

Does the Prevention of Money Laundering Act, 2002 Safeguard Third-party Rights in the Course of Attachment of Properties?

The Prevention of Money Laundering Act, 2002 (the “**Act**”) was enacted to prevent ill-gotten wealth being reintroduced into India’s financial system. A key feature of the enactment is the power of the investigating agency under the Act, i.e., the Directorate of Enforcement (the “**ED**”), to provisionally attach any property believed to be involved in money laundering for an initial period up to 180 days from the date of such attachment.¹

Section 5 of the Act ensures that proceeds that are obtained directly or indirectly from the offences noted under the Act (“**scheduled offences**”) are not dealt with in any manner so as to frustrate proceedings relating to the confiscation of such proceeds under the Act. *Ex facie*, this provision appears to be in direct conflict with the rights of *bona fide* third-parties such as banks, mortgagees, transferee, and lessee etc. who may otherwise have a lawful interest in a property alleged to be involved in money laundering and had no knowledge of such involvement at the time of acquisition of interest in such property.

This article examines the scheme of the Act and the scope of provisional attachment of property under the Act to evaluate whether the Act adequately safeguards the rights of such third-parties.

SCHEME OF THE ACT AND THE EXTENSIVE DEFINITION OF “PROCEEDS OF CRIME”

Under Section 3 of the Act, the offence of money laundering is defined as: (a) a direct or indirect attempt, (b) any direct or indirect assistance, or (c) being, directly or

¹ Section 5(1) of the Act.

indirectly, a knowing party to or being involved in any process or activity that is connected with the proceeds of a crime including its concealment, possession, acquisition or use, with the intention of projecting / claiming those proceeds of crime as untainted property. Therefore, it is clear that the offence of money laundering is preceded by the commission of a scheduled offence, the proceeds of which become the subject matter of the offence of money laundering. Scheduled offences are listed in Part A to C of the Schedule to the Act and include offences under various statutes such as the Indian Penal Code, 1860; Prevention of Corruption Act, 1988; Securities and Exchange Board of India Act, 1992; and Companies Act, 2013; among others.

The definition of “proceeds of crime” under the Act includes any property derived or obtained directly or indirectly by any person as a result of a criminal activity falling under the ambit of a scheduled offence or, value of such property or the property equivalent in value held within the country if such property is taken or held outside the country.² Therefore, it is possible that even untainted or clean properties which are of the same value as the tainted property could be deemed as proceeds of crime. An explanation to Section 2(u) was inserted by the Finance Act, 2019 which expanded the scope of “proceeds of crime” under the Act to include *“any other property which may directly or indirectly be derived or obtained as a result of any criminal activity relatable to the scheduled offence”*. The use of the words “relatable to” indicates that the legislative intent behind this amendment was to include within the definition of “proceeds of crime” any property derived as a result of a criminal activity that has a nexus with a scheduled offence.

PROVISIONAL ATTACHMENT OF PROPERTY UNDER THE ACT

The Act grants wide powers to the ED to attach properties believed to be involved in the offence of money laundering. Under Section 5 of the Act, the ED is empowered to provisionally attach “any property” of “any person” who is in the possession of proceeds of crime. The ED could rely on the expressions “value of any such property” and “equivalent in value” under Section 2(u) to attach even untainted properties where such untainted property potentially has a link or nexus with the offence or offender of money laundering.³

The standard of test to be followed by the ED in order to effect a provisional attachment is the “reason to believe” standard and the ED is empowered to exercise this authority if, on the basis of material in its possession, it has a “reason to believe” (such reason(s))

² Section 2(u) of the Act.

³ *Deputy Director, Directorate of Enforcement Delhi and Ors. v. Axis Bank and Ors.* 2019 SCC OnLine Del 7854.

to be recorded in writing) that such proceeds of crime are likely to be dealt with in a manner which may frustrate any proceedings under the Act. Although the phrase “reason to believe” is not defined in the Act, courts have interpreted the phrase to mean “*more than a nagging suspicion or personal conviction*”⁴ and not a “*rubber stamp of the opinion formed by someone else*”⁵. Such attachment may be in place for an initial period up to 180 days from the date of such attachment⁶ and may continue to be attached during the pendency of the proceedings under the Act, if the Adjudicating Authority confirms the provisional attachment under Section 8 of the Act.

The wide import of Section 5 of the Act makes it clear that an order of provisional attachment may even be invoked against a person who is not accused of a scheduled offence in respect of a property involved in money laundering. The constitutional validity of this provision was upheld by the Andhra Pradesh High Court in *B. Rama Raju v. Union of India and Ors.*⁷ where the Andhra Pradesh High Court held that the intention of the legislature behind the proviso to Section 5(1) was to clarify that there are two sets of proceedings provided for in the Act – a criminal action pertaining to whether the offence of money laundering is made out, and a civil action pertaining to the attachment and confiscation of property which is subject to proceeds of crime. While deciding on an identical issue, the Delhi High Court in *J. Sekar v. Union of India*⁸ following the decision of the Madras High Court in *Dr. V.M. Ganeshan v. Joint Director, Directorate of Enforcement*⁹ made an observation that the proviso includes “*a person who is not accused of any offence, but who was merely come to possess, under fortunate or unfortunate circumstances, a property that represents the proceeds of crime*”.

Therefore, even from judicial precedents it is sufficiently clear that Section 5 of Act empowers the ED to serve an order of provisional attachment of property on *bona fide* third-parties who may otherwise have a lawful interest in such property and had no knowledge of the property’s nexus to money laundering at the time of acquisition of such interest.

POSITION OF THIRD-PARTIES UNDER THE ACT

Any person other than the person accused of the offence of money laundering, who otherwise has a lawful interest in the property which is provisionally attached by the

⁴ Kavitha G. Pillai v. The Joint Director, Director of Enforcement, Government of India, 2017 SCC OnLine Ker 10118.

⁵ *J. Sekar v. Union of India*, 2018 Cri LJ 1720.

⁶ Section 5(1) of the Act.

⁷ *B. Rama Raju v. Union of India and Ors.*, [2011] 108 SCL 491 (AP).

⁸ *J. Sekar v. Union of India*, 2018 Cri LJ 1720.

⁹ *Dr. V.M. Ganeshan v. Joint Director, Directorate of Enforcement*, 2014 SCC OnLine Mad 10702.

ED would qualify to be a third-party. Although the Act does not define a third-party or stipulate the rights and remedies that are available to such *bona fide* third-party, this issue was dealt with in detail by the Delhi High Court in *Deputy Director, Directorate of Enforcement Delhi and Ors. v. Axis Bank and Ors.*¹⁰ (the “**Axis Bank**”).

In *Axis Bank*, several banks and financial institutions had granted credit facilities against hypothecation/charge over certain assets, the title-holders of which assets were charged under the Act and attachment orders were passed in respect of these assets deemed as proceeds of crime, thereby affecting the rights vested with banks and financial institutions under various other statutes. The Appellate Tribunal constituted under the Act (the “**Appellate Tribunal**”) had set aside these attachment orders on certain grounds and the orders of the Appellate Tribunal were challenged before the Delhi High Court separately. The Delhi High Court, clubbed these appeals together, and held that rights under other statutes and the Act must co-exist and be enforced in harmony, without one being in derogation of the other. The Delhi High Court observed that an order of attachment under the Act is as lawful as an action claimed by a third-party and such an order of attachment is not rendered illegal merely because a third-party has acquired prior interest in the property. The Delhi High Court further observed that mere issuance of an order of attachment cannot render illegal a *bona fide* third-party’s interest in the property, unless it was created to defeat the object of the Act, and a balance ought to be struck between the two competing interests. According to the Delhi High Court, the scheme of the Act itself makes way for a balance between these interests. For instance, the Act provides an opportunity to a person claiming legitimate interest to approach the forums under the Act to prove that he had acted in good faith, took all reasonable precautions, is himself not involved in money laundering, and to seek a release or restoration of the property under Section 8(8) of the Act.

On the issue of the authority of the ED to provisionally attach a property involved in money laundering and conflicting third-party claims on the property, the Delhi High Court in *Axis Bank* made the following observations:

Who is a *bona fide* third-party?

A *bona fide* third party is a party who can show by cogent evidence that he had acquired interest in the attached property lawfully and for adequate consideration; that he was not privy to, or complicit in, the offence of money laundering; and that he has made all compliances with existing laws.

¹⁰ *Deputy Director, Directorate of Enforcement Delhi and Ors. v. Axis Bank and Ors.* 2019 SCC OnLine Del 7854.

What remedies are available to a *bona fide* third-party?

If the third-party can show by cogent evidence that he had acquired interest in the attached property at the same time or after the commission of the scheduled offence, he can seek release of attachment of the property by proving that he had taken due diligence to ensure that the attached property was not a tainted asset and that the transactions indulged in were legitimate at the time of acquisition of such interest. If the third-party can show by cogent evidence that he had acquired the same after the commission of the scheduled offence, the property to the extent of such interest of the third-party will not be subject to confiscation so long as the charge or encumbrance of such third-party subsists, subject to satisfaction of the charge or encumbrance of such third-party and restricted to such part of the value of the property as is in excess of the claim of the said third-party.

At what stage is the claim of a *bona fide* third-party adjudicated?

If the order confirming the attachment has attained finality, or if the order of confiscation has been passed, or if the trial of a case under Section 4 of the Act has commenced, the claim of a third party asserting to have acted *bona fide* or having legitimate interest in the nature mentioned above will be inquired into and adjudicated upon only before the special court, and not at the stage of provisional attachment.

The judgment in *Axis Bank* has been challenged by way of a Special Leave Petition and is pending adjudication before the Supreme Court of India.¹¹ Although these observations made by the Delhi High Court are pivotal in safeguarding the rights of *bona fide* third-parties, recourse to these defences is available only before the Adjudicating Authority in response to the show cause notice issued¹² and after the order confirming the attachment has attained finality¹³ but, in the view of the Delhi High Court, is not available to resist an order of provisional attachment by the ED. Accordingly, the impact of delay in adjudication of third-party rights deserves further consideration especially since such delay could make the remedy of an eventual release of the attached property almost meaningless.

Under Section 8(1) of the Act, once any property of any person is provisionally attached by the ED, and a complaint is filed by the ED under Section 5(5), the Adjudicating Authority is required to serve a notice on the person whose properties have been attached and offer an opportunity to be heard and satisfy the burden of proof before confirming the order of attachment. Therefore, even if a third-party is able

¹¹ *Axis Bank Ltd. v. Deputy Director, Directorate of Enforcement Delhi* (Diary No. 28906/2019).

¹² Section 8(1) of the Act.

¹³ Section 8(6)-(8) of the Act.

to prove to the ED that it has paid adequate consideration and had no knowledge about the property being acquired with the proceeds of crime, there is no provision under the Act to resist the order of provisional attachment. As a result, the vesting of an almost absolute authority to provisionally attach “any property” of “any person” may put the lawful interest of a third-party, who may have acted *bona fide* and with genuine due diligence, in jeopardy.

CONCLUSION

The object of the Act, *inter alia*, is to provide for confiscation of property involved in money laundering and the ED’s authority under the Act, to provisionally attach a property believed to be involved in money laundering, is in furtherance of such object. However, it is manifestly arbitrary if a third-party vested with an otherwise lawful interest in a property acquired by payment of adequate consideration, who has no knowledge or means to know that the property constitutes “proceeds of crime”, is subjected to an order of provisional attachment. In particular, when such third-party has not received any unjust benefits from the acquisition of such lawful interest in the property.

Further, if a *bona fide* third-party is able to show documented proof of the acquisition of interest in the property along with proof of payment of adequate consideration, the ED should be restrained from passing an order of provisional attachment on the property and should instead trace and attach the consideration received in the hands of the accused towards sale of such property or transfer of interest in such property. This principle is also supported by the fact that, under the Act, the term “proceeds of crime” includes “value of any such property”. In light of the aforesaid, the safeguards available to *bona fide* third-parties who could potentially get and/or are getting adversely impacted by provisional attachments under the Act in its present form, in particular the stage at which such safeguards may be invoked, deserve reconsideration.

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