landmark judgment passed by NCLAT was in the case of *The Directorate of Enforcement Vs. Sh. Manoj Kumar Agarwal & Others*⁴ on the interplay between the provisions of PMLA and IBC in April 2021. The matter of concern before the NCLAT was whether imposition of moratorium under Section 14 of IBC following the initiation of the CIRP would impact an attachment of property made under the provisions PMLA. It was held that the assets which are attached under PMLA would be available under IBC. Since the very objective of IBC is revival of the CD, the same shall be nullified if the assets are attached and not handed over to the RP for its custody and control.

6. Noteworthy Observations and Conclusions of Judiciary on conflicting provisions of PMLA and IBC

The core objective of PMLA is attachment, seizure and confiscation of property involved in money laundering

i.e., to recover the assets from the laundered money and prevent money laundering. However, to achieve successful resolution under IBC, it is important that assets of the corporate debtor are in custody and control of the IRP/RP. The judgement passed by NCLAT in *Manoj Kumar Agarwal*⁵ seeks to uphold the objective of IBC by ensuring that the assets of corporate debtor are available to the IRP/RP and in turn the same is transferred to the successful Resolution Applicant. Similar kind of judgments also passed by the Delhi High Court in the matter of *Nitin Jain, Liquidator, PSL Limited*⁶. These judgments are beneficial for the PRAs as it will boost confidence in them as the provisions of PMLA will not remain in force once the CIRP commences and in a way, these judgements are in the interests of the economy. The noteworthy observations and conclusions that can be deciphered from the above stated two judgments are as follows:

6.1. Effect of applicability of Section 14 of IBC i.e., imposition of moratorium on attachment proceedings under the PMLA

- a) The attachment of properties would be quasi-criminal in nature and are thus hit by Section 14, moratorium, of the Code till the time special courts do not establish the criminality of the accused. On commencement of CIRP, Section 14 would be triggered and the institution and continuation of such proceedings before the AA under the PMLA would be barred.
- b) The judgement of *Alchemist ARC Vs. M/s Hotel and Gaudavan Private Limited & Ors*^{7&8} is a fine example of supremacy of moratorium under the IBC. In this case, the CD failed to repay the loan of State Bank of India (SBI) and thus petition was filed before DRT. In accordance with Section 5 of

² *Sterling SEZ Infrastructure Limited*, NCLT, Mumbai Bench, Date of order: Feb. 12, 2019.

³ *Sterling International Enterprises Limited*, NCLAT, Principal Bench, New Delhi, Company Appeal (AT) (Insolvency) No. 575 and 576 of 2019, Date of order: April 09, 2021.

⁴ *The Directorate of Enforcement Vs. Sh. Manoj Kumar Agarwal*, NCLAT, Principal Bench, New Delhi, Company Appeal (AT) (Insolvency) No. 575 and 576 of 2019, Date of order: April 09, 2021.

⁵ *Manoj Kumar Agarwal*, NCLAT, Principal Bench, New Delhi, Company Appeal (AT) (Insolvency) No. 575 and 576 of 2019, Date of order: April 09, 2021.

⁶ *Nitin Jain, Liquidator, PSL Limited*, High Court, Delhi, W.P.(C) 3261/2021, Date of order: Dec. 15, 2021.

⁷ *Alchemist ARC Vs. M/s Hotel Gaudavan Private Limited & Ors*, High Court, Delhi, W.P.(C) 11814/2015, Date of order: Feb 04, 2016.

⁸ *Alchemist ARC Vs M/s Hotel Gaudavan Private Limited & Ors*, Supreme Court of India, CIVIL APPEAL NO. 16929 OF 2017 (Arising out of S.L.P. (C) No. 18195/2017), Date of order: Oct. 23, 2017.

SARFAESI Act, SBI transferred its debt to Alchemist ARC. The Financial Creditor (FC) i.e., Alchemist ARC, had supplanted SBI in the ongoing proceedings before DRT. Simultaneously, the CIRP under IBC commenced against the CD by the FC and moratorium under Section 14 was imposed. The CD invoked the arbitration clause between the FC and the CD and appointed an arbitrator as per the loan agreement. The conflict between arbitration and insolvency proceedings was put to rest through this judgement. The Supreme Court held that the appointment of an arbitrator and the arbitration proceeding is non-est in law on account of imposition of moratorium.

6.2. Overriding effect of IBC

- a) Since the IBC was introduced and enacted later than PMLA, the same will override the PMLA by virtue of section 238, which provides that the provisions of IBC shall have over-riding effect notwithstanding anything contained in any other law. Thus, the authorities under the PMLA are compelled to hand over the custody and control of the attached properties of the CD to the IRP/RP to assist him/her to maintain it as a GC until the successful resolution plan is achieved. If the CIRP admission order is set aside or if the application admitted under Section 7 of the IBC is withdrawn under Section 12A of the IBC, then the provisions of PMLA will prevail over IBC and the assets shall remain attached.

The over-riding effect of Section 238 of the IBC was also upheld in the matter of *Anand Rao Korada, RP Vs. Varsha Fabrics P Ltd*^{9&10}. In the said case, a writ petition was filed before Orissa High Court and interim order was passed. The Varsha Fabrics P Ltd. had inked Share Purchase Agreement on July 10, 2006, with M/s Varsha Fabrics Pvt.

Ltd, India Finance Ltd., Mudrika Commercial Pvt. Ltd., Hirakud Industrial Works Ltd., and Industrial Development Corporation of Orissa Ltd. This agreement was cancelled

In the matter of *Anand Rao Korada, RP Vs. Varsha Fabrics P Ltd*, the Supreme Court upheld that Section 238 of the IBC has an over-riding effect and hence interim order of Orissa High Court ought not to proceed with the auction.

and dispute regarding payment of arrears and salaries to workmen arose. The High Court further directed the assets to be sold through public auction and the proceeds to be utilised for disbursement of the arrears. Meanwhile, during the pendency of these proceeding, CIRP was initiated. An appeal was filed by the RP to challenge the interim orders passed by Orissa High Court in writ petition and sought auction proceedings to be stayed on account of imposition of moratorium. The Supreme Court directed that Section 238 gives an over-riding effect and hence interim order of High Court ought not to proceed with the auction.

- 6.3. **Section 32A of IBC:** The Section 32A of IBC provides immunity against prosecution of the CD, to successful Resolution Applicant in relation to any offence committed by directors/promoters prior to the commencement of the CIRP, and immunity against CD's assets. Section 32A(2) also provides for immunity to the property of the CD if the said property is covered under sale of liquidation assets and is transferred to a person who was not a promoter/in management or control of the CD/related party. The said provisions were referred to by NCLAT in these judgements.

⁹ *Anand Rao Korada, RP Vs. Varsha Fabrics P Ltd*, Orissa High Court, W.P. (Civil) No. 7939/2011, Date of order: Aug. 14, 2019 & Sept 05, 2019.

¹⁰ *Anand Rao Korada, RP Vs. Varsha Fabrics P Ltd.*, Supreme Court of India, CIVIL APPEAL NOS. 8800-8801 OF 2019 (Arising out of S.L.P. (C) No. 23349-23350/2019), Date of order: Nov. 18, 2019.

6.4. Jurisdiction of AA under Section 60(5) IBC:

What is interesting is to refer to the Supreme Court's judgment in the matter of *Embassy Property Developments Pvt. Ltd.*¹¹. is that the Apex Court held that Section 60(5) of the Code cannot be used to claim everything under the sky.

The Supreme Court, in the matter of *Embassy Property Developments Pvt. Ltd.* held that Section 60(5) of the IBC cannot be used to claim everything under the sky.

However, in the present case, both the NCLAT and High Court noted the insertion of new Section 32A in the Code which intends to de-clog the assets of the CD from the clutches of the different criminal proceedings. The NCLAT held that the NCLT has the necessary jurisdiction to interfere with the provisional attachment orders passed under the PMLA as it is the duty of the RP under section 18(1)(f)(vi) to take over the control and custody of the assets of the CD even if the ownership status thereof is subject to determination by court/competent authority. The NCLAT took a pragmatic view that since the attachment would directly interfere with the duty of the IRP/RP to take over the assets and management of the CD, the question of detachment of assets under PMLA could very well lie before the NCLT under the IBC as it would be a question of priority arising out of or in relation to the CIRP or liquidation proceedings of the CD to be decided by the AA under Section 60 (5)(c).

6.5. Contradiction between two Non-Obstante

Clauses: As we all know that Section 238 of the Code notified in the year 2016 contains a non-obstante clause giving it precedence over other contrary laws. Similarly, the PMLA, notified in the year 2005, also contains a non-obstante Section 71 which has an overriding effect

notwithstanding anything contained in any other laws. Through further amendments made in the year 2019, another non-obstante Section 32A was inserted in the IBC. After noticing the rationale behind introduction of Section 32A to the IBC, the Court upheld the supremacy of the IBC on account of following reasons:

- a) IBC being later in time would prevail over the PMLA, being the former one as the legislature was oblivious of the reach and ambit of the earlier legislation while introducing the later one. This rationale is also supported by the Latin maxim '*Leges posteriores priores contrarias abrogant*' which states that "*the later laws shall abrogate the earlier laws that are contrary or in conflict with the subsequent laws*"
- b) Once the Legislature has chosen to step in and introduce a specific provision for cessation of liabilities and prosecution (Section 32A), it is that alone which must govern, resolve and determine the extent to which powers under the PMLA can be permitted in law to be exercised while a resolution/liquidation process is ongoing.
- c) If the Authorities under PMLA, based on the attachment or seizure done or possession taken under the said Act, resist handing over the properties of the CD to the IRP/RP/Liquidator, the operations of the CD could not be managed as a GC during and after the CIRP.

To summarize the substance of the above stated judgments; it can be concluded that the assets of the CD are available for achieving the successful resolution/auction under the IBC. The Parliament upon due consideration deemed it appropriate and expedient to infuse the clean slate doctrine by introduction of Section 32A in the Code bearing in mind the larger economic results sought to be achieved with the introduction of the IBC.

¹¹ *Embassy Property Developments Pvt. Ltd.*, Supreme Court of India, Civil Appeal No. 9170 of 2019 (Arising out of S.L.P. (C) No. 22596 of 2019), Date of order: Dec. 03, 2019.

Section 14, 18, 32A and 238 of the Code makes it abundantly clear that IRP/RP/Liquidator is fully empowered to take over the assets of the CD even if the same is subject to attachment under any other law.

Section 14, 18 and 32A of the Code makes it abundantly clear that IRP/RP/Liquidator is fully empowered to take over the assets of the CD even if the same is subject to attachment under any other law. It has been further clarified that the AA under the IBC is duly posed with the jurisdiction to order for detachment or unfreezing of the assets as held in the case of *Manish Kumar Vs. Union of India and Another*¹² by the Supreme Court. The PSL Limited judgment has further clarified that all the protection of Section 32A is also available for sale of the CD as a GC and accordingly no embargo will have effect on such sale which is covered under the provisions of the Code. Meanwhile, the constitutional validity of Section 32A of the Code has already been upheld by the Supreme Court in the matter of *Manish Kumar Vs. Union of India and Another*. Certainly, owing to the insertion of section 32A, the present NCLAT ruling is an overturn of its own judgment rendered in *Varrsana Ispat Vs. Deputy Director, Directorate of Enforcement*¹³ wherein the tribunal held that the proceedings under the PMLA are criminal in nature and had further declined to intervene in the said proceedings.

Also, though attachment proceedings are civil in nature but even if the same could not come within the ambit of Section 14, owing to their quasi-criminal nature, Section 32A and 238 would still apply and the IBC, being a subsequent enactment, will override anything inconsistent contained in the PMLA. Having regard to the duties of the RP in relation to the assets of the CD, which includes management of its operations as a GC, and having regard to the offering of CD to the RP on a clean slate, it goes to establish the efficacy of the IBC proceedings, and any obstruction created by attachment or other proceedings



under the PMLA would be vitally detrimental to the interests of the CD and the concerned stakeholders.

7. Conclusion

The recent NCLAT and Delhi High Court rulings have brought back the focus on the IBC's overriding powers under Section 238 read with Section 32A. Attachments by various law enforcement agencies like Serious Fraud Investigation Offices (SFIO), Central Bureau of Investigation (CBI), Enforcement Directorate (ED), Economic Offences Wing (EOW) has been a major concern while taking over the assets of the CD and further inviting resolution plan or putting such assets on auction. The judgments are laudable ones and will go a long way in making IBC a more stable and reliable resolution statute in India. The inclination of NCLAT to do a constructive interpretation of Section 32A to apply it even during the concurrency of the CIRP/liquidation, rather than waiting till achievement of successful resolution, will enable the RP/Liquidator to take better control of the assets of the CD. This would surely result in the CoC commanding better commercial bargaining powers against the PRAs as the detached assets would give them more confidence and bring maximization of value of underlying assets thereby serving the objective of the IBC.

¹² *Manish Kumar Vs. Union of India and Another*, Supreme Court of India, Civil Original Jurisdiction Writ Petition(C) No.26 of 2020, Date of order: Jan. 19, 2021

¹³ *Varrsana Ispat Vs. Deputy Director, Directorate of Enforcement*, NCLAT, New Delhi, Company Appeal (AT) (Insolvency) No. 493 of 2018, Date of order: May 02, 2019.