
CURRENT LEGAL POSITION ON CONFLICTS BETWEEN ATTACHMENTS UNDER THE PREVENTION OF MONEY LAUNDERING ACT, 2002 AND MORATORIUM UNDER SECTION 14 OF INSOLVENCY AND BANKRUPTCY CODE 2016

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INTRODUCTION

The framework of the Indian legal system has witnessed friction between the two statutes enacted to serve competing purposes. On one side, there is Prevention of Money Laundering Act, 2002 (**"PMLA"**) which is a statute enacted to combat economic offences and prevent money laundering by enabling Enforcement Directorate (**"ED"**) to confiscate/ attach assets which are believed to be involved in money laundering as covered under the Section 5 of the PMLA Act, 2002.

However, on the other side, the Insolvency and Bankruptcy Code, 2016 (**"IBC"**) was enacted in order to tackle the banking crisis with a time-bound process for resolving debts and insolvency. The Section 14 more specifically acts like a cornerstone of the IBC code to provide a "moratorium" period in order to protect the Corporate Debtor during the Corporate Insolvency Resolution Process (**"CIRP"**). This moratorium stays the continuation or institution of proceedings, the transfer of assets, and, most importantly, any action which aims to recover or enforce any interest over the security of the Corporate Debtor. The objective is to facilitate the resolution process by preserving the Corporate Debtor and maximising the value of its assets in order to benefit its stakeholders, more particularly the Financial Creditors.

Therefore, conflict arises when these two statutes collide as, the PMLA empowers the ED to attach or confiscate the assets whereas, the IBC prohibits any action against those assets and even puts a bar on the enforcement once moratorium under Section 14 of the Code begins.

NON-OBSTANTE CLAUSES UNDER BOTH THE STATUTES AND HARMONIOUS CONSTRUCTION

Both the IBC and the PMLA contain non-obstante clauses which create an apparent legislative deadlock.

Section 238 of the IBC states that the Code will prevail over any other inconsistent law. Similarly, Section 71 of the PMLA provides that the PMLA will override any other conflicting law. Thus, the direct conflict between the two statutes becomes inevitable.

The Courts are often compelled to look beyond the simple textual comparison when these two non-obstante clauses clash. The Courts have often resorted to the principles of ‘**harmonious construction**’ and the identification of the ‘**later in time**’ statute¹. The IBC, which came into effect in 2016 and is later enactment as compared to the PMLA, which came into effect in 2005, is often argued to have an implied overriding effect. However, this is not a strict rule which always applies, especially when a statute like the PMLA is vested with a crucial sovereign function like preventing crime.

Nonetheless, authorities under the PMLA must acknowledge the practical reality that insolvency proceedings under the IBC are not intended to protect persons from lawful measures stemming from financial crimes. Instead, they provide a formal procedure to settle, resolve and utilise the distressed enterprises. The likelihood of a successful settlement is increased when assets are charged to banks, improving the stability of the financial system.

PROTECTION UNDER SECTION 32A OF IBC

Section 32A was introduced on 28.12.2019, and it plays an important role in resolving the conflicts between the statutes like the IBC and the PMLA. Not only it grants immunity to the Corporate Debtor from proceedings under any legislation upon the approval of the Resolution Plan, but also at the same time, it expressly preserves the liabilities of the directors, promoters, and other key persons who were involved in offences under the PMLA. Thus, while the Corporate Debtor can be insulated from post-resolution enforcement actions, the individuals responsible for the economic offences still continue to face legal consequences. This balanced

¹ **Anant Merathia**, The IBC vs. PMLA - A Critical Study, **IBC Laws** (May 12, 2020), <https://ibclaw.in/the-ibc-vs-pmla-a-critical-study/>

framework promotes the broader objective of deterring economic offences. The constitution validity of Section 32 A was interpreted and upheld in the Hon'ble Supreme Court's landmark judgement *Manish Kumar v. Union of India (2021)*².

DISTINCTION BETWEEN "ATTACHMENT" AND "RECOVERY"

The PMLA is a framework which works as a strong anti-money laundering regime and is often countered this argument by drawing a crucial distinction. It is argued that the attachment under the PMLA is not just an action for the "recovery of a claim" by a creditor, rather it is a sovereign and in-rem action which is aimed at identifying and preserving the proceeds of crime. The action is not against the Corporate Debtor but is against the property itself. The purpose is not to recover the debt owed to the state but to prevent the dissipation of assets that are obtained illicitly, which is vital to the public interest.

This distinction gained significant traction in subsequent rulings.

A turning point could be witnessed in this regard by the way of judgment delivered by the Ld. National Company Law Appellate Tribunal ("NCLAT") which overturned the stance taken in *Varrsana Ispat Limited v. Deputy Director, Directorate of Enforcement, 2019*³. The NCLAT in *Ashok Kumar Sarawagi v. Enforcement of Directorate, 2022*⁴ marked a dramatic shift as it recognized the PMLA as a statute that serves a distinct and paramount purpose which transcends the commercial and economic objectives of the IBC. The NCLAT thus, effectively ruled that the moratorium provided under Section 14 of the IBC does not apply to actions under the PMLA, as the latter is a special statute which deals with a specific and grave offence.

The Hon'ble Supreme Court has not ruled directly on this specific conflict yet, however, the judgment titled as *State Bank of India v. V. Ramakrishnan (2018)*⁵ provides key guidance. In the said case, the Hon'ble Court was dealing with the applicability of the moratorium on the personal guarantors. The Hon'ble Court while analysing the matter, observed that the moratorium under section 14 of the IBC applies only to the Corporate Debtor and does not bind the third parties such as the guarantors or, by extension, assets that are covered under the

² WP. (C) No. 26 of 2020- Decided by SC on 19.01.2021

³ Company Appeal (AT) (Insolvency) No. 493 of 2018- Decided by NCLAT on 02.05.2019

⁴ 2022 SCC OnLine NCLAT 3453

⁵ 2018 Volume 17 SCC 394

"proceeds of crime."

The same logic can thus be extended in order to support the view that an attachment of property under the PMLA, can be an action against the tainted property (the proceeds of crime) rather than against the Corporate Debtor per se, which may not be automatically affected by the moratorium under section 14 of the IBC. The property, by that interpretation, is considered distinct once it is identified as a part of proceeds of crime.

CURRENT LEGAL POSITION

As on date, the legal position is not completely settled with respect to the conflicting interpretations of the two statutes. However, the trend is leaning towards giving primacy of the PMLA subject to qualification of some strict and significant conditions.

The Courts through judgements like *Varrsana Ispat Limited*⁶ and *Rotomac Global Private Limited v. Deputy Director*⁷, have consistently held that, the PMLA proceedings would operate as a distinct domain focusing and dealing with "proceeds of crime" and thus the moratorium under Section 14 of the IBC would not be applicable to such actions. This view was also affirmed by the Ld. NCLAT's larger bench in *Kiran Shah, RP of KSL and Industries Ltd. v. Enforcement Directorate, Kolkata*⁸ and then confirmed by the Hon'ble Delhi High Court judgements in *Nitin Jain, Liquidator PS: Ltd. v. Enforcement Directorate*⁹ and *Rajiv Chakraborty RP of EIEL v. Directorate of Enforcement*¹⁰, which ruled that Section 14(1)(a) of the IBC cannot be interpreted and used to shut out provisional attachment powers which are vested under the PMLA, as such attachment does not extinguish rights over the property but merely restrains the alienation pending trial.

The following conditions can be concluded from the recent judgments:

- **"Proceeds of Crime" can give primacy to PMLA over IBC:** The Courts have been increasingly inclined towards holding that if the ED has lawfully attached properties which have been conclusively identified as the proceeds of crime under the PMLA, such attachment will prevail over the moratorium provided under Section 14 of the IBC.

⁶ Company Appeal (AT) (Insolvency) No. 493 of 2018- Decided by NCLAT on 02.05.2019

⁷ Company Appeal (AT)(Insolvency) No. 140 of 2019 - Decided by NCLAT on 02.07.2019.

⁸ Company Appeal (AT)(Insolvency) No. 817 of 2021 - Decided by three Member of NCLAT on 03.01.2022.

⁹ W.P.(C) 3261 of 2021 - Decided by Delhi High Court on 15.12.2021.

¹⁰ W.P.(C) No. 9531 of 2020 - Decided by Delhi High Court on 11.11.2022.

The rationale is to not allow tainted assets to enter a resolution that could lead to frustrate the very object of the PMLA and can further allow the beneficiaries of the said crime to profit from the process.

- **Conclusiveness derived from the Burden of Proof:** The critical factor to consider is the stage and conclusiveness of the PMLA proceedings. If the attachment by the PMLA authorities is merely provisional and the proceedings are at an initial stage, the Resolution Professional is likely to argue for the control of the Corporate Debtor's assets in order to ensure a successful CIRP. However, if the Adjudicating Authority under the PMLA concludes or confirms the attachment, then the scales lean heavily in favour of the ED.
- **Difference between "Tainted" and "Untainted" Assets:** One of the popular middle paths which is gaining significant acceptance is to distinguish the assets of the Corporate Debtor. The moratorium under Section 14 of the IBC should fully apply to the assets that are not considered to be in the category of proceeds of crime. However, assets which are conclusively shown as "proceeds of crime" can be subjected to the proceedings under the PMLA. This distinction ensures that the CIRP can proceed smoothly for the legitimate business only of the Corporate Debtor while, the state can pursue its action against illicit proceeds.
- **The Doctrine of "Lifting the Corporate Veil":** The Courts can be willing to apply the doctrine of Corporate Veil in certain situations where the Corporate Debtor is itself used as a vehicle for money laundering. In such cases, the protection offered to the Corporate Debtor under the IBC may be pierced, and the PMLA's actions against the individuals and the tainted assets would proceed to take the precedence.¹¹

KEY TAKEAWAYS AND CONSIDERATIONS

A strategic foresight can be required for the legal practitioners, Resolution Professionals, and creditors, navigating through this conflict.

1. **In case of the Resolution Professional ("RP"):** The RP upon its appointment, must

¹¹ **Nirmal Singh v. State of U.P. & Others**, *IBC Laws* (Mar. 15, 2024), <https://ibclaw.in/nirmal-singh-vs-state-of-u-p-and-4-others-allahabad-high-court/>

immediately conduct a thorough due diligence in order to identify, if any of the assets belonging to the Corporate Debtors are subject to separate a PMLA attachment or investigation. A proactive communication with the authorities of the PMLA such as the ED is essential. The RP should ensure to seek clarity on the status of the assets and, preferably argue for the release of the assets which are definitively not linked to the proceeds of crime, to keep the company as a going concern.

2. **In case of the Financial Creditors:** The Creditors of the Corporate Debtor must keep in mind the factor of the PMLA risk during the CIRP. A resolution plan which includes the assets that can be covered under the cloud of attachment by the authorities under the PMLA is fraught with legal and financial uncertainty. A successful resolution applicant may witness its plan being jeopardised if the ED decides to confiscate any of the critical asset. Thorough due diligence should not be optional but must be treated as an essential requirement.
3. **In case of the Enforcement Directorate:** The ED must act with diligence, speed and conclusiveness. In order to effectively assert its primacy, it should ensure that its attachments are legally backed by strong evidence which can demonstrate the link to proceeds of crime. Vague or overly broad attachments with no credible proof, can be successfully challenged by the RP.

CONCLUSION: The current Legal Position is inclined towards a Harmonious Construction, as a Co-existing Model.

The said interplay between the PMLA and the IBC is a prime example of the legal system maintaining a balance and protecting the objectives of the two competing statutes. On one side there is an urgent need for economic efficiency, and corporate revival which is governed under the IBC. On the other side, there is an uncompromising imperative of the national security and ethical governance vested in the PMLA.

The ideal resolution thus lies in a principled and evidence-based co-existence rather than absolute supremacy of one statute over the other. The Courts must ensure that:

- a) The IBC is not in any way misused as a shield to protect the assets which comes under the category of proceeds of crime.

- b) The powers vested under the PMLA are not used casually and indiscriminately to purposely derail or delay the legitimate resolution processes and destroy value of the Corporate Debtor.

The emerging judicial trend thus makes it clear that, while IBC is considered to be the supreme in the sphere of commercial insolvency, PMLA remains the unquestioned statute wherein the proceeds of crime are involved.