

## DECONSTRUCTING THE CONUNDRUM BETWEEN IBC, SARFAESI & PMLA

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### *Abstract*

*The legislative intent behind the enactment of the Insolvency and Bankruptcy Code, 2016 was to remove the ambiguity in features of the insolvency resolution process existing in earlier legislations. It also aimed to prevent unnecessary delays in the resolution process and the deterioration of properties that occurred because of the same. However, in the past two decades, many other acts like the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and the Recovery of Debt due to Banks and Financial Institutions Act, 1993 were also passed to provide creditors with alternative and efficient remedies. These legislations coupled with the enactment of the Prevention of Money Laundering Act, 2002 create conflicts in prioritisation of claims of different creditors on the assets of an insolvent debtor. Presence of non-obstante clauses in all these “special” enactments further increases difficulty. The case of Union of India v Punjab National Bank is one of the*

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*cases where these legislations clash and the issue of attachment of property comes into play. This case comment discusses the opaque nature of the phrase “proceeds of crime” contained in the Prevention of Money Laundering Act, 2002 in context of the civil/criminal nature of different acts. It also considers the question of non-obstante clauses and other prioritisation clauses in the enactments. Further, the authors question the consistency of application of the aforesaid clauses in multiple cases, highlighting the need for the Supreme Court to settle this question with finality, in order to prevent unnecessary.*

## I. INTRODUCTION

In the last two decades, the Indian parliament passed several legislations to provide various remedies to creditors in case the borrower defaults on repayment of the loan amount. The Recovery of Debts due to Banks and Financial Institutions, 1993 (“**DRT**”) established Debt Recovery Tribunals as a one-stop adjudicatory body for banks and financial institutions struggling with non-performing assets.<sup>1</sup> The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (“**SARFAESI Act**”) empowered secured creditors to recover their dues from the defaulting

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<sup>1</sup>Recovery of Debts due to Bank and Financial Institutions Act, 1993, § 3.

borrowers by sale of secured assets without any requirement of judicial intervention.<sup>2</sup>

However, by enacting the Insolvency and Bankruptcy Code, 2016 (“**IBC**”), the legislature intended to consolidate claims of all creditors with other pending liabilities of an insolvent entity for a timely wrap-up of the resolution process.<sup>3</sup> This ensured that assets of the corporate debtor are efficiently managed and do not deteriorate due to stretched proceedings, while also aiming to keep the debtor company as a going concern.<sup>4</sup> To reach this end, Section 25(2)(a) of the IBC empowered the resolution professional to take possession of all assets of the corporate debtor. This provision must also be noted as it ensures that these assets are not disposed of by the debtor hurriedly to escape liability.

At this juncture, IBC has often been at odds with the Prevention of Money Laundering Act, 2002 (“**PMLA**”). This act was passed by the parliament to prevent money laundering in India and to provide adequate remedy in case such illegal gratifications occur.<sup>5</sup> The scheme of the act envisaged attachment of assets as an interim measure before adjudicating on the merits of the case.<sup>6</sup> This ensured that the properties which might have been acquired by the accused person illegally are not disposed of, preventing the final remedy of

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<sup>2</sup>The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002, § 13(1).

<sup>3</sup>Trilegal, *The Insolvency and Bankruptcy Code, 2016 - Key Highlights*, MONDAQ, <http://www.mondaq.com/india/insolvencybankruptcy/492318/the-insolvency-and-bankruptcy-code-2016--key-highlights>.

<sup>4</sup>*Id.*

<sup>5</sup>Samudra Sarangi, *It's time to revisit and revise India's money laundering laws*, REUTERS, <https://in.reuters.com/article/india-money-laundering-laws/its-time-to-revisit-and-revise-indias-money-laundering-laws-idINKCN1MB2LJ>.

<sup>6</sup>Vijay Pal Dalmia, *Confirmation of The Attachment by The Adjudicating Authority and Right Of 3rd Parties Under PMLA (AML Laws India)*, MONDAQ, <http://www.mondaq.com/india/money-laundering/798446/confirmation-of-the-attachment-by-the-adjudicating-authority-and-right-of-3rd-parties-under-pmla-aml-laws-india>.

confiscation. But as proceedings under IBC and PMLA have been initiated against the same entity in an overlapping timeline, conflict arose due to the inherently different nature of PMLA from other legislations like the DRT Act, SARFAESI Act and IBC. This is because all three legislations prioritised dues owed to creditors over any other outstanding amounts but there is a moral dilemma in allowing the alleged offender to use money illegally obtained through an offence under PMLA to pay-off its debts. Thus, the ends of the remedies under these legislations are opposite and the jurisdiction of appellate courts has often been sought to reconcile the conflict.

In the case of *Union of India v Punjab National Bank*,<sup>7</sup> a single judge bench of the Delhi High Court ruled on a similar conundrum. This case was one of the five cases which were heard together by the Court and decided by a common judgment. The present article will review the judgement in light of other judgements rendered on this issue by other courts, analysing and critiquing the interpretation and conclusions of the court in the matter at hand.

In the present case, six properties of the borrower company were mortgaged with the Punjab National Bank (“**PNB**”) to avail credit facilities. PNB’s inquiries revealed that supply orders, which were the bases of the withdrawals from the credit facility, were forged and the amount received against them was diverted to dummy accounts set up in the name of employees of the borrower company. PNB took possession of the properties through Section 13(2) of SARFAESI Act.<sup>8</sup> In a simultaneous development, relying on CBI inquiries, the Enforcement Directorate filed a case against the borrowers under PMLA and provisionally attached all the properties on 29/03/2017. The attachment order was confirmed by the Adjudicating Authority

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<sup>7</sup>Union of India v. Punjab National Bank, CRL.A.764/2018.

<sup>8</sup>The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

on 4/08/2017. PNB's appeal against the attachment order before the appellate tribunal of PMLA was allowed and the orders were cancelled. Next, PNB filed a claim under the IBC against the borrowers and a Corporate Insolvency Resolution Process was initiated against the borrower on 27/09/2018. The present appeal has been filed by the Union of India against the order of the appellate tribunal. The Resolution Professional has sought audience in the appeal. Thus, the court considered the interplay of SARFAESI Act, IBC and PMLA in detail. The court laid down the following observations regarding the question of law –

DRT Act, SARFAESI Act or IBC shall not prevail over PMLA as the objects of all three are very different from what PMLA seeks to achieve. The three statutes must be construed in harmony with each other but whenever a proceed of crime, i.e. tainted property is concerned, proceedings under the PMLA shall prevail.

The enforcement officer, after assessing the approximate value of proceeds of crime, has the power to attach property of similar value as alternative attachable property or deemed tainted property if the exact property which can be termed as proceeds of crime cannot be traced. The onus is on the accused person to prove that such deemed tainted property was not obtained directly or indirectly from a criminal activity.

In case of a tainted property, PMLA shall prevail over the provisions of any other act by the virtue of Section 71 of the Act.

In case of a deemed tainted property, the secured creditor or a third party with interest in the property shall prove bona fide to claim that interest. An added liability of due diligence lies on the third party if it acquired such interest after the commission of the offence of money laundering.

Further, the court set aside the order passed by the appellate tribunal. Returning the case back to the appellate tribunal, it directed it to

examine the facts of the case in light of the above principles and then come to a conclusion regarding the status of attachment of the properties.

## II. DECONSTRUCTING THE NON-OBSTANTE

Parliament includes an overriding clause in an Act if it is perceived that it may conflict with other statutes and it is intended that its provisions are prioritised over any other enactment. However, sometimes both the laws conflicting with each other have a non-obstante clause. The Supreme Court settled the position of law on such cases in *Solidaire India Ltd v. Fairgrowth Financial Services Pvt. Ltd.* (“*Solidaire*”).<sup>9</sup> In this case, it was held that in case two enactments with a similar non-obstante clause are in conflict with each other, the statute that was enacted later in time shall prevail over the one which was enacted earlier. The court explained its verdict by observing that the non-obstante clause signifies the intention of the legislature regarding any laws enacted by it till that time. If it passes a different law later, it is implied that the lawmakers were aware of the presence of non-obstante clause in earlier legislations and still chose that the current one should prevail over all others.

IBC, which contains a non-obstante clause in Section 238, came into force in 2016. However, Section 71 of the PMLA<sup>10</sup> which contains the non-obstante clause was enacted along with the rest of the PMLA in 2005. Thus, using the ratio laid down by the Supreme Court in the case of *Solidaire*, IBC should have been held to prevail over PMLA.

However, the court in the present case digressed from such a conclusion by hinting at two vague reasons. *Firstly*, it observed that

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<sup>9</sup>*Solidaire India Ltd. v. Fairgrowth Financial Services Ltd.*, (2001) 3 SCC 71.

<sup>10</sup>Prevention of Money Laundering Act, 2002.

the ratio of *Solidaire* was for cases involving two special statutes. However, according to the bench, the two legislations cannot be considered as a ‘special law’ owing to the manner in which they have been invoked in the present case. Referring to the principle of contextual interpretation as discussed in *Ksl & Industries Ltd.v. M/S. Arihant Threads Ltd. &Ors*,<sup>11</sup> the Court observed that the special or general nature of a statute is not absolute and is relative to each other. It concluded that PMLA is a special legislation to the extent of its dealing with proceeds of crime as it was specifically enacted to prevent and deal with matters of money laundering. However, neither did the court elaborate on this line of reasoning any further nor was any reason given to show how IBC cannot be construed as a special legislation. The important nature of the duty envisaged at the behest of the resolution professional to take control of the assets of the corporate debtor was not taken into account either. To that extent, the judgement failed to explain the distinction between special and general statutes, an issue which the court itself created while deciding the case. The court’s holding that PMLA should prevail in cases involving *proceeds of crime* is in vacuum as its real-time conflict with other legislations was not considered.

*Secondly*, it held that the objectives of all four concerned legislations are distinct and they do not overlap. Simply noting that, the court switched into its analysis of a different clause of the SARFAESI Act and no reasons or case-law were provided to substantiate this observation or highlight its relevance.

After analysing the non-obstante, the court also discussed in detail the effect of a special clause which was added in SARFAESI Act as well as the DRT Act by an Amendment in 2016. Section 26-E of the SARFAESI Act provides that:

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<sup>11</sup>*Supra* note 9.

*"26E. Priority to secured creditors - Notwithstanding anything contained in any other law for the time being in force, after the registration of security interest, the debts due to any secured creditor shall be paid in priority over all other debts and all revenues, taxes, cesses and other rates payable to the Central Government or State Government or local authority.*

*Explanation: For the purposes of this section, it is hereby clarified that on or after the commencement of the Insolvency and Bankruptcy Code, 2016 (31 of 2016), in cases where insolvency or bankruptcy proceedings are pending in respect of secured assets of the borrower, priority to secured creditors in payment of debt shall be subject to the provisions of that Code."*

The intent of the amendment adding Section 26E was to create a priority of secured creditor over any other governmental claim. It was in line with other parliamentary initiatives like the enactment of IBC to create a creditor friendly regime in India to ensure healthy circulation of public money. As this clause has been brought into force in 2016, much later than the enactment of PMLA, it should have been given effect to by the court.

However, in *Union of India v PNB*, the court narrowly read this Section by holding that the proceedings under PMLA and the Enforcement Directorate's power to attach assets cannot be considered as "*all other debts and all revenues, taxes, cesses and other rates payable to the Central Government.*" Section 9 of PMLA provides that any property confiscated under the scheme of the act shall vest in the central government. Any proceeds obtained by the auction of the same go to the central government free of all encumbrances that property might have. In the context of this explanation, it is difficult to see why the court held that the same is not within the ambit of the Section. Such strict reading defeats the legislative intent behind the enactment of that Section. A broad interpretation in favour of the creditor has been used by the Madras

High Court<sup>12</sup> as well as Appellate Tribunal, Mumbai<sup>13</sup> to hold that Section 26E and Section 31B of SARFAESI Act and DRT Act respectively will prevail over the operation of PMLA. The judgement in *Union of India v PNB* goes against the creditor-friendly regime that the Indian parliament has been trying to build.

### III. THE CIVIL NATURE OF PMLA

Additionally, the court rightly rejected the argument by the counsel for Appellants wherein it was contended that PMLA will prevail over the SARFAESI Act as well as the DRT Act because the former is criminal in nature, whereas the latter two are civil laws. It has been duly noted by the National Company Law Tribunal that proceedings under PMLA are civil in nature, and therefore cannot escape the moratorium under Section 14 of IBC.<sup>14</sup>In the present case, the court noted that the procedure for preliminary attachment before a final decision on merits is merely a preventive measure and not a punishment under the act. It also differentiated ‘attachment of property’ from the ultimate remedy of ‘confiscation’ of the property. As the attachment proceedings are civil in nature, PMLA cannot be applied to the detriment of the third party who is nowhere involved in the offence of money laundering and is an innocent creditor.

### IV. INTERPRETATION OF PROCEEDS OF CRIME

Proceeds of Crime are defined in Section 2(1)(u) of the PMLA as –

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<sup>12</sup>The Assistant Commissioner (Ct) v. The Indian Overseas Bank, 2014 SCC OnLine Del 555.

<sup>13</sup>Bank of India v. The Deputy Director Directorate of Enforcement Mumbai, FPA-PMLA-2173 & 2155/MUM/2018.

<sup>14</sup>Punjab National Bank v. The Deputy Director, Directorate of Enforcement Raipur, FPA-PMLA-2633/RP/2018.

*“any property derived or obtained, directly or indirectly, by any person as a result of criminal activity relating to a scheduled offence or the value of any such property or where such property is taken or held outside the country, then the property equivalent in value held within the country or abroad.”*

The Delhi High Court, in the present case,<sup>15</sup> interpreted the said definition to include two kinds of properties

Tainted property – property which has been directly or indirectly obtained from such criminal activity

Deemed Tainted property – in case tainted property is not available, not traceable or of a lesser value than the case made of money laundering, any other property of similar value can be attached

Making this distinction, the court held that proceedings under PMLA will override those under any other legislation or any other encumbrances created in favour of third parties in case of a tainted property. But if deemed tainted property is in question, the adjudicating authority will have to enquire into the bona fide of the third party and the burden to prove such bona fide lies on the third party.

The observations of the court must be critiqued for reading words into the act which are not otherwise present. The language of the legislation is clear as to the type of property which can be attached as proceeds of crime. It provides only for attachment of property directly or indirectly obtained from the proscribed scheduled criminal offence and the alternative of attaching some other property is provided only for properties that are located outside the country. This was provided to account for the possibility that the attachment of such property may be outside the jurisdiction of the Enforcement Directorate and the

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<sup>15</sup>Union of India v. Punjab National Bank, CRL.A.764/2018.

proceedings under the act must not be frustrated for jurisdictional reasons.<sup>16</sup>

However, the Delhi High Court took the liberty to interpret the rider to include even those cases wherein no such case of a property existing outside India has been made. It held that the Enforcement Directorate is empowered to attach any other property as well. But this observation has neither been substantiated by any other judgments nor is it well-reasoned to back the same. Such an interpretation gives the Enforcement Directorate the unmatched power and further shifts the burden on the accused person to prove that the said property is not tainted, even though the Enforcement Directorate lacks a prima facie case for the involvement of the property.

A similar situation was also considered by the Appellate Authority under PMLA in a 2018 case.<sup>17</sup> In this case, it was held that the Adjudicating Authority cannot confirm the provisional attachment of any property if the Enforcement Directorate itself believes that the property is innocent and has been attached only because the tainted property is untraceable. The scheme of the Act does not envisage that the onus to prove innocence is shifted onto a third party against whom a prima facie case is itself absent.

The High Court gave such a reasoning to ensure that an accused person under PMLA does not have an escape route to use the money illegally gained by money laundering to set off its claims against the creditors. However, this intention of the court must be considered in two different cases.

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<sup>16</sup>The Deputy Directorate of Enforcement, Delhi v. Axis Bank &Ors, CRL.A.210/2018 &CrI.M.A.3233/2018.

<sup>17</sup>Punjab National Bank v. The Deputy Director, Directorate of Enforcement Raipur, FPA-PMLA-2633/RP/2018.

First situation arises when a secured creditor is not involved in an act of money laundering and has a bona fide claim against the debtor with a rightful interest in its property/ properties. If such property is attached by the Enforcement Directorate claiming it to be deemed tainted property, the rightful claim of the creditor fails. This goes against the legislative scheme of the last five years wherein the intention was to make the Indian market a creditor friendly regime to ensure greater circulation of public money. Further, such authorisations by the courts of law will also demotivate the average creditor from lending money fearing such exceptional circumstances.

The second situation is a bit more complicated than the first one. Suppose the property attached as deemed tainted property does not have any encumbrances, it is concluded that the property is not anyhow a proceed of crime but is still confiscated as no other property of the alleged offender is traceable. An issue arises when the accused person either goes into the insolvency process under IBC or a case is filed with the DRT for any unsatisfied but unsecured claims. In case the remaining assets of the accused person are enough to meet all its financial and operational liabilities, the attachment under PMLA will be prioritised as the accused is an offender under the act. But in more cases than not, resources with the accused person are insufficient to meet all liabilities and one out of the multiple claims need to be prioritised. In such scenarios, the legislative intent must be prioritised over the moral sentiment against unjust enrichment. As observed in the aforementioned cases with the PMLA Appellate Authority,<sup>18</sup> prioritisation of secured creditors' right must be undertaken in light of Section 26 E and Section 31B of SARFAESI Act and DRT Act respectively.

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<sup>18</sup>*Supra* note 13; 14.

## V. CONCLUSION

The judgment of Delhi High Court in the present case puts a pause on the otherwise creditor-friendly regime envisaged by the legislature. In 2016, amendments were made to SARFAESI as well as DRT Act to make it creditor friendly. The enactment of IBC was a move to bring the Indian insolvency paradigm at par with the international insolvency paradigm. The number of such cases is likely to increase given that IBC proceedings have been initiated against many reputed companies due to non-payment of dues. Therefore, it is necessary that the question is answered by the Supreme Court to reinforce finality in the ordeal.