

# INCONGRUITY ENCIRCLING THE PROCEEDINGS UNDER IBC AND PMLA IN LIGHT OF S. 32A OF IBC

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## • ABSTRACT

*There has been a quest to resolve the prolonged ambiguity with regards to the proceedings under the Insolvency and Bankruptcy Code, 2016 (Hereinafter 'IBC') and the attachment proceedings under the Prevention of Money Laundering Act 2002 (Hereinafter 'PMLA'). The proceedings under IBC and PMLA are inconsistent with one another and cannot subsist unhindered when invoked simultaneously. The judiciary has made various judicial decisions in this regard which are diverging with one another and causing uncertainty. It is important to analyze the plausible rationale behind these diverging decisions to seek clarity with regards to the proceedings that shall prevail over the other. Recently, an ordinance was promulgated and the IBC Amendment Act 2020 was introduced. The amendment inter alia introduced S.32A which absolves the liability of the corporate debtor prior to the commencement of the insolvency resolution process. This would essentially discharge the liabilities of the corporate debtor and its property in lieu of the offences committed prior to the commencement of the resolution process although, may hamper the proceedings which are instituted for the investigation of these offences such as proceedings under PMLA. The persisting ambiguity with regards to the proceedings when simultaneously invoked may stand resolved by this amendment. In this article, we shall attempt to critically analyze the inconsistencies between the IBC and the PMLA with the help of judicial decisions and examine whether the introduction of Section 32A resolves the aforementioned ambiguity.*

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- **INTRODUCTION:**

Moratorium under Section 14 of the IBC refers to the period after the commencement of the *corporate insolvency resolution process (CIRP)* wherein, all the operations of a corporate entity come to a standstill including pending suits, proceedings, enforcement of orders and decrees. The scope of moratorium however, has been altered time and again by restricting its applicability to certain proceedings. The judiciary through its decisions has determined that declaration of moratorium does not restrict the institution or continuation of the proceedings that are in benefit of the corporate debtor<sup>1</sup>, suits under Articles 32 or 226 of the Constitution of India<sup>2</sup> proceedings under Section 138 of the Negotiable Instruments Act<sup>3</sup> and other regular criminal proceedings.<sup>4</sup> However, an ambiguity persists with regards to the continuity of attachment proceedings under the PMLA during the subsistence of moratorium under IBC. The Courts and tribunals have made an attempt through judicial interpretations to resolve this ambiguity however it persisted. Recently, an ordinance was promulgated and the Insolvency and Bankruptcy (Amendment) Act, 2020 was introduced. This came to be the fourth amendment to the IBC which inter alia introduced Section 32A. This section asserts that once a resolution plan is approved by the adjudicating authority and if it results in a change of management, then the corporate debtor and its assets shall have immunity against the offences committed prior to commencement of CIRP. Let us review the inconsistencies between IBC and PMLA;

- **INCONSISTENCY BETWEEN IBC AND PMLA:**

While analysing the inconsistencies between IBC and PMLA it is important to consider the case of *The Deputy Director Directorate of Enforcement Delhi v. Axis Bank & Ors.*,<sup>5</sup>(Axis bank case) as the Delhi High Court delivered a disputable decision.

Before dwelling into the intricacies, it would be apposite to consider the factual matrix of this case; the decision granted was in lieu of five appeals with similar factual matrix. In each of these matters, there was an involvement of third-party claims (creditors such as banks and other

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<sup>1</sup>Power Grid Corporation of India Ltd. v. Jyoti Structures Ltd, O.M.P.(COMM.) 397/2016.

<sup>2</sup>Canara Bank v Deccan Chronicle Holdings Ltd, (Insolvency) No. 147 of 2017.

<sup>3</sup>Shah Brothers Ispat Pvt. Ltd. v. P. Mohanraj, (Insolvency) No. 306 of 2018.

<sup>4</sup>Tayal Cotton Pvt. Ltd. v. The State of Maharashtra, WP (Cri) No.1437/2017.

<sup>5</sup>The Deputy Director Directorate of Enforcement Delhi v. Axis Bank & Ors., CrI.A.143/2018 & CrI. M.A 2262/2018.

institutions). The holder of the assets was charged with certain provisions under the PMLA and the properties were to be attached in lieu of the proceedings. This was however in conflict with the proceedings initiated by the third parties for recovery under the IBC. Here, the court was of the opinion that the proceedings under PMLA shall continue during the subsistence of the CIRP as these two legislations have varied objectives, therefore, cannot be inconsistent with one another and must be interpreted harmoniously although the court failed to construe them harmoniously.

The judgement upheld the objectives of PMLA but was completely opposed to the objectives of IBC. The rights of the third party guaranteed under the IBC and other debt recovery legislations were affected. It failed to consider the judicial decisions and the principles upheld by the adjudicating authorities thereby, further, causing ambiguity. The points that were not considered by the Delhi High Court while rendering this decision are as follows;

- **JURISDICTION TO ATTACH PROPERTIES:**

In the case of *SREI Infrastructure Finance Ltd. v Sterling SEZ and Infrastructure Ltd.*<sup>6</sup> the tribunal explicitly took the view that the adjudicating authority under PMLA does not have the jurisdiction to attach the properties of the corporate debtor undergoing CIRP. The Tribunal was very much correct in stating that even though PMLA also has provisions to compensate the affected third parties (creditors) through the sale of assets attached under the act, it is a time-taking and complex procedure just like any other criminal proceeding which is not time bound. The IBC provides a time bound mechanism and has set strict time frames to reach a resolution. The innocent third parties should not be required to go through such a time taking process under PMLA when they have speedy mechanisms under the IBC. If they have to go through the process which is prolonged it will cause erosion of assets and therefore, will be financially disadvantageous as the value of the assets will depreciate over time. The Delhi High Court in the *Axis bank case* has failed to take into consideration the decision in the case of *SREI Infrastructure*<sup>7</sup> and has passed a judgement solely in the favour of the PMLA by allowing the

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<sup>6</sup>*SREI Infrastructure Finance Ltd. v. Sterling SEZ and Infrastructure Ltd.*, M.A 1280/2018 in C.P 405/2018.

<sup>7</sup>*Ibid.*

attachment of property of the corporate debtor during the subsistence of moratorium thereby defeating the object of the IBC.

- **ATTACHMENT ORDERS DURING THE SUBSISTENCE OF MORATORIUM:**

In *Bank of India v The Deputy Director Directorate of Enforcement*<sup>8</sup> the appellate tribunal held that the subject property, in this case, was mortgaged with the appellant bank much prior to the date of alleged offence thus; the subject property could not have been purchased from the proceeds of crime. The Appellate Tribunal made it very clear that when the properties are mortgaged with a third party prior to commitment of the alleged offence, then the innocent third party has the first legal right over the property and in that case debt recovery legislations will prevail over PMLA.<sup>9</sup>

According to the factual matrix in the *Axis bank case*, the offence was committed after the properties were hypothecated/mortgaged by the third-party creditors thus, the properties in question should not have been deemed to be the proceeds of crime but were sought to be attached as they would have been eventually subjected for confiscation on account of being alternative attachable properties or deemed to be tainted properties as per the law. Comparing the present case with the *Axis bank case*, we understand that even though the facts in both the cases were similar, the Delhi High Court did not consider the observations of the Appellate tribunal.

- **NON-OBSTANTE CLAUSE:**

The Delhi High Court in the *Axis Bank case* has rejected the argument of primacy of IBC over PMLA and reasoned that the said legislation is not inconsistent with the PMLA as they have varied objectives. It declared that the PMLA by the virtue of Section 71 (non-obstante clause) that it has an overriding effect over other existing laws and such provisions containing the non-obstante clause with regards to inconsistency apparently to be construed as referable to the dealings in 'money laundering' and 'proceeds of crime' relating thereto.<sup>10</sup>

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<sup>8</sup> Bank of India v. The Deputy Director Directorate of Enforcement, FPA-PMLA-2173 & 2155/MUM/2018.

<sup>9</sup> *Ibid.* at para 12 and 13.

<sup>10</sup> The Deputy Director Directorate of Enforcement Delhi v. Axis Bank & Ors., CrI.A.143/2018 & CrI. M.A 2262/2018, para 148.

Further, Section 53 of IBC and Section 8 of PMLA are in conflict as both of them provide for their respective procedures for a secured creditor to follow in order to get the properties. Subsequently, the court has failed to take into account the observations of Hon'ble Supreme Court that when two special statutes are in conflict and when both of them have a non-obstante clause (under Section 71 of PMLA and under Section 238 of the IBC) then the later statute shall prevail for the simple reason that, the legislature, while framing the later statute, was well aware of the former statutes and knowingly included a non-obstante clause to enable the later statute to have an overriding effect over anything inconsistent to it and the legislature wanted the later statute to prevail.<sup>11</sup> This view has been taken by the adjudicating authority in the case of *Bank of India v Deputy Directorate of enforcement*. The lack of coherence among the judicial decisions has made the ambiguity more complex as there is no uniformity as to whether the debt recovery proceedings will prevail over the proceedings under PMLA.

- **PLAUSIBLE RATIONALE BEHIND THE DIVERGING DECISION IN THE AXIS BANK CASE:**

Even though the proceedings under PMLA have been regarded as civil in nature, it has an essence of crime in them which is evident from the following provisions; Section 65 of PMLA provides that provisions of *Code of Criminal Procedure, 1973 (CrPC)* shall apply to PMLA as far as they are not inconsistent. Section 42 to Section 46 of the PMLA specifically incorporates the provisions of CrPC for the trials under the PMLA.

As a crime is considered a wrong against the state, it is prosecuted by the state. The seriousness of the proceedings under criminal law is more as compared to regular civil proceedings. The jurisprudential essence of criminal proceedings leads to a judicial tilt towards it during a conflict between proceedings under criminal law and proceedings under civil law.

Considering the situation at hand, despite the fact that proceedings under PMLA are of civil nature, both IBC and PMLA are statutory in nature and the adjudicating authority for both the statutes is a tribunal, proceedings under IBC are subjected to PMLA or jurisdiction of the *Enforcement Directorate (ED)*. The courts decide entirely in accordance with the provisions of

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<sup>11</sup>*Solidaire India Ltd v. Fairgrowth Financial Services*, 2001 (1) SCR 932.

PMLA. In the Axis bank case and various other cases<sup>12</sup> there has been a judicial tilt towards the proceedings under PMLA and the above-mentioned fact that the proceedings have an essence of crime in it could be the reason for the same. Due to the attachment provision under PMLA, the whole CIRP comes to a standstill and therefore the judiciary needs to sternly look into this matter.

- **SECTION 32A AND PROCEEDINGS UNDER PMLA:**

This amendment gives a new dimension to the persisting ambiguity with regards to the IBC and the PMLA. The property of the corporate debtor even if deemed to be 'proceeds of crime' by the ED and is pending probe by the ED once the resolution plan is approved by the Adjudicating Authority the corporate debtor's liability shall be absolved till the completion of the resolution process. The law laid down in *Axis Bank case* was that the objective of PMLA and IBC is different from one another and IBC cannot prevail over PMLA but, with the introduction of Section 32A which provides immunity to the corporate debtor from the liability for the offences committed prior to the CIRP the same cannot prevail. Therefore, ED cannot attach properties of corporate debtor or conduct investigation against him because after the resolution plan is approved it results in the change of management; this, however, does not apply to the previous management of the corporate entity at the time of alleged money laundering and thus, the probe can be conducted against them. This amendment resolves the uncertainty to a large extent by upholding the provisions of the IBC and its legislative intent which was being hampered by provisions under other statutes.

It is important to understand that, after the commencement of CIRP and during the subsistence of moratorium, the properties of the corporate debtor should not be attached under any other proceedings as the primary objective of the IBC is revival of the corporate entity<sup>13</sup> and in order to devise an efficient resolution plan, the assets of the corporate debtor are paramount and should be in possession of the Resolution Professional for maximum benefit.

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<sup>12</sup>Rotomac Global Pvt Ltd. v. Deputy Director Directorate of Enforcement, (Insolvency) No.140 of 2019.

<sup>13</sup>Swiss Ribbons Pvt. Ltd &Anr. v. Union of India, WP(Civil) 99 of 2018.

- **TRIGGERING POINT FOR SECTION 32A:**

The amendment to the IBC was triggered while the matter of *JSW Steel Limited v. Mahendra Kumar Khandelwal*<sup>14</sup> (*JSW Steel case*) was pending in appeal. The factual background of the case is such that the adjudicating authority National Company Law Tribunal, Delhi (NCLT) approved the resolution plan of '*JSW steel limited*' (*JSW Steel*) on 5th September 2019 to take over the debt ridden *Bhushan Power and Steel Limited (BSPL)* as per the procedure under IBC following which on 10th October 2019 the ED attached properties of BSPL under PMLA. As a result, the resolution process came to a standstill. JSW Steel objected to the jurisdiction of ED to attach properties of the corporate debtor after approval of the resolution plan. On the 14th of October 2019, the Adjudicating Authority passed an order prohibiting the ED from attaching the properties of the Corporate Debtor without the approval of this adjudicating authority and that the property that had already been attached was to be released in favour of the Resolution Professional but the impugned order was also to stay the enforcement of the resolution plan. During the pendency of this appeal by JSW steel, Section 32A was introduced by the amendment act, 2020. This appeal was allowed by the Appellate Tribunal however, it clarified that the judgement shall not come in the way of the ED or the Serious Fraud Investigation Office or the Central Bureau of Investigation to proceed with the investigation or to take any action against the erstwhile promoters, officers and others of the Corporate Debtor.

The appellate tribunal has regarded Section 32A as a mere clarification of Section 238 of the IBC. This means that the provisions of IBC can override anything inconsistent with it. Further, the contention of the ED that the amendment was prospective in nature and thus not applicable in the present case was denied as the appellate tribunal held that it being in a clarificatory nature must be applied retrospectively.<sup>15</sup> Thus, applicable to the JSW Steel case.

This decision of the tribunal brings clarity with regards to the properties attached by the ED prior to the approval of the resolution plan.

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<sup>14</sup> *JSW Steel Limited v. Mahendra Kumar Khandelwal*, (Insolvency) No. 957 of 2019, (NCLAT, Delhi).

<sup>15</sup> *Ibid.* at para 45.

- **ANALYSIS:**

The above discussion makes it very clear that since the inception of criminal proceedings being adjudged as an exception to the moratorium it has created more difficulties in the smooth functioning of the CIRP and also in settling the apparent repugnance between the IBC and PMLA. At this point, there was a need for the aforesaid amendment but the question now is, whether the amendment is really sufficient and to what extent it harmonizes the repugnance between IBC and PMLA. The Section 32A being non-obstante, as mentioned earlier, comes as a very strong and dominant change along with Section 238 of the IBC. It makes Section 238 more stringent. It has the ability to cease all proceedings related to offences committed by the corporate debtor and render attachment of properties illegal once the resolution plan is approved. The amendment is in consonance with the object of the IBC but at some length, it may hamper the proceedings under PMLA because on the approval of the resolution plan the liability of the corporate debtor stands discharged and the objective of PMLA may not be satisfied as once the resolution plan is approved it will handicap all the proceedings under PMLA.

Although the Amendment to the IBC is welcomed as it upholds the objective of the IBC, there is still a lot of uncertainty when it comes to the interpretation and application of the amended provision with regards to proceedings under other legislations such as the PMLA. The pending proceeding in the Hon'ble Supreme Court in the JSW Steel Limited case is most awaited as it will bring clarification with regards to the interpretation and applicability of Section 32A which may help in resolving the ambiguities.



- **CONCLUSION:**

After an in-depth analysis of the said inconsistencies and Section 32A, one can recognize that it plays an important role in resolving the ambiguity between IBC and PMLA to a great extent as, the uncertainty with regards to the continuation of the proceedings under PMLA during the subsistence of moratorium is cleared by the introduction of Section 32A. It brings clarity pertaining to the matters related to the liability of the corporate debtor and elucidates the legislative intent for the IBC to be resolute. It has emerged as a way to put it out there that IBC will have primacy when it comes to safeguarding the rights of the creditors.

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