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SECTION 65 OF THE INSOLVENCY AND BANKRUPTCY CODE, 2016: DETERRING MALICIOUS PROCEEDINGS WITHOUT DISCOURAGING LEGITIMATE CIRPS

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Introduction

When IBC was introduced in 2016, it was viewed as a genuine attempt to fix a business that is going insolvent, rather than outright shutting it down; this position was reiterated by the Supreme Court in Swiss Ribbons Pvt Ltd v Union of India[1]. It laid down a mechanism to rescue distressed companies by ensuring the maximisation of the value of their assets, and to try to save the company from getting ripped apart.

But when a framework designed to address insolvency is used fraudulently and maliciously, Section 65[2] comes into play by laying down penalties for different forms of 'misuse', which requires careful consideration and analysis of the facts and circumstances. This essay would argue that effectively deterring companies will require consistent and evidence-based enforcement of Section 65, without making it difficult for legitimate CIRPs.

The Statutory Threshold under Section 65

Section 65(1)[3] penalises a person who initiates the CIRP or liquidation proceedings fraudulently or with malicious intent for any purpose other than the resolution of insolvency or liquidation; the provision does not itself enumerate the prohibited conduct, which has to be inferred from the facts and may include (but is not limited to): using coercive methods to recover debts; disguising themselves behind the veil of moratorium that triggers Section 14[4]; and stripping of assets; when it is established, the Adjudicating Authority may impose a monetary penalty (not less than ₹1 lakh and which may extend to a maximum of ₹1 crore) on the person who initiated the proceedings.

But under the amended Section 7(5)[5], if the Adjudicating Authority is satisfied that default has occurred and the other statutory conditions are met, it shall admit the application; hence Section 65 has been elevated from a secondary measure to a primary one for penalising and quashing

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fraudulent initiations; but one thing is very important to differentiate here; not every unsuccessful application is malicious; there can be various reasons such as: the debt does not meet the strict legal definition of a 'financial debt' under Section 5(8)[6]; the application may have incurable procedural defects.

Establishing the Evidentiary Threshold

To trigger the statutory penalty, tribunals require cumulative and evidentiary proof that the insolvency framework was actively used for an irrelevant purpose. To understand it; courts have tried to draw a line in the practical application of cases; among which we will focus on 3 very important cases; that have established some rules for Section 65, starting with the case of Hytone Merchants Pvt Ltd v Satabadi Investment Consultants Pvt Ltd (2021)[7]; NCLAT held that proving a 'debt and default' is not a concrete free pass if the intent is malicious; this judgement connects directly to Section 65; and reiterates that Tribunals have a duty to look behind paperwork, and ensure there is no set-up behind the same; however this section cannot be triggered by mere suspicion. In the case of Monotrone Leasing Pvt Ltd v PM Cold Storage Pvt Ltd (2020)[8]; the tribunal made it clear that a malicious motive would require concrete evidence; a corporate debtor cannot point to a commercial dispute to escape an insolvency process. In continuation of Unigreen Global Pvt Ltd v Punjab National Bank (2017)[9]; these cases help us understand the practical implementation in compliance with Section 7.

Section 65 in Practice: Judicial Enforcement

When the tribunals implement Section 65, it leads to the immediate termination of the ongoing insolvency proceedings, plus the imposition of huge monetary fines; but courts need perfect and consistent evaluation of evidence; that ensures actual fraudsters are getting punished and no innocent is caught up in this!

In the case of Pragati Impex India Pvt Ltd v Vistar Construction Pvt Ltd (2023)[10], the tribunal stopped the insolvency process on the intervention of a homebuyer and laid down the penalty of ₹1 crore on both of them, i.e., the financial creditor and the corporate debtor; similarly, in the case of Expert Realty Professionals Pvt Ltd v Logix Infrastructure Pvt Ltd (2025)[11], the NCLAT upheld the penalty of ₹55 lakh; but the parties were not punished just because they were related somehow; the tribunal looked at a combination of factors such as: hidden relationships; debt changes that were not documented in the books; and also a clear attempt to cheat genuine homebuyers.

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These cases prove that Section 65 works most effectively when tribunals lift the corporate veil and look at the combination of evidence of asset stripping. However, in the case of Three C Green Developers Pvt Ltd v Three C Infratech Pvt Ltd (2025)[12], the court removed the person in charge to ensure fairness; this proved that a related party is not an essential basis for penalty. Hence, the effective implementation of this section should be reasoned critically so that fraudsters are punished, and genuine attempts to protect a business are not discouraged.

Effectiveness and Institutional Challenges

The most pressing question that arises in the case of Section 65 is the credibility of its deterrence → does it look good only on paper, or does the timing of enforcement ruin its implementation?

The primary fault of Section 65 is that it works retroactively rather than preventively; time taken by courts to identify that the bankruptcy is a scam and put a stop to it; the targeted company by that time has lost its reputation & assets are frozen, and ultimately loss of control over its operations; punishing the bad actors after years; does not discourage them; especially if they have successfully misused the law to cause chaos. If courts impose heavy penalties easily, there is a risk of scaring the honest creditors; they might avoid the process completely if they fear a low fine for losing a case on technical grounds. The core issue is that proving someone has 'bad intentions' is difficult; that leads to judges making different decisions across the country.

Towards a More Predictable Enforcement Framework

To eliminate this problem; we need to shift the system from arbitrary, delayed punishments to a structured, predictable; and early detection mechanism; as established in the September 2026 IBBI circular[13] highlights, IPs i.e. the insolvency professionals have access to details and must act as the first line of defence by reporting the problems to the tribunals where there are reasonable grounds, which could include fake transactions or a single creditor dominating the process etc. the tribunals can adopt this framework of a structured assessment of the evidence; i.e. judges use these IPs reports to link Section 65 penalties to concrete evidence, by combining these; IBC can deliver proportionate penalties that punish real fraudsters without scaring away honest creditors.

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Conclusion

To conclude and summarize; Section 65 is very essential to stop the framework of IBC from getting misused; it should not be limited only to paperwork, but serve as an effective measure to prevent its malicious use; but it is not very easy; because it involves a tough act of balancing between identification and separation of abuse as seen in the case of Expert Realty; without putting honest creditors at risk; to maintain the balance; the system would have to mend its approach a little bit and start relying on evidence based on scrutiny; → empowering professionals to find inconsistencies, so that judges can rely on it and deliver justice quickly, swiftly and proportionately.

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[1] Swiss Ribbons Pvt Ltd v Union of India (2019) 4 SCC 17.
[2] Insolvency and Bankruptcy Code 2016, s 65.
[3] Insolvency and Bankruptcy Code 2016, s 65(1).
[4] Insolvency and Bankruptcy Code 2016, s 14.
[5] Insolvency and Bankruptcy Code 2016, s 7(5).
[6] Insolvency and Bankruptcy Code 2016, s 5(8).
[7] Hytone Merchants Pvt Ltd v Satabadi Investment Consultants Pvt Ltd Company Appeal (AT) (Insolvency) No 258 of 2021 (NCLAT, 30 June 2021).
[8] Monotrone Leasing Pvt Ltd v PM Cold Storage Pvt Ltd (NCLAT, 16 July 2020).
[9] Unigreen Global Pvt Ltd v Punjab National Bank Company Appeal (AT) (Insolvency) No 81 of 2017 (NCLAT, 1 December 2017).
[10] Pragati Impex India Pvt Ltd v Vistar Construction Pvt Ltd IA No 4654/ND/2023 in CP (IB) No 662/ND/ 2021 (NCLT New Delhi, 25 February 2026) [30].
[11] Expert Realty Professionals Pvt Ltd v Logix Infrastructure Pvt Ltd Company Appeal (AT) (Insolvency) No 383 of 2025 (NCLAT, 8 September 2025).
[12] Three C Green Developers Pvt Ltd v Three C Infratech Pvt Ltd IA No 2789/2023 in CP (IB) No 617/ND/ 2022 (NCLT New Delhi, 12 March 2025).
[13] Insolvency and Bankruptcy Board of India, 'Due diligence by Insolvency Professionals regarding misuse of IBC framework' (Circular No IBBI/CIRP/105/2026, 9 September 2026).