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### SECURED CREDITORS V. ENFORCEMENT DIRECTORATE: RIGHT TO ATTACHMENT OF PROPERTY

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Recently in the case of Standard Chartered Bank v. Deputy Director, Directorate of Enforcement, the Appellate Tribunal, Prevention of Money Laundering Act, New Delhi has clarified the anomaly regarding the right of the Enforcement Directorate (ED) to attach assets, which have previously been mortgaged to banks, by way of lending. The Appellate Tribunal held that the ED cannot claim right over assets of individuals who are suspected of criminal activity if banks have created prior right over such assets through lending and there exists no direct or indirect relation between the asset and the proceeds of crime. The Appellate Tribunal further noted that such mortgaged assets act as security to the loans and cannot be subject to attachment, particularly when they were purchased and mortgaged prior to the events of funds diversion or fraud committed by the borrowers.

#### Background

M/s Winsome Diamonds & Jewellery Limited, M/s Kohinoor Diamonds Private Limited, M/s Bombay Diamonds Company Private Limited and Forever Diamond Private Limited (Defaulting Companies) mortgaged various properties, valued at around Rs 155,68,06,162 to a consortium of 14 banks, led by Standard Chartered Bank (SCB). The consortium of banks upon failure of the Defaulting Companies to repay the borrowed amount filed an Original Application before the Debt Recovery Tribunal, Ahmedabad (DRT) under Section 13(2) of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest, Act 2002 (SARFAESI Act) and subsequently took possession of the mortgaged assets of the Defaulting Companies. A final recovery certificate to the tune of Rs 4687,04,04,315 was issued in favour of the consortium of banks by the DRT along with an attachment warrant. Being aggrieved by the default on part of the Defaulting Companies, SCB and Punjab National Bank (PNB) also filed a complaint against the Defaulting Companies with the ED, Mumbai. Upon such complaint being made, the ED also attached the properties of the Defaulting Companies, despite being aware of the fact that these properties were already mortgaged in favour of the consortium of banks.

#### Issue

Whether the ED can attach the properties of defaulters, which were mortgaged to banks, prior to the act of funds diversion and fraud committed by the borrowers?

## Key observations and findings of the Appellate Tribunal

The Appellate Tribunal noted that there is no dispute that consortium of banks, led by SCB shall have the first right over the attached properties as they were mortgaged to the consortium of banks prior to the order of attachment by the ED. Accordingly, the Appellate Tribunal analysed the scheme of the SARFAESI Act and the Prevention of Money Laundering Act, 2002 (PMLA) and made the following observations:

### ➤ **Scheme of attachment under the SARFAESI Act**

- Section 31B was inserted in the SARFAESI Act with the objective of giving the secured creditors (in this case the consortium of banks) a priority over the rights of Central or State Government or any other Local Authority. The intent was to safeguard the interest of the secured creditors, which was frustrated pre-amendment, due to the practise of attachment of properties in favour of the Government Institutions.
- The applicability of the amendment in the SARFAESI Act was not only limited to pending litigation, but would also to all dues, including governmental dues, qua the SARFAESI Act. Further, it was not possible for secured creditors to check whether the contribution made by the Borrowers towards their share of the sale consideration was lawfully earned or represented the proceeds of crime.

### ➤ **Scheme of attachment under the PMLA**

- Section 5 of PMLA requires that the properties sought to be attached must be purchased from the alleged proceeds of crime. The said provision further requires that attachment may only be made in cases where the proceeds of crime are likely to be concealed, transferred or dealt with any other manner.
- Various judicial precedents have held that illegally acquired properties are earned and acquired in illegal and corrupt ways, at the cost of the people and the state. The state in such cases is deprived of its legitimate revenue and in such cases the properties must go back where they belong i.e. the state.
- The primary objective of Section 8 and Section 9 of the PMLA is that the adjudicatory authority takes prima facie view on the material available on record. Section 5 and Section 8 of the PMLA cannot be utilized by such authorities to inflict injury to the victim i.e. the banks. The intention of PMLA cannot be to block the loan amount against the mortgaged properties.

### ➤ **Supremacy of SARFAESI Act over PMLA**

- The Hon'ble Supreme Court in *Solidaire India Ltd. Vs Fairgrowth Financial Services Ltd. &Ors., (2001) 3 SCC 71* has held that the provisions of the amended SARFAESI Act prevail over the provisions of the PMLA as the amended SARFAESI Act is the subsequent legislation to the PMLA.
- If there is no direct / indirect involvement of any person or property with the proceeds of the crime, then it cannot be said that the said person is connected with any activity or process with the proceeds of the crime. The same principle should be applied while judging the involvement of any property of any person in money laundering.

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Based on the above stated analysis, the Appellate Tribunal was of the view that the Properties which are mortgaged with the banks were acquired and possessed by the respective owners much before the Respondents availed the loan from the Appellant Banks and therefore no proceeds of crime are involved in these properties. The Appellate Tribunal noted that the mortgaged properties of the Appellant Bank cannot be attached or confiscated unless link and nexus directly or indirectly established.

The Appellate Tribunal accordingly held that the Appellant Bank shall be entitled to recover huge amounts in the above loan accounts and stood as mortgagee/transferee of the interest in the properties. Further, no case of money-laundering is made out against the consortium of banks. In such circumstances, the bank will have priority on assets of the secured creditors to recover the loan amount/debts by sale of assets over which security interest is created.

## Comment

This ruling by the Appellate Tribunal will be widely welcomed by the banking sector, especially in the present circumstances wherein various banks have been unable to recover dues from various loan defaulters. With such defaulters increasingly fleeing the country, the avenues available to secured creditors, such as banks remain limited to the properties mortgaged, at the time of availing the loan. This ruling shall not only ensure that the interest of the banks is secured, but also secures the individuals, who essentially are left to face the brunt of such wrongdoings. The judgment will ensure protection of rights of banks especially when the banks have granted loan facilities bona fide and when they are not involved in any schedule offence.

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