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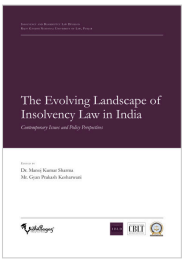
CHAPTER 21



The Issue of Primacy: An Intersection between the Insolvency and Bankruptcy Code, 2016 and the Prevention of Money Laundering Act, 2002

Samridhi Sahay and Meenakshi Singh

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CHAPTER 21

The Issue of Primacy: An Intersection between the Insolvency and Bankruptcy Code, 2016 and the Prevention of Money Laundering Act, 2002

SAMRIDHI SAHAY[*] AND MEENAKSHI SINGH[**]

In the influential work "Law as a Means to an End", the German jurist argued that the sole purpose of law is not to ensure individual liberty but to establish equilibrium between the individual principle and the social principle. The Prevention of Money Laundering Act, 2002 ("PMLA") was enacted by the legislature to curb the usage of illegal money obtained from criminal activities, referred to as proceeds of crime. The legislature enacted the Insolvency and Bankruptcy Code, 2016 ("IBC"), to ease the insolvency process for companies. It has revolutionized the procedure in order to preserve the interests of the creditors while also giving the corporate debtor a clear opportunity to start afresh on a clean slate. The announcement of a moratorium period is a fundamental change in the present Act, as it protects the interests of both the creditor and the corporate debtor. This provision is in contrast with the PMLA.

At this juncture, the court has, on several occasions, sought to resolve the conflict between proceedings under the IBC and the PMLA. The problem arises when a company that has opted for the insolvency process is found to be involved in money laundering. At present, the settled law gives primacy to insolvency proceedings. The assets attached by the ED under a provisional order must be released for the Corporate Insolvency Resolution Process ("CIRP"). The authors argue in the present paper that the current scheme defeats the purpose envisaged by the legislature under the PMLA and serves the economic interests of the corporate debtor solely. Both legislations must be read harmoniously, and the insertion of the 2020 amendment has made the imbalance between the laws quite apparent.

The paper is divided into seven chapters. Firstly, the authors will explain the nature of proceedings undertaken under the PMLA (Section 2). Secondly, the authors will briefly examine how the IBC has introduced changes to the country's insolvency regime (Section 3). Thirdly, the authors will discuss the interpretation of the non-obstante clause in the two legislations (Section 4). Fourthly, the authors will analyse the effect of the "2020 amendment" under the IBC and how it seeks to address the primacy dispute between the two legislations (Section 5). Fifthly, the authors will analyse the leading judgment on this aspect to identify gaps in the interpretation of both laws (Section 6). Lastly, the authors will put forward arguments

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in favour of giving a harmonious interpretation to both legislations, so that neither statute jeopardises the intent of the other (Sections 7 and 8).

Keywords: PMLA, Insolvency, Harmonious Interpretation, Moratorium

1 INTRODUCTION

The Prevention of Money Laundering Act, 2002 ("PMLA") was enacted by the legislature to serve a public purpose. It aims to curb the use of illegal funds obtained through criminal activities, known as the proceeds of crime. The impact of profits derived from such activities is catastrophic for a nation, as they create a vicious cycle that further facilitates the funding of more heinous crimes. The Act vests the Enforcement Directorate ("ED") with the authority to provisionally attach the properties of companies where it has reason to believe that a person has proceeds of crime and that such property is likely to be transferred or concealed. The ED issues this provisional attachment order before the completion of the pending investigation. The rationale for this is that the corporate debtor might dispose of or transfer the asset, making it difficult for the authorities to trace. It can thus be seen as a caveat provision intended to preserve the property intact.

On the other hand, the Insolvency and Bankruptcy Code, 2016 ("IBC") was enacted by the legislature to streamline the insolvency process for companies. It has revolutionised the procedure by safeguarding creditors' interests while also providing the corporate debtor with a clear opportunity to start afresh on a clean slate. The Act repeals earlier insolvency laws and has brought about a paradigm shift from *the 'debtor in possession' regime to the 'creditor in control'* regime.[1] The IBC scheme allows for the timely resolution of insolvency proceedings and empowers the adjudicating authority to order a moratorium to preserve the company's assets. This helps in treating the corporate debtor as a going concern.[2] The announcement of a moratorium period is a fundamental change, as it protects the interests of both the creditor and the corporate debtor, which stands in contrast to the PMLA. At this juncture, the courts have, on several occasions, attempted to resolve the conflict between proceedings under the IBC and the PMLA. The problem arises when a company that has opted for the insolvency process is found to be involved in money laundering.

Before the 2020 Amendment to the IBC, the courts had delivered varying interpretations regarding the primacy to be given in cases of conflict. Section 238 of the IBC contains a non-obstante clause, granting it an overriding effect in the event of any inconsistency with other laws in force at the time. However, the judiciary's stance on this issue has not been unanimous.

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[1] Chitra Sharma v. Union of India, (2018) 18 SCC 575, ¶ 26.

[2] Gujarat Urja Vikas Nigam Ltd. v. Amit Gupta, (2021) 7 SCC 209, ¶ 2.

At present, the settled law gives primacy to insolvency proceedings. The assets attached by the ED by a provisional order[3] have to be released for the corporate insolvency resolution process ("CIRP"). The interests of the corporate debtor and the creditors are being protected by giving the IBC an overriding effect over the PMLA. The authors, in the present paper, will argue that the current scheme defeats the purpose envisaged by the legislature under the PMLA and caters solely to the economic interests of the corporate debtor. Both legislations must be read harmoniously, and the insertion of the 2020 amendment has made the imbalance between the laws quite apparent.

2 NATURE OF PROCEEDINGS UNDER THE PMLA

Money laundering is the process of channelling money obtained from an illegal activity into a legitimate financial source in a manner that makes it difficult to trace its origin. There are three stages by which 'tainted money' is converted into 'untainted money'. The stages involve placement, layering and integration.[4] PMLA empowers the adjudicating authority to attach the properties of a person that are the proceeds of crime.[5] To constitute the offence of money laundering under Section 3 of the PMLA, there must be proceeds of crime. The term 'proceeds of crime' means any property derived or obtained directly or indirectly by any person as a result of criminal activity.[6] The ED provisionally attaches this property under Section 5(1) of the Act.[7] The offence of money laundering depends on a predicate or scheduled offence whose proceeds are shown to be untainted by the offender. The Act aims to protect the property from being disposed of by the offender, and this is where the provision for attachment assists in carrying out the proceedings smoothly without being concerned about its probable disposal.

The provisional orders by the adjudicating authority are then confirmed under Section 8 of the Act. There exists a separate set of proceedings before the adjudicating authority, and to carry out its functions, the Act has bestowed it with powers similar to those of a civil court.[8] The attachment orders are indicative that there may be a chance the accused is associated with the crime. The orders are merely a preventive measure taken by the authority to protect property, and they do not prove the offender's guilt. The accused is tried in special courts[9], which run parallel to the proceedings before the adjudicating authority. The nature

[3] *Id.* ¶ 3.
[4] M.C. MEHANATHAN, LAW ON PREVENTION OF MONEY LAUNDERING IN INDIA ch. 2 (3d ed. 2022).
[5] *Id.* ¶ 2.
[6] *United Nations Global Programme Against Money Laundering*, IMOLIN (Aug. 8, 2023), https://www.imolin.org/imolin/gpml.html.
[7] *Id.* ¶ 3.
[8] Prevention of Money Laundering Act, 2002, § 11.
[9] *Id.* § 44.

of the crime of money laundering is cognizable and non-bailable,[10] and the proceeding is thereby criminal in nature. Thus, two sets of proceedings run in parallel. One in which the ED assesses the property attached, and the other in which the special courts try the accused for the offence of money laundering.

There is a conundrum in interpreting the nature of proceedings undertaken by the adjudicating authority, the ED. A bare reading of Section 11 of the PMLA will reveal the civil nature of the proceedings.[11] It gives the adjudicating authority the power of a civil court, as provided under the Code of Civil Procedure, 1908. It has further been held by the National Company Law Tribunal that proceedings initiated by the adjudicating authority are civil in nature and, as such, cannot be exempted from the moratorium under Section 14 of the IBC.

However, there have been several instances in which tribunals and courts have held that attachment proceedings under the PMLA are criminal in nature. The NCLAT, in the case of *Varsana Ispat v. Deputy Director, Enforcement Directorate*[12], held that the application of Section 14 of the IBC[13] does not override the attachment proceedings undertaken by the ED, since it relates to proceeds of crime and cannot be understood in isolation as merely a preventive order with civil consequences. Section 14 of the IBC does not apply to the act having the essence of a crime or any of its proceeds. Later, the Hon'ble High Court, in the case of Directorate of Enforcement, Delhi v. Axis Bank,[14] opined that the attachment proceeding under the PMLA is a *"civil sanction which runs parallel to investigation and criminal action vis-a-vis the offence of money laundering."*[15]

3 INSOLVENCY AND BANKRUPTCY CODE, 2016 – A MEANS TO AN END

Before the enactment of the IBC, there was no comprehensive legislation governing companies in the insolvency process. Companies that were not performing well or were distressed found it difficult to exit the business. As a result, the IBC was enacted in 2016, serving as the country's umbrella legislation governing insolvency and bankruptcy proceedings. There have been several legislations before the IBC, such as *the Recovery of Debts Due to Banks and Financial Institutions Act, 1993* ("DRT")[16], which provided for the establishment of Debt Recovery Tribunals for the recovery of unpaid debts by the companies, helping the financial institutions suffering from non-performing assets. *The Securitisation and Reconstruction*

[10] J. Sekar v. Union of India, (2018) 145 SCL 637, ¶ 36 (Del.).
[11] Prevention of Money Laundering Act, 2002, § 11.
[12] Varsana Ispat Ltd. v. Deputy Director, Directorate of Enforcement, 2019 SCC OnLine NCLAT 236.
[13] Prevention of Money Laundering Act, 2002, § 14.
[14] Directorate of Enforcement v. Axis Bank, 2019 SCC OnLine Del 7854, ¶ 147.
[15] *Id.* ¶ 171(i).
[16] Recovery of Debts Due to Banks and Financial Institutions Act, 1993, § 3.

of Financial Assets and Enforcement of Security Interest Act, 2002 ("SARFAESI Act")[17] also provides a remedy for secured creditors to recover their loans without judicial intervention.

However, with the enactment of the IBC, the legislators have addressed earlier issues surrounding the insolvency provisions, providing for the timely wrap-up of insolvency proceedings and a 'moratorium period' to preserve assets from depletion and carry on the business as a going concern.[18] The Act has empowered the resolution professional under Section 25(2)(a) to take possession of the assets of the corporate debtor to ensure the same. After the announcement of the moratorium period, the resolution professional takes charge of the assets.

It is at this juncture that the IBC provisions come into conflict with the PMLA. Once a moratorium is announced, the property, if in the ED's custody, must be released to give effect to the insolvency proceedings. This is because of the overriding provision, which gives primacy to insolvency proceedings over any other law for the time being in force. The arrangement is such that creditors' interests are given greater primacy over criminal acts. There is a moral dilemma in paying off debts with property that could be the proceeds of crime. It is believed that the law is not harmoniously balanced to coexist with both legislations.

4 Interpretation of the Non-Obstante Clause

A non-obstante clause is an internal aid for the interpretation of legislation, which is resorted to when there exists a conflict between two or more statutes. In *Union of India v. G.M. Kokil,* it was stated to be a legislative device used to preclude the operation and effect of all contrary provisions.[19] It gives an overriding effect to the proceedings under one statute, thereby resolving the conundrum that existed between the legislations. However, there could also be a situation in which both statutes in question contain a non-obstante clause; this is not uncommon, given the multiplicity of legislation in the country.

As we are aware, there exists a non-obstante clause in both the IBC[20] and the PMLA.[21] The issue is which piece of legislation would have primacy over the other. The court has addressed this issue in *Solidaire India Ltd. v. Fairgrowth Financial Services Ltd.*[22] and has resolved the issue enumerated above. The Apex Court held that, in assessing the effect of non-obstante clauses in the Sick Industrial Companies Act, 1985, and the Special Court Act, 1992,

[17] The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, § 13(1).
[18] Gujarat Urja Vikas Nigam Ltd. v. Amit Gupta, (2021) 7 SCC 209.
[19] Union of India v. G.M. Kokil, 1984 Supp. SCC 196, ¶ 11.
[20] The Insolvency and Bankruptcy Code, 2016, § 238.
[21] Prevention of Money Laundering Act, 2002, § 71.
[22] Solidaire India Ltd. v. Fairgrowth Fin. Servs. Ltd., (2001) 3 SCC 71.

the newer legislation prevails over the older statute. The Court reasoned that the legislature is well-equipped to enforce existing laws and that, when it enacts a new piece of legislation with a non-obstante clause, it signifies that Parliament does not want the older laws to have an overriding effect over the new law.

Section 238 of the IBC[23] contains a non-obstante clause that gives it an overriding effect over any other law prevailing at the time in the event of any conflict. On the other hand, Section 71 of the PMLA[24] contains a non-obstante clause that bars any other law from overriding the PMLA. The issue arises when the ED attaches the property of an offender against whom CIRP has commenced. The question is whether the moratorium period under the IBC should take precedence over the proceedings under the PMLA against the property.

The objectives of the two statutes differ, and therefore, a balance has to be maintained between them. The courts must not be ignorant of the fact that there must be a reason why the legislature inserted an overriding provision under the PMLA, and that it is not without purpose. The IBC calls for the timely resolution of insolvency proceedings and the securing of creditors' interests. In contrast, the PMLA is a special legislation enacted to address the offence of money laundering and to trace and dismantle the illicit sources of tainted money, which can further stimulate crime on a global scale.

The current interpretation calls for a straightjacket approach, which fails to address the above aspects. The settled position, as interpreted from the ruling of the court in the *Solidaire case*[25], gives primacy to the IBC proceedings and accords them an overriding effect over the PMLA. However, the jurisprudence surrounding the same is much more complex than the current interpretation, since the judgment fails to take into account the contextual circumstances and the intent behind the given legislation. Therefore, the current view calls for a review of the decision.

5 INSERTION OF SECTION 32A UNDER THE IBC: HAS THE BATTLE OF PRIMACY BEEN RESOLVED?

One of the underlying objectives of the IBC is to ensure the timely resolution of insolvency proceedings so that the corporate debtor can start afresh. In furtherance of this purpose, and also to address inconsistencies with the PMLA, Parliament introduced the 2020 amendment, which inserted Section 32A into the IBC.[26] This provision provides that there exists no liability of the corporate debtor for any offence committed before the commencement

[23] *Id.* ¶ 24.
[24] *Id.* ¶ 25.
[25] *Id.* ¶ 26.
[26] The Insolvency and Bankruptcy Code, 2016, § 32A.

of the CIRP. It further protects the property of the corporate debtor by prohibiting any proceedings against it once the CIRP has commenced. The CIRP process is initiated when operational creditors file an application before the NCLT for insolvency proceedings against the corporate debtor. It commences when the NCLT admits the application. Once a resolution plan is approved under Section 31 and control of the corporate debtor changes hands, the corporate debtor enjoys immunity from liability for prior offences, and that immunity extends to its property. This means that if there is a provisional attachment order under the PMLA, the Enforcement Directorate must release the property to allow the insolvency process to proceed.

However, a bare reading of Section 32A suggests that this immunity applies only after the commencement of the CIRP, leaving certain questions unresolved regarding the legal position before the resolution plan is approved. Although the amendment shields the corporate debtor, it preserves the liability of promoters and directors for continuing offences, thereby aligning with the overarching purpose of the PMLA. The judiciary has upheld the validity of Section 32A in the case of *Manish Kumar v. Union of India.*[27]

6 Does the Case of Rajiv Chakraborty, RP of EIEL v. Directorate of Enforcement Finally Put an End to This Conundrum?

The case of *Rajiv Chakraborty, RP of EIEL v. Directorate of Enforcement*[28] comprehensively dealt with this issue. First, whether the 'proceedings' under the PMLA are civil in nature and, if so, whether the same would be affected by Section 14 of the IBC. Second, which of the Acts would prevail over the other, given that both have a non-obstante clause in Section 238 of the IBC and Section 71 of the PMLA, respectively? Lastly, how the insertion of Section 32A has changed the landscape of the operation of both laws.

To resolve the first issue, the meaning of the term 'proceedings' with respect to the PMLA was considered by the Court. It was found that the act of attaching the assets of the corporate debtor cannot be solely termed as civil proceedings. Further, in support of the above, under Section 5 of the PMLA, there is a prior requirement that a report concerning the scheduled offence must be forwarded to the magistrate or a complaint must have been filed before the provisional attachment of assets. Therefore, insofar as interpretation goes, the provision must not be understood in isolation and must be read in consonance with other provisions of the Act.

Coming to the second issue, regarding the primacy to be given to the non-obstante clauses in both legislations, the Court considered the timing of their entry into force and

[27] Manish Kumar v. Union of India, (2021) 5 SCC 1.

[28] Rajiv Chakraborty Resolution Professional of EIEL v. Directorate of Enforcement, 2022 SCC OnLine Del 3703.

applied the principle that the later Act shall prevail. The Court, on this reasoning, held that, since the IBC was enacted later, it would prevail over the PMLA. It is important to underscore that this is not an inviolable rule and should be applied only when there is an apparent conflict between the two legislations. It should be noted that there is no explicit inconsistency between the provisions of the two statutes; the issue arises only concerning their enforceability. They are not, per se, inconsistent, and both serve their distinct purposes.

Lastly, while the Court asserted that Section 32A of the IBC serves as the terminal point for provisional attachment proceedings once the corporate insolvency resolution process has begun, this creates a slight imbalance, tilting more towards giving effect to the IBC's provisions.

While the case has succinctly addressed some persistent issues, a lacuna remains that reignites the need to revisit the matter. In our opinion, the PMLA is special legislation that serves public welfare, and subordinating its interests can jeopardise the interests of the nation's people. While Section 32A is an important provision that settles the law, as held in Rajiv Chakraborty[29], whether it actually balances or harmoniously interprets both legislations is a question worth raising.

7 WAY FORWARD

The issue surrounding both the IBC and the PMLA goes beyond mere statutory interpretation; it concerns the legislative prioritization of one over the other. It should be borne in mind that a particular law is enacted with a specific intent, and every other branch of government must ensure, in its rulings, that such intent is upheld. The current judicial trend of giving primacy to the IBC, particularly after the insertion of Section 32A, appears heavily tilted towards safeguarding economic revival at the expense of criminal accountability. It is crucial to ensure that the resolution process does not become a "safe harbour" for laundering illicit gains under the garb of the CIRP.

8 STRUCTURAL REFORMS TOWARDS A MORE BALANCED APPROACH

8.1 Coordination between NCLT and ED

1. The legislature should expressly mandate a coordination mechanism between the Adjudicating Authority under the IBC and the ED under the PMLA. Before releasing attached assets for the CIRP, the NCLT should require the ED to certify that such

[29] *Id.*

release will not frustrate ongoing criminal proceedings or risk the dissipation of evidence.

8.2 Differentiation between 'Clean' and 'Tainted' Assets

1. Resolution Professionals under the IBC must be statutorily empowered—and obligated—to identify assets suspected to be proceeds of crime. Clean assets should be included in the insolvency pool for creditor recovery, whereas tainted assets must remain under the ED's control until a judicial decision is made. This ensures creditors are protected without undermining the PMLA's core purpose.

8.3 Section 32A Must Be Applied Conditionally

The application of Section 32A can be made conditional upon the following:

1. a. Complete disclosure of any pending PMLA proceedings against the corporate debtor.
2. b. Seeking court approval after a preliminary determination that the assets in question are not directly linked to the proceeds of crime.

9 Conclusion

The intersection between the Insolvency and Bankruptcy Code (IBC) and the Prevention of Money Laundering Act (PMLA) in India presents a significant legal challenge, particularly in cases involving the provisional attachment of assets. Both laws serve distinct objectives: the IBC aims to maximise the value of a debtor's assets for the benefit of creditors and economic recovery. At the same time, the PMLA seeks to prevent and penalise money laundering by seizing the 'proceeds of crime'. The conflict arises when assets under insolvency proceedings are simultaneously attached by the Enforcement Directorate under the PMLA, leading to delays and disruptions in the resolution process.

On paper, there may be no dispute, as there is nothing per se conflicting between the two laws. However, a closer examination reveals a genuine conundrum. To resolve this, a clear legal demarcation, improved coordination between insolvency professionals and enforcement agencies, and the exercise of judicial discretion to balance creditor interests with anti-money laundering enforcement are essential. The proposed reforms can help India establish mechanisms to harmonise the application of both laws, ensuring the smooth functioning of insolvency resolutions while upholding the objectives of criminal law enforcement.

* * *