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Overlapping Issue: Insolvency and Bankruptcy Code, 2016 & Prevention of Money Laundering Act, 2002 and Judiciary's Stance

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ABSTRACT

Insolvency and Bankruptcy Code, 2016 (herein referred to as IBC) and Prevention of Money Laundering Act, 2002 (herein referred to as PMLA) are legislations dealing with diverse domains. However, a major conflict between the IBC and the PMLA exists in India. During the Corporate Insolvency Resolution Process (CIRP), while the PMLA aims to seize and attach any property or asset connected to money laundering, the IBC strives to enhance the value of the financial creditors' assets. This hampers the implementation of both legislations, depicting the inefficient implementation of their legislative material. This research paper aims to evaluate the friction between these two legislations. To have an insight into the paper, it has been divided into various segments. The paper unfolds with an introduction and overview of the two statutes. The next part deals with the distinct objectives and key provisions of these two statutes and the resolution process under IBC. The paper further discusses the point of conflict and the instances where the provisions of IBC and PMLA can overlap and lastly the problems faced by the corporate debtors and creditors and the stance of judiciary on certain cases.

Keywords: IBC, PMLA, insolvency, Money laundering, Resolution Process, corporate debtor.

I. INTRODUCTION

In today's legal and financial framework, two statutes, IBC and PMLA are playing significant roles in India in dealing with money laundering issues and cases of insolvency and bankruptcy to address the issue of Non-Performing Assets (NPA). The research paper makes an effort to discuss the issues, conflicts, and inconsistencies between the PMLA and IBC provisions. The contentious issue is whether or not, the corporates going through IBC proceeding need to be subject to PMLA provisions? PMLA's provisions seem to undermine the goals of IBC and impede the just and fair process of resolution as they contradict with each other. While IBC

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seeks to maximize value and preserve corporate debtors' going concern (GC) status, PMLA seeks to seize assets obtained through money laundering.

According to Section 5 of the PMLA, the Enforcement Directorate (ED) attaches the company's property and prevents it from being transferred, converted, disposed of, or moved; nevertheless, with the start of the CIRP, the Insolvency Professional (IP) must take over the CD's assets and invite the resolution proposals. The associated action taken by ED may cause ambiguity throughout the process and dissuade Prospective Resolution Applicants (PRA). Any PRA would only be willing to take over a CD if it was given custody, control, and possession of all of the CD's assets after making a payment under the resolution plan. However, both IBC and PMLA appear to have contradicting clauses.

Both are the foundations of India's legal framework. Nonetheless, both statutes were created with the intention of preserving the interests of creditors, debtors, and the overall economy. Sometimes, the provisions of both these two essential legislations overlap and create a complex web of legal ambiguities

II. BACKGROUND OF IBC & PMLA

The IBC was enacted in 2016 to streamline the process of reorganising and resolving insolvency for corporate entities, partnership firms, and individuals. It aims to maximise the value of assets for the entities facing bankruptcy. Prior to the introduction of the Code, the legal system for winding up companies was as dysfunctional as the companies themselves. Previously, the regime was adversarial and favouring debtors. Previously, throughout the insolvency procedures, the debtor controlled the Company's management. The Code resolves this issue by transferring management of the Company to the resolution professional. The old regime's numerous laws resulted in extremely fragmented insolvency processes. Due to multiple statutes, the powers of creditors and debtors were unclear during insolvency procedures. In nutshell the Code switches from the debtor-in-possession paradigm to one in which both creditors and debtors act under a framework of equity and fairness to all stakeholders in order to preserve the value of the Company.

PMLA, 2002 is a crucial statute in India that is intended to combat money laundering and related financial crimes. Its primary goal is to prevent money laundering and make it easier to seize assets that are obtained through or connected to money laundering.

According to the statute, money laundering is broadly defined as any procedure or action meant to give legitimacy to proceeds gained illegally, including those that result from criminal activity. The law makes money laundering operations illegal and imposes severe punishments, such as

arrest time and fines, on those found guilty of such crimes. Several agencies work together to enforce the PMLA, with the ED leading the charge. The task of looking into and prosecuting violations of the legislation falls to the ED.

According to the PMLA Act, it is the duty of banking groups, financial institutions, and intermediaries to confirm and keep thorough records about the identities of all customers and transactions.

(A) Objectives of IBC & PMLA

IBC was brought by the government of India in 2002 in order to establish a transparent and effective system to deal with the cases of insolvency and bankruptcy within a set time period. The main objective behind bringing the structured approach was to resolve the financial distress of the entrepreneurs effectively, to recover the maximum value from the assets of insolvent entities, to expedite the resolution process, to protect the best interest of the creditors both operational and financial. The main goals of the IBC are, not only to recover the money owed to the creditor, but also to safeguard the corporate debtor from its own management and prevent a "Corporate death" through liquidation.

On the contrary, PMLA has a substantially distinct focus and aim compared to the IBC. Its primary objective is to discourage and resist the money laundering activities; protecting the credibility of the monetary framework by making sure that money which is obtained illegally does not infiltrate legitimate financial channels; to seize and confiscate assets and properties derived from money laundering activities and to maintain legal and ethical standards.

(B) Key provisions under IBC

Section 7 deals with the beginning of CIRP. Under this section, when a corporate debtor defaults payments, a financial creditor may apply to the National Company Law Tribunal² to start the CIRP.

Section 14(1)(a) of IBC states that once a moratorium order is issued by the Adjudicating Authority (AA), no new legal actions or the continuation of existing ones, including the execution of court judgments or orders, can be taken against the corporate debtor. **Section 33(5)** of the IBC says, when an order with respect to liquidation is passed, no new lawsuits or proceedings can be initiated against the corporate debtor.

Section 238 of the IBC is a "*non-obstante clause*" and prevails over any conflicting provisions in other laws.

²Constituted under Sec. 408 of The Companies Act, 2013.

Ordinance of 2019 and the insertion of section 32A

Section 32A can be described as the most influential and all-encompassing amendment incorporated into IBC. When considered in conjunction with Section 238, it has the potential to halt any legal actions, including prosecutions, asset attachments, and seizures, against the corporate debtor, regardless of the existing laws in effect, which includes actions initiated under the PMLA. This newly introduced provision can be categorised into three sub clauses:

Section 32A (1) makes it crystal clear that it a non-obstante clause that seemingly provides complete immunity to the new directors of the resolution applicant. They take charge of the corporate debtor, replacing the previous directors, and are shielded from any liabilities stemming from the actions of the former promoters or directors prior to the initiation of the CIRP. This immunity begins to operate on the day the adjudicating authority approves the resolution plan.

Section 32A (2) explicitly prohibits any actions against the property of a corporate entity undergoing the CIRP if that property is included in a resolution plan approved by the Adjudicating Authority. This provision disallows government agencies from attaching such properties. Importantly, it's worth noting that this sub-clause does not bar actions against the property of third parties, like guarantors.

Section 32A (3) makes it clear that, regardless of what is mentioned in clauses (1) and (2) of Section 32A, both the Corporate Debtor and any individual involved must provide full assistance and cooperation to any investigative authority looking into an offense that occurred before the initiation of CIRP.

This was another instance of taking quick action to ensure the effective operation of the code. Later, the legislature converted the ordinance into an amendment with the same wording as the ordinance, clearly demonstrating their strong commitment to prioritizing the resolution objective outlined in the code.

(C) Key provision of PMLA

Section 5 deals with Attachment and confiscation of property. The PMLA empowers authorities to attach properties and assets believed to be involved in money laundering. These assets can be confiscated by the government upon proving their connection to money laundering activities.

(D) CIRP procedure under IBC

1. The CIRP under IBC is a time-bound process of 180 days extendable up to 90 more days in certain cases. There are two adjudicating authorities under the Act - the NCTL for

corporate entities and the DRT for non-corporate entities. The process could be outlined in four steps.

2. Under Section 7 of the IBC, the financial creditor may initiate corporate insolvency resolution. The creditors may approach the NCLT or the DRT as the case may be. This plea must be accepted by the respective adjudicators within 14 days.

3. Once the case has been accepted, lenders form a committee called the 'Committee of Creditors'. The committee further appoints an IP. IPs are professionals who manage the entity and its assets and run the entity as a going concern. Hence, the case is managed by the IP in the interim period.

4. After the stipulated period the Committee of Creditors will form a debt recast plan. Section 33 of the Act states that when resolution plan is not received by Adjudicating Authority within the stipulated time period then it shall pass an order of liquidation of CD.

5. The Committee by voting decide to either accept the debt recast plan or reject it. If rejected, in the final resolution, the company will be liquidated and assets will be handed over to the creditors.

(E) Point of conflict between IBC & PMLA

The debatable question is whether the provisions of PMLA needs to be applied to the corporates undergoing through CIRP. The attachment done by ED under section 5 of the PMLA may lead to uncertainty in the entire process.

In the case of *Nitin Jain, Liquidator of PSL Limited v. Enforcement of Directorate*³, the hon'ble High Court of Delhi on 7th December 2021 recognized the immunity granted to the resolution applicant and ruled that once the adjudicating authority approves the method chosen during liquidation, the capacity to attach the property granted by Section 5 of the PMLA would no longer be usable. The Court additionally noted that Section 32A must be the exclusive basis for addressing the question of harmonisation between the PMLA and the IBC.

Instances where provisions of IBC and PMLA can overlap

- In instances of corporate fraud, where a corporate debtor engages in deceitful practices that come under the jurisdiction of the PMLA, such as money laundering or illicit fund transfers, it can initiate investigations under both the IBC and the PMLA concurrently.
- Individuals or entities who have been labelled as "wilful defaulters" according to the

³ Nitin Jain, Liquidator of PSL Limited v. Enforcement of Directorate (2021).

PMLA, having deliberately and consciously failed to meet their loan repayment obligations, can also become subjects of insolvency proceedings as per the IBC.

- In cases where a corporate debtor has diverted funds or been involved in financial improprieties, these activities could potentially be categorized as money laundering offenses under the PMLA. Such situations might lead to an overlap with insolvency proceedings if the debtor seeks bankruptcy protection.
- The PMLA permits the seizure of assets obtained through money laundering. When these assets are also part of the insolvency proceedings, disputes can surface regarding the sequence in which claims are prioritized among different authorities and creditors.
- Directors or promoters of a company discovered to be engaged in money laundering actions can be personally held accountable under the PMLA, even as these same individuals may be participants in the insolvency resolution process.
- Deals involving related parties, a concern for both the IBC and the PMLA, can create intersections when assessing their validity and influence on the financial stability of the debtor.
- Inaccuracies in asset valuation or the misrepresentation of assets can draw the scrutiny of both insolvency authorities and those responsible for enforcing PMLA regulations.

III. PROBLEMS FACED BY STAKEHOLDERS (CORPORATE DEBTORS & CREDITORS) DUE TO COLLISION OF PROVISIONS OF IBC & PMLA

The collision of certain provisions of IBC and PMLA can create significant problems for stakeholders such as:

Freezing of assets: One of the primary problems is the freezing of the corporate debtor's assets under the PMLA. Under PMLA when the investigation starts, during the investigation, an order of freezing of assets and bank accounts of corporate debtor can be passed by the appropriate authorities. And this action of freezing can cause difficulties for the debtor to continue its commitments and pay off obligations such as to make payment to the staff and other similar obligations.

Delay in CIRP: IBC resolution procedure can be hampered due to conflicting clauses. The CIRP procedure is supposed to get completed within the time bound manner however when procedure under PMLA is started at the same time, it can essentially cause the delay and stretches the time which is required to finish the insolvency procedure.

Legal complexities: The corporate debtor could find himself enmeshed in complicated legal procedures and a wide range of forums. It needs to handle the insolvency proceeding, the PMLA inquiry, and maybe other legal challenges all at the same time, which can be both mentally and financially.

Harm of reputation: PMLA procedures may also cause CD to lose their goodwill. Investigations into money laundering can damage a company's reputation and make it challenging to bring in new customers or investors.

Unable to raise fund: The freezing of assets and the uncertainty surrounding the corporate debtor's financial soundness may severely impede its capacity to acquire further funds or obtain financing during bankruptcy procedures.

Excessive legal fee: Multiple court cases might result in excessive legal fees for the CD, severely taxing its financial resources.

IV. JUDICIAL INTERPRETATION

When the question regarding non-obstante clause arose before the court. The supreme court held that when a non-obstante clause appears in two special statutes, the later statute will take precedence over the earlier one because the legislature knew about the earlier non-obstante clause when it was drafting the later statute. The insertion of a non-obstante clause in the later statute demonstrate that the legislature intended to supersede the previous statute. The issue was resolved logically with IBC taking precedence over PMLA because the former was passed in 2016 and the latter in 2002 in case of *Solidaire India Ltd. v. Fairgrowth Financial Services Private Limited*⁴.

- **Cases in which the property of CD was attached before CIRP**

Mumbai NCLT bench in the case of *Sterling SEZ Infrastructure Finance Ltd. V. Sterling International Enterprises Ltd.*⁵ directed the RP to take custody of the assets which were attached under PMLA provisions prior to commencement of CIRP. An appeal was filed against NCLT order. And it was held by NCLAT 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.

In another case of the *ED vs. Sh. Manoj Kumar Agarwal & other*⁶, it was held that the assets which were attached under PMLA would be available under IBC. Since the very purpose of

⁴ *Solidaire India Ltd. v. Fairgrowth Financial Services Private Limited*, (2011), (3) SCC 71.

⁵ *Sterling SEZ Infrastructure Finance Ltd. V. Sterling International Enterprises Ltd.*, (2019), NCLAT (PB).

⁶ *ED vs. Sh. Manoj Kumar Agarwal & other*, (2021) NCLAT.

IBC is revival of CD, the same shall be nullified if the assets are attached and not handed over to the RP for its custody and control.

- ***Cases where during the CIRP, property of CD was attached***

The landmark case of *Bhushan Power & Steel limited*⁷ (BPSL), the resolution plan was submitted by M/S JSW steels in the CIRP of BPSL. While the plan was under consideration, ED attached the assets worth Rs 4,025 cr. Of BPSL in accordance with provisions of PMLA on the ground that assets were acquired from proceeds of crime. The RP knocked the doors of NCLAT to seek protection from attachment by ED, while the NCLAT'S final judgement was awaited there was an amendment in code and section 32A was inserted in IBC. Based on the amendment, 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 case is a classic example where assets of the CD under PMLA were attached post initiation of CIRP.

- ***Case regarding jurisdiction of AA under section 60(5) IBC***

In the case of *Embassy Property developments pvt. Ltd*⁸, the supreme court held that section 60(5) of the code cannot be used to claim everything under the sky.

In another case of *Manish kumar vs. Union of India and another*⁹, it was clarified that the Adjudicating Authority (AA) under IBC is duly posed with the jurisdiction to order for detachment or unfreezing of the assets.

In the case of *Rajiv Chakraborty Resolution Professional of EIEL v. ED*¹⁰, the hon'ble Delhi High court determined that the legislature had expressly stated in section 32A the end point at which the PMLA's powers would cease to exist. Court further additionally noted that Section 32A must be the exclusive basis for addressing the question of harmonisation between the PMLA and the IBC.

- ***Case of effect of applicability of section 14 which deals with imposition of moratorium on attachment proceedings under the PMLA.***

The case of *Alchemist ARC vs. Hotel and Gaudavan Private Limited & ors*¹¹. Is a fine example of supremacy of moratorium under the IBC. In this case, the CD failed to repay the loan of state

⁷ JSW Steel Ltd. V. Mahender Kumar Khandelwal & Ors, (2019) NCLAT.

⁸ M/S Embassy Property Development Pvt. Ltd. v. State of Karnataka & Ors., (2019) S.C 9170.

⁹ Manish Kumar vs. Union of India and another (2019) S.C 26.

¹⁰ Rajiv Chakraborty Resolution Professional of EIEL v. ED, (2022) 004739.

¹¹ Alchemist ARC vs. Hotel and Gaudavan Private Limited & Ors, (2017) S.C 16929.

bank of India and thus petition was filed before DRT. Simultaneously, the CIRP was under IBC commenced against the CD by the Financial creditor (FC) and the moratorium under section 14 was imposed. The CD invoked the arbitration clause between FC and the CD and appointed an arbitrator as per the loan agreement. The conflict between arbitration and insolvency was put to rest through this judgement. And the supreme court held that the appointment of arbitrator and the arbitration proceeding is non-est in law on the account of imposition of moratorium.

V. CONCLUDING REMARKS AND SUGGESTIONS

The judgements of NCLAT and other high court's ruling have brought back the focus on the Overriding powers of IBC under section 238 read with section 32A. Attachments by various law enforcement agencies have been a major concern while taking over the assets of CD and further inviting resolution plan or putting such assets on auction. So, to strike a balance between these two is essential and a well-balanced and synchronized legal framework is needed to ensure that the interest of debtors, creditors and broad economy are safeguarded, otherwise, the corporate debtor may misuse the IBC laws in order to avoid being punished for money laundering.

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