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Property under Proceeds of Crime: Conflicting Actions in PMLA and IBC

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INTRODUCTION

The legislative intent of the Parliament while enacting The Insolvency and Bankruptcy Code, 2016 **("IBC")** in all its wisdom was clear, i.e. to make the business environment in the country, creditor friendly, wherein the value of the assets of a debtor gets maximised and remains free from the factors of its failure while going into insolvency.

The said intention was strengthened vide Section 32A of the IBC, which was introduced by the Insolvency and Bankruptcy Code (Amendment) Act, 2020 ("2020 Amendment Act**").**

Even the Standing Committee on Finance **("Standing Committee")** on the Insolvency and Bankruptcy Code (Second Amendment) Bill, 2019 **("2019 IBC Amendment Bill")** noted the following while discussing the proposed amendments contained therein:

"2.5. The Committee note that the Insolvency and Bankruptcy Code, 2016 was promulgated on concepts such as promoting maximisation of value of assets, transparent and predictable insolvency resolution framework, avoiding destruction of value of the debtor, and recognising the difference between malfeasance and business failure."

To realize this intent of the IBC, it is imperative to get rid of any / all factor(s) (during the process of insolvency) which may affect the value of the assets of the corporate debtor and create any apprehensions in the mind of prospective bidder/buyer of the assets of the corporate debtor during the liquidation process.

Although, the same stood clarified by Section 32A which was introduced to keep the aforesaid intention of legislature intact. Recently, the Hon'ble Supreme Court ("SC") has expressed concern over the same in the case of ***Committee of Creditors through Punjab National Bank and Anr.v. Ravi Prakash Goyal and Ors***. While, the proceedings are pending, the said issue can be analysed through the ruling of the High Court of Delhi ("DHC") in the case of ***Nitin Jain Liquidator PSL Limited v. Enforcement Directorate*** ("**Nitin Jain Case**") and of the National Company Law Appellate Tribunal ("**NCLAT**") in the case of ***Directorate of***

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Enforcement v. Manoj Kumar Agarwal ("**MK Agarwal Case**").

The present piece delves into the enquiry of the aforesaid issue in light of Section 32A of the IBC and the judgments in the *Nitin Jain case* and *MK Agarwal case*.

II. Safeguard to the bonafide bidder/buyer under the IBC

Sub clause (2) of Section 32A of the IBC provides for a statutory safeguard to the property of the corporate debtor from any such action that may arise as a result of any offense committed by the corporate debtor prior to the commencement of the corporate insolvency resolution process ("**CIRP**"). The provision can also be interpreted to mean that the tainted property of corporate debtor, even if, constitutes 'proceeds of crime' under Section 2(u) of the Prevention of Money Laundering Act, 2002 **("PMLA")** and thereby, an offence of money laundering under Section 3 of the PMLA by way of possession or acquisition of proceeds of the crime, would therefore be insulated from the effects of the said offence only if such tainted property has been transferred by way of liquidation of assets and bought as proceeds of crime by the corporate debtor before the commencement of CIRP.

The provision in its simple and ordinary meaning is fairly straightforward and does not create any exception for any offence, including offence of money laundering. However, question about the effect of the PMLA on the IBC, specifically with regards to liquidation process has been time and again raised by the PMLA Authorities.

III. Legislative intent of Section 32A of the IBC

Section 32A was introduced in the 2020 Amendment Act. The Standing Committee on 2019 IBC Amendment Bill noted the following about the section:

"3.9. The Secretary, Ministry of Corporate Affairs during the sitting held on 15th January, 2020 remarked : - 'If the bidder, who is coming and participating under the court-supervised competitive process, does not get security and is not indemnified, there may be a problem.'"

The SC in the case of ***Ghanashyam Mishra and Sons Pvt. Ltd.* v. *Edelweiss Asset Reconstruction Company***, while observing the overriding effect of the IBC in case of inconsistency between two laws (under Section 238), noted the following statements of Hon'ble Finance Minister in Rajya Sabha:

"*There is also this question about indemnity for successful resolution applicant. The amendment now is clearly making it binding on the Government. It is one of the ways in which we are providing that. The Government will not raise any further claim. The Government will not make any further claim after resolution plan is approved. So, that is going to be a major, major sense of assurance for the people who are using the resolution plan. Criminal matters alone would be proceeded against individuals and not company. There will be no criminal proceedings against successful resolution applicant. There will be no criminal proceedings against successful resolution applicant for fraud by previous promoters. So, I hope that is absolutely clear. I would want all the Hon'ble Members to recognise this message and communicate further that this Code, therefore, gives that*

comfort to all new bidders. So now, they need not be scared that the taxman will come after them for the faults of the earlier promoters. No. Once the resolution plan is accepted, the earlier promoters will be dealt with as individuals for their criminality but not the new bidder who is trying to restore the company. So, that is very clear. …"

It is also pertinent to note that the observations with regard to the Section 32A was also provided in the Ministry of Corporate Affairs' report on the Insolvency Law Committee, which states:

"*17.10. Thus, the Committee agreed that the property of a corporate debtor, when taken over by a successful resolution applicant, or when sold to a bona fide bidder in liquidation under the Code, should be protected from such enforcement action, and the new Section discussed in paragraph 17.7 should provide for the same. Here too, the Committee agreed that the protection given to the corporate debtor's assets should in no way prevent the relevant investigating authorities from taking action against the property of persons in the erstwhile management of the corporate debtor, that may have been involved in the commission of such criminal offence*"

Considering the above, the intention of the legislature is amply clear that Section 32A was introduced to provide safeguard to the tainted property of the corporate debtor which has been purchased by the bonafide bidder/buyer in the liquidation of the assets.

IV. Interplay between PMLA and IBC

It has been seen in the recent past that the PMLA authorities have claimed primacy on their provisional attachment orders **("PAOs")** over the charge of the interim resolution professionals and the resolution professionals. Although, the said view of the PMLA authorities is based on Section 3 and 5 of the PMLA, which falls well within their area of operations, however, in a very specific situation, where such property is covered under a resolution plan that is approved by the Adjudicating Authority under Section 31 of the IBC, the authority and jurisdiction of the PMLA is restricted.

Primacy of the Statute: PMLA or IBC?

Considering the special nature and specific purposes of both the statutes, issues arise with regard to the primacy of the statute. Although, there exists Section 238 of the IBC which provides overriding effect to the IBC in case of inconsistency between any two laws. However, time and again the courts have clarified that the PMLA and the IBC have no overlap or inconsistencies. For example, in the case of ***Directorate of Enforcement v. Axis Bank*** ("**Axis Bank Case**"), wherein the DHC dealt with appeals brought by the Enforcement Directorate **("ED")** against the decision delivered by the Appellate Tribunal for PMLA which held that the rights of banks and financial institutions as recognised under SARFESI Act, RDB Act or the IBC would rank superior and PMLA would have to take a back seat. This decision of Appellate Tribunal of PMLA was rejected by the DHC on the grounds that both the PMLA and the IBC are special statutes having distinct purposes and spheres of

operations, hence, there is no inconsistency and thus, issue of primacy of the IBC over the PMLA does not arise.

Position prior to the introduction of Section 32A of the IBC

The *Axis Bank Case* has authoritatively provided that a balance needs to be maintained between the legitimate interests of secured creditors under the IBC for recovery of dues and the conflicting claim of the PMLA authorities over the tainted property. In this regard, the Court held that:

"149. …On account of exercise of the prerogative of the State under PMLA, the lawful interest of a third party which may have acted bonafide, and with due diligence, cannot be put in jeopardy. The claim of bonafide third party claimant cannot be sacrificed or defeated. A contrary view would be unfair and unjust and, consequently, not the intention of the legislature…"

Position post introduction of Section 32A of the IBC

The DHC in *Nitin Jain Case* was posed with the question, whether the PMLA authorities would retain jurisdiction or authority to proceed against the properties of the corporate debtor after the liquidation measure has come to be approved under the IBC, wherein it noted:

"45. …the provision unmistakably also insulates the property of the corporate debtor from any action that may otherwise be taken in respect thereof for an offense committed prior to the commencement of the CIRP. A close reading of Section 32A (1) and (2) establishes that the legislature in its wisdom has erected two unfaltering barriers. It firstly prescribes that the offense, which may entail either prosecution of the debtor or proceedings against its properties, must be one which was committed prior to the commencement of the CIRP. Secondly the cessation of liability for the offense committed is to occur the moment when a resolution is approved by the Adjudicating Authority or upon sale of liquidation assets. The provision in unequivocal terms terminates the prospect of prosecution or coercive action against properties on the happening of either of two critical events:
(a) the date from which a resolution plan comes to be approved by the Adjudicating Authority, or
(b) the sale of liquidation assets."

NCLAT reached to a similar conclusion in the *MK Agarwal Case,* wherein it was held that even if a property has been attached in the PMLA which is belonging to a corporate debtor, if CIRP is initiated, the property should become available to fulfil objects of the IBC till a resolution takes place or sale of liquidation asset occurs in terms of Section 32A.

V. Conclusion

It is quite apparent from a bare perusal of Section 32A of the IBC that it is aimed to prioritise the interests of the bidders/

buyers of the tainted property where such property is covered under a resolution plan approved by the Adjudicating Authority under Section 31 of the IBC. The specific addition of the Section 32A by way of 2020 Amendment Act makes it obvious that the Government is forsaking its entitlement to proceed against the tainted property once the CIRP is initiated.

On the other hand, the Government (under Section 8(5) read with Section 9 of the PMLA) has power to confiscate the property involved in money laundering in case the trial court finds that the offence of money laundering has been committed. The property so confiscated will vest absolutely in the State with all the rights and title. However, the language of Section 32A of the IBC provides the expression *"No action shall be taken against the property of the corporate debtor",* which means that once the CIRP has been initiated and the property has been covered under the resolution plan approved under Section 31, the right of the Government to vest the property in.

itself will extinguish, even if the offence of money laundering has been proved. Thus, a combined reading of the above said provisions provides for an overriding power to the IBC which has also been recognised in the Nitin Jain Case observing the cessation of liability for the offenses committed prior to CIRP, the moment a resolution is approved by the Adjudicating Authority or upon sale of liquidation assets under the IBC.

It is imperative to note that although the right of the Government to confiscate the property is being snatched by Section 32A of the IBC, it is ultimately in the interest of the business environment of the country as it is benefitting the interests of the bidders/buyers of the tainted property as well as the creditors of the corporate debtors, whose money is at stake during the process.

In view of the authors, by the introduction of Section 32A of the IBC and the jurisprudence developed by the Courts and Tribunals thereafter, a sufficient safeguard to the property of a bidder/buyer of the tainted property has been provided.

REFERENCES

1. 32A. (2) No action shall be taken against the property of the corporate debtor in relation to an offence committed prior to the commencement of the corporate insolvency resolution process of the corporate debtor, where such property is covered under a resolution plan approved by the Adjudicating Authority under section 31, which results in the change in control of the corporate debtor to a person, or sale of liquidation assets under the provisions of Chapter III of Part II of this Code to a person, who was not— (i) a promoter or in the management or control of the corporate debtor or a related party of such a person; or
(ii) a person with regard to whom the relevant investigating authority has, on the basis of material in its possession reason to believe that he had abetted or conspired for the commission of the offence, and has submitted or filed a report or a complaint to the relevant statutory authority or Court.
2. Committee of Creditors through Punjab National Bank and Anr. v. Ravi Prakash Goyal and Ors., SLP(c) No.13755/2019
3. Nitin Jain Liquidator PSL Limited v. Enforcement Directorate
4. Directorate of Enforcement v. Manoj Kumar Agarwal, 2021 SCC OnLine NCLAT 121.
5. Ghanashyam Mishra and Sons Pvt. Ltd. v. Edelweiss Asset Reconstruction Company, 2021 SCC OnLine SC 313.
6. Ministry of Corporate Affairs, Report of the Insolvency Law Committee, 20 feb 2020.
7. Directorate of Enforcement v. Axis Bank, 2019 SCC OnLine Del 7854.

1. ARBITRATION

Order passed by a court under Section 36 of the Arbitration & Conciliation Act, 1996 ("**A&C Act**") is an interim order, can be modified on grounds of financial hardship: The Calcutta High Court in ***Damodar Valley Corp. v. Reliance Infrastructure Ltd***. has held that grounds of suffering adverse financial hardship, financial indebtedness and having a potential right to the fruits of the arbitral award were sufficient grounds for modifying the order in favour of the award holder. In this case, the court modified its order by directing the award debtor to furnish an enhanced portion of the awarded amount by way of cash security. The Court further held that in appropriate cases it can permit the decree holder to withdraw the whole or a portion of the awarded amount upon furnishing a bank guarantee without prejudice to the rights of the parties. The Court added that it was an equitable measure in balancing the competing rights of the parties.

Agreement on the name of the arbitrator would not amount to a waiver of notice under section 21 of the A&C Act: The Bombay High Court in ***Malvika Rajnikant Mehta & Ors v. JESS Construction*** held that the requirement to issue a notice of arbitration under Section 21 of the A&C Act is mandatory subject to an agreement of the parties to dispense with such a requirement. The Court held that an inference that the parties had waived the notice cannot be drawn merely for the reason that the parties had named an Arbitrator. The Court refuted the argument of the applicant that since the parties had agreed on the same of the arbitrator, there was no requirement to give the notice of arbitration.

The Arbitral Tribunal cannot reduce the liquidated damages on 'guess work': The Delhi High Court **("DHC")** in ***Haryana Vidyut Prasaran Nigam Ltd. v. M/s Cobra Instalaciones Y. Services S.A. & M/s Shyam Indus Power Solution Pvt. Ltd.*** held that the Arbitral Tribunal cannot reduce the liquidated damages on 'guesswork' if it finds that it is a pre-estimated damages and it is not possible to quantify the damages. The Court held that once the arbitrator finds that the employer has suffered substantial losses due to the fault of the contractor and the contract provides for liquidated damages which were genuine pre-estimate of the loss as the quantification of the claim is not possible, then the arbitrator cannot reduce the amount of the damages on a 'guesswork' for the reason that some of the losses could be quantified.

Party failing to raise the issue of jurisdiction at Section 11 notice stage or during arbitral proceedings, cannot raise it under Section 34 of the A&C Act: The Gujarat High Court in ***Leepee Enterprise v. Mehul Industries*** has held that the issue of jurisdiction of the Arbitrator ought to be raised at the first available opportunity, *i.e.*, when the notice under Section 11 of the A&C Act is served for appointment of Arbitrator. The Court held that since the party had not raised the issue of lack of jurisdiction of the Arbitrator by responding to the notice issued under Section 11 of the A&C Act nor had it participated in the arbitral proceedings to raise the said issue, the arbitral award could not be set aside under Section 34 of the Act on the ground of lack of jurisdiction of the Arbitrator.

Arbitral Tribunal is permitted to fix its fee, if its appointment is made by way of an ad hoc agreement between the parties: The DHC in ***National Highway Authority of India v. MEP Chennai Bypass Toll Road Pvt. Ltd. & Anr.*** has held that where the Arbitral Tribunal has accepted its appointment outside the mandate of the International Centre for Alternative Dispute Resolution **("ICADR")**, it is entitled to determine its fee and is not bound by ICADR Rules. The Court upheld the order of the Arbitral Tribunal fixing the arbitral fee separately for the claims and the counter-claims. The Court added that continuation of arbitral proceedings and periodical payments made by petitioner, without any protest or reservation, signified that the petitioner had agreed and accepted the fee decided to be charged by the Arbitral Tribunal.

Award not in consonance with judicial decisions laid down by courts of India would be in violation of fundamental policy of Indian law under Section 34 of the A&C Act: The DHC in *Sanjay Roy v. Sandeep Soni & Ors.* upheld the order of the Single Judge setting aside the arbitral award under Section 34 on the ground that the Arbitrator had failed to apply the basic fundamental law as contained in the Limitation Act, 1963 and the Transfer of Property Act, 1882. It was observed that as per the decision of the Supreme Court **("SC")** in the case of ***Renusagar Power Co. Ltd. v. General Electric Co.,*** disregarding the orders passed by superior courts would adversely affect the administration of justice and consequently an award passed in such disregard to the orders of superior courts would also be a violation of the fundamental policy of Indian law.

A party cannot dispute the jurisdiction on account of non-existence of the arbitration agreement after submitting to the jurisdiction of the arbitrator: The DHC in ***Amrish Gupta v. Gurchait Singh Chima*** held that when a party agrees to refer the dispute to arbitration and chooses to dispute only the main agreement without laying any challenge to the arbitration clause, it is deemed to have waived its objections qua the arbitration clause and it cannot contend that the arbitrator had no jurisdiction to decide the dispute. The court further held that it can have a second look at the issue of arbitrability, however, it must be within the four corners of the limited grounds of interference under Section 34 of the A&C Act.

If contract is extended by the employer, it cannot be allowed to reduce the period of the extension retrospectively: The DHC **in *North Delhi Municipal Corp. v. IJM Corp.*** has held that when the employer has granted the contractor an extension of time for a specified period, it cannot turn around to contend that the extension was only provisional and it is allowed to reassess or reduce the number of days by which the execution of the contract was executed. It was thus held that once the petitioner acceded to the request of the respondent to grant various extensions for the completion of the project work, it could not turn around and reduce the period retrospectively.

The weak financial condition of a party cannot be the sole ground to deposit security or bank guarantee: The DHC in ***Manish Aggarwal and Anr v. RCI Industries and Technologies Ltd.*** held that merely because a party is in financial distress, it cannot be the sole ground to direct it to deposit the security when the other party has failed to satisfy the arbitral tribunal that it has a prima facie case in its favour. It was further observed that the purpose of Section 17 of the A&C Act is not to securitise

an unsecured and indeterminate sum, therefore, the tribunal would not allow an application for direction to a party to furnish security unless the party claiming such a relief satisfies the arbitrator that it is likely to succeed in arbitration and the other party is transferring its assets intending to render the award unenforceable.

Tribunal cannot examine the commercial wisdom of a party and rewrite the Agreement on the basis of the commercial difficulties it would face in performing the obligations: The DHC in ***Union of India, ministry of railways, railway board & Anr. v. M/s Jindal Rail Infrastructure Ltd.*** has held that when the agreement confers on one party the right to place an additional order on the same terms and conditions during the currency of the contract, the condition under the agreement must be given effect to and the arbitrator cannot negate the mandate of such a stipulation. It was further held that an award wherein the arbitrator re-works a bargain between the parties merely because it is commercially difficult for one party to perform the same would be against the fundamental policy of Indian Law and vitiated by patent illegality.

2. INSOLVENCY AND BANKRUPTCY

Article 1 of Limitation Act, 1963 will not apply to proceedings under Insolvency and Bankruptcy code, 2016: The National Company Law Appellate Tribunal **("NCLAT")** in ***S M Ghogbhai v. Schedulers Logistics India Pvt. Ltd*** held that the Article 1 of Limitation Act, 1963 is not applicable to the Petition filed by the Operational Creditor under Section 9 of the Insolvency and Bankruptcy Code **("IBC"**). NCLAT held that Article 1 of Limitation Act deals with 'suits relation to account' and an application under Section 9 of the IBC cannot be said to be a suit relating to accounts.

Committee of Creditors **("CoC")** competent to revise the approved fees of resolution professional: The NCLAT in ***Kushwinder Singhal v. Reena Tiwari*** held that the CoC is fully competent to revise its earlier approval of the fees of the Resolution Professional. The NCLAT further observed that the entitlement of fee depends on several factors including the change of circumstances, the length of Corporate Insolvency Resolution Process **("CIRP")** proceeding, and hence the regulations under IBC do not fetter the CoC to consider the fee and expenses.

SARFAESI proceedings cannot be continued against corporate debtor once CIRP is admitted and moratorium is ordered: The SC in ***Indian Overseas Bank v RCM Infrastructure Ltd.*** has held that the proceedings under the SARFAESI Act, 2002 cannot be continued once the CIRP is initiated under IBC and the moratorium is ordered. It was observed that Section 14(1)(c) of the IBC has overriding effect over any other law and therefore, after commencement of CIRP there is complete prohibition for any action to foreclose, recover or enforce any security interest created by the Corporate Debtor in respect of its property. The words 'including any action under the SARFAESI Act' in Section 14 of the IBC convey the legislative intent.

A liability in respect of a claim arising out of a Recovery Certificate **("RC")** would be a financial debt within Section 5(8) of the IBC: The SC in ***Kotak Mahindra Bank Ltd. V. A. Balakrishnan & Anr.*** has held that a liability in respect of a claim arising out of a RC would be a "financial debt" within the meaning of clause (8) of Section 5 of the IBC.

The court further observed that the holder of the RC would be a financial creditor within the meaning of Clause (7) of Section 5 of the IBC and that the holder of such certificate would be entitled to initiate CIRP, if initiated within a period of three years from the date of issuance of the RC.

3. COMPANY LAW

Companies (Share Capital and Debentures) Amendment Rules, 2022: Ministry of Corporate Affairs vide notification dated 04.05.2022, issued a notification in exercise by the powers conferred by sub-section (1) and (3) of Section 56 read with sub-section (1) and (2) of Section 469 of the Companies Act, 2013, to notify the Companies (Share Capital and Debentures) Amendment Rules, 2022. The Rules shall come into force from the date of their publication in the official Gazette i.e. 04.05.2022.

In the annexure to the Form No. SH-4, the following declarations are to be inserted before the Enclosure:

- Transferee is not required to obtain the Government approval under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 prior to transfer of shares, or
- Transferee is required to obtain the Government approval under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 prior to transfer of shares and the same has been obtained and is enclosed herewith.

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AWARDS & RECOGNITIONS

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