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DIRECTORS DUTIES IN THE TWILIGHT ZONE OF INSOLVENCY (A COMPARATIVE ANALYSIS OF INDIA, THE UK, AND AUSTRALIA)

~ Eakansh Bansal

Abstract

This paper examines the gap in India's framework dealing with the absence of laws in twilight zone i.e. the pre insolvency period particularly for creditor protective duties on directors of the company. Even though India has Insolvency and Bankruptcy Code 2016 however the twilight zone (Period between foreseeable financial distress and formal insolvency) is substantially unregulated. This paper highlights that the lack of laws in India on twilight zone are not just an oversight by the lawmakers but rather a structural consequence of its promoter dominated corporate architecture. It also reiterates the need for a better creditor protection method, triggered by objective awareness of likely insolvency enforced through institutional mechanisms including the company secretory as the sole insolvency trigger locks and the implementation through IBBI regulation making power without the need of parliament amendment.

Keywords: Twilight Zone of Insolvency, Directors Duties, Creditor Protection

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RESEARCH QUESTIONS

Question 1

What specific pre insolvency creditor protective duties do Indian company law frameworks particularly IBC 2016 & Companies Act 2013 fail to impose on directors, and how does this gap compare structurally and functionally to UK and Australian models?

Question2

How does the absence of pre insolvency duties enable directors to strategically exploit Section 10 voluntary filing and Section 14 moratorium, and what are the structural and demonstrated consequences for creditors and the integrity of insolvency process?

Question 3

What statutory and institutional reforms (drawing on UK/Australian precedent but adapted to Indias promoter dominated corporate structure) would effectively impose creditor protective duties on directors without disrupting legitimate insolvency access?

INTRODUCTION

The insolvency environment in India has changed with the introduction of Insolvency and Bankruptcy code 2016. *The Code has radically reorganized creditor recovery solutions, shortened resolution timeframes, and stipulated the Insolvency and Bankruptcy Board of India as a quasi-judicial regulator, charged with the responsibility of imposing insolvency procedure with more rigour than ever before.*[1] *This is known as twilight zone which is when a company faces financial distress but it has not initiated formal insolvency.*[2] An example of the tension is the case of Go first Airlines, which declared voluntary insolvency proceedings under Section 10 IBC in 2023 whilst still operating as a functional airline, the directors of the company, with catastrophic cash flow deterioration, declared insolvency whilst the airline remained in operation, *leading to an automatic moratorium under Section 14 that suspended claims of creditors, including fuel.*[3]

This mechanism was legal according to the IBC 2016, but poses a normative question, did the directors have any express creditor protective obligations at the time of the pre insolvency period, could such strategic timing have been limited. This can be illustrated by contrasting with Go First had such a law been included in Indian law or even a limited version of West Mercia duty, the airline's directors would have had to take into account creditor considerations before its Section 10 filing amid declining cash flows, rather than having total freedom up until that point.

A. India's Pre-insolvency Director Duties Framework

The Companies Act 2013, which brought the first codification of directorial responsibility in India, has radically changed the foundations of directorial accountability in the country. Before this change, Indian law was based largely on common law. *Through the 2013 Act, it was fixed that this uncertainty was remedied with Section 166*[4] creating key duties i.e. to act in accordance with the company articles of association, to bring into existence the objects of the company in good faith, to act in the best interests of the employees, shareholders, community and environment, to exercise reasonable care and due diligence, to avoid conflicts of interest of stakeholders, and to refrain from undue personal gain. *These 6 duties have been bifurcated by*

[1] Insolvency and Bankruptcy Code 2016 (India), s 6.
[2] Kristin van Zwieten, Director Liability in Insolvency and its Vicinity (2018) 38(3) Oxford Journal of Legal Studies 382.
[3] Go First Airlines Ltd NCLT Mumbai (2023), Insolvency and Bankruptcy Code 2016 (India), ss 10, 14.
[4] Companies Act 2013 (India), s 166.

court into 2 categories i.e. duty of care, skill, and diligence and fiduciary duties.[5] The shortcomings of such an approach during financial distress become clear. The scope of obligations set out in Section 166 is limited to the going concern environment. Its duties, including acting in good faith, abstaining from conflict of interest, and taking due care, all assume the fact that the company is working within the scope of its solvency. No time-based limitation exists, no change of the duty object, and no obligation to the creditor in case of approaching insolvency in this section.

Fiduciary duty of directors are traditionally focussed on the company, as a legal person, instead of individual shareholders or creditors.[6] *There is no mechanism per se which shifts focal point of accountability (director) when the corporate insolvency is inevitable.*[7] The IBC 2016 provides a comprehensive framework for debtor rescue and creditor recovery, but nothing is expressed to impose any creditor protective obligations on directors in the period before their insolvency is declared officially (*The so called twilight zone)*[8]. Neither *Section 10 or Section 14*[9] puts done any obligations owed by directors towards creditors in anticipation of formal insolvency. *The United Kingdom Companies Act 2006, Section 172(3)*[10] specifically imposes the duty on directors to consider the interests of creditors in circumstances where the company is nearing insolvency. *While Australia's corporations act 2001 section 588G*[11] *imposes prohibition on insolvent trading. India lacks both provisions and it is not accidental*. IBC 2016 has been modelled considerably on the UNCITRAL Legislative Guide on Insolvency Law (2004), and even though the latter does not require pre-insolvency obligations on directors to be a component of the model insolvency law, the drafters of IBC in light of Bankruptcy Law Reforms Committee Report (2015) aimed at remedying the pro-debtor resolution process and creditor recovery rate improvement in formal procedures. The governance aspect of the twilight zone problem has not been included in the BLRC's Terms of Reference. Moreover, there is not a single mention in Report concerning the existence of the need for directors to have any pre-insolvency obligations toward their creditors before the start of CIRP proceedings.

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[5] Umakanth Varottil, Codification of Directors Duties Is Common Law Excluded in The Reform Decade Corporate and Commercial Law in India (2013) 27–28.

[6] Umakanth Varottil, Codification of Directors Duties: Is Common Law Excluded in The Reform Decade Corporate and Commercial Law in India (2013) 31–33.

[7] Janak Panicker, Simplifying the Quandary of Corporate Governance in Light of the TataMistry Saga (2021) 8.2 RFMLR 29, Mar Jacob Thoomkuzhy v Jeevan Telecasting Corporation Ltd NCLT Kochi, TCP No 57/KOB/2019.

[8] Kristin van Zwieten (n 2), West Mercia Safetywear Ltd v Dodd (1988) 4 BCC 30.

[9] Insolvency and Bankruptcy Code 2016 (India), ss 10, 14.

[10] Companies Act 2006 (UK), s 172(3).

[11] Corporations Act 2001 (Australia), s 588G.

A director who is dealing with worsening cash flows can make a Section 10 petition at a time that maximally benefits the company, whereas a prior filing would have afforded creditors greater protection. In the present circumstances, the law does not impose any liability on the director, as long as he or she does not violate the fiduciary duty to the company per se, or commit a fraud. *In the case of Manish Kumar vs Union of India*[12], court held the validity of section 10 mentioning that corporate debtors retain significant discretion over the timing and intimation of insolvency petitions.

The moratorium provisions of Section 14 enhance the debtor benefit established by Section 10. Upon commencement of CIRP, *Section 14*[13] automatically imposes a moratorium suspending all creditor enforcement actions for 180 days (extendable to up to one year in exceptional cases). This suspension is absolute and overrides conflicting provisions in other statutes, including the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 (SARFAESI Act). *The Supreme Court, in Indian Overseas Bank v. RCM Infrastructure Ltd*[14], confirmed that once CIRP commences, creditors cannot pursue enforcement remedies, *even if such enforcement was validly initiated prior to the moratorium.*[15] A director may permit the company to approach insolvency whilst maintaining facade of operational normalcy, then trigger Section 10 proceedings precisely when creditors are poised to enforce security. This has been consistent in future judgments as well. In the case of *Embassy Property Developments Pvt Ltd vs Union of India*[16], the Supreme Court reiterated the wide sweep of Section 14 by stating that even proceedings in front of statutory authorities shall come to a stop once a CIRP is invoked. Similarly, in the case of *Edelweiss Asset Reconstruction Company Ltd vs Sachet Infrastructure Pvt Ltd*[17], the NCLAT further emphasized that moratorium automatically applies without any further act on part of the resolution professional. Collectively, it can be said that Section 14 creates an estate which is protected from all creditor action hence the crucial time being that at which Section 10 is filed.

[12] Manish Kumar v Union of India (2021) 5 SCC 1.
[13] Insolvency and Bankruptcy Code 2016, s 14, Insolvency and Bankruptcy Board of India Regulations 2016.
[14] Indian Overseas Bank v RCM Infrastructure Ltd AIR 2022 SC 2687.
[15] Ibid.
[16] Embassy Property Developments Pvt Ltd vs Union of India (2019) 20 SCC 394.
[17] Edelweiss Asset Reconstruction Co Ltd v Sachet Infrastructure Pvt Ltd Company Appeal (AT)(Insolvency) No 377 of 2019 (NCLAT)

The recovery of creditors is only allowed under the legislative scheme in restricted circumstances i.e. under Section 43 and 50[18], the Insolvency Professional may recover preference transactions (payments made within 90 days before insolvency to related parties) and undervalued transactions (disposals made within 12 months before insolvency at less than fair value).

B. The UK Comparative Framework (Statutory codification and the Twilight Zone Doctrine)

The UK policy towards the twilight zone is a significant contrast to the Indian doctrine of silence. Instead of letting the pre-insolvency stage to play with itself, the UK has built a system of graded statutory codification, common law doctrine, and wrongful trading liability that expressly says that the greater the solvency diminishes, the greater the obligations imposed upon the directors. *This model represents what Ziegel described in 1993 as a quiet revolution a paradigm shift in the traditional theory that the responsibilities of directors are owed solely to shareholders and in favour of a system that acknowledges creditors as stakeholders in a company entitled to statutory and common law protection when that company is in distress*.[19] Although Ziegel's work is based on Anglo Canadian business corporations law, the move from the bilateral relation between the shareholder and the director to the three-party arrangement including the creditor is no less pertinent to the case of India. Corporate law in India too has always functioned within the shareholder supremacy paradigm supported by promoter-controlled capital structure; and the debate about the status of creditors as beneficiaries remains as valid here as in the Anglo-Canadian scholarship of the 1990's.

The statutory foundation is section 172(3) of the Companies Act 2006, which codified directors duties in statutory form for the first time in English law.[20] *West Mercia Safety wear Ltd v. Dodd*,[21] was the seminal common law statement of this principle. The court opined that, in an insolvent company (or a company whose insolvency is questionable), directors must bear in mind the interests of creditors when they are acting in the best interests of the company. *Importantly, it does not imply the duty shifting to the beneficiary of the duty, which in the*

[18] Insolvency and Bankruptcy Code 2016 (India), ss 43, 50.
[19] Jacob S Ziegel, Creditors as Corporate Stakeholders The Quiet Revolution – An Anglo Canadian Perspective (1993) 43 University of Toronto Law Journal 511, 511–12.
[20] Companies Act 2006, s 172.
[21] West Mercia Safety wear Ltd v Dodd (1988) 1 WLR 1169 (CA).

present case is the company, but a change in the content of the former.[22] As the company worsens in financial terms, so do the interests of creditors since it is their economic interests that are at stake. Directors must thus exercise their powers in a way that will safeguard the assets of the company to the satisfaction of creditors, and not to waste them at the expense of shareholders.

This is what Keay described in 2005 as an entity maximisation strategy, where directors are required to act in a way that maximises the value of the company as a whole, and the interests of creditors are part of the calculus of solvency as the company becomes less solvent.[23] The ambiguity of what exactly brings about this duty was resolved in 2022 by the UK Supreme Court *in Sequana SA*,[24] which determined that the duty of creditors of the company exists when directors know, or they should know, that the company is insolvent, or bordering insolvency, or that an insolvent winding up or administration is about to occur. *Notably, the Court dismissed the suggestion that a real risk of insolvency is enough.*[25] Rather, it stated a sliding scale approach, as the financial situation of the company becomes weaker, the weight attributed to the interests of creditors also rises accordingly, but at the point of insolvency, at least, the interests of the creditors have the upper hand. This restructuring maintains the flexibility of the managers to undertake valid rescue operations and at the same time, creditor protection is enhanced as insolvency becomes inevitable. Sequana's sliding scale model has criticisms as well. Some scholars have contended that the model generates great uncertainty for directors trying to understand the nature of their duties. Indeed, de Carvalho and Reddy themselves recognize that the threshold element of the duty which states that directors owe creditors a duty of care if they knew or should have known of the likely insolvency of the business opens up several questions that make it difficult to understand when the duty kicks in and how directors would fulfil the duty once the threshold is satisfied. Nonetheless, for the purposes of this discussion, these criticisms do not detract from the comparison being made here because an imperfect sliding scale is still superior to a lack of duty.

De Carvalho and Reddy have noted that this practice appeals to the principles of the UK company law, which does not take too much caution at an early stage of distress, and so the

[22] Ibid 1182 (Dillon LJ).
[23] Andrew Keay, Formulating a Framework for Directors Duties to Creditors An Entity Maximisation Approach (2005) 64 Cambridge Law Journal 614, 620–22.
[24] BTI 2014 LLC v Sequana SA (2022) UKSC 25, (2022) 3 WLR 709.
[25] ibid (67)–(203) (Lord Reed PSC).

board is still free to seek a turnaround, and at the same time still guard creditors when insolvency becomes imminent.[26] As a matter of fact, *Section 214*[27] imposes a personal liability on directors, this came from Cork committees recommendation in 1982 to put directors personally liability for such trading once company has unavoidable financial liquidation in sight. *A foundational article Prentice in 1990 examined the logic undermining above section.*[28]

Article by Sofia Ellina analyses that section 214(3) gives defence[29] to directors in a case where they took reasonable steps to minimise creditors losses which actually distinguishes legitimate insolvent trading and wrongful trading. *In an article by Keay, they mentioned that many creditors through contract cannot protect themselves adequately*[30] and there exists a need for statutory protection as it enhances the efficiency by reducing agency costs associated with risk shifting by insolvency directors. *As Rosemary and Ian Ramsay observe the directors duty works on a continuum where in the balance shifts favouring creditors as their right on company's assets becomes more heavy.*[31]

This reasoning has its origin in the case of Kinsela vs Russel, where court held that when insolvency is inevitable, creditors become prospectively entitled which means that the assets of the company which were to be otherwise saved for shareholders are now preserved for these creditors. [32] Even though Kinsela is an Australian decision from the Court of Appeals of New South Wales, it has become well-established precedent for persuasive authority in English Commonwealth law relating to insolvency and has even been recognized as such by the Court of Appeals of England in West Mercia itself. India has left the twilight zone as a grey area which is unregulated allowing directors to exploit the gap between the foreseeable distress and formal insolvency which is detriment to the interests of creditors and in benefit of the shareholders. This gap had been solved by UK crystalizing creditors interests through a combination of common law doctrine and statutory codification. By way of comparison, Go

[26] Pedro Schilling de Carvalho and Bobby V Reddy, Credit Where Credits Due The Supreme Court Take on Directors Duties and Creditors Interests (2023) 82 Cambridge Law Journal 17, 18–19.

[27] Insolvency Act 1986 (UK), s 214, Review Committee on Insolvency Law and Practice, Insolvency Law and Practice, Report of the Review Committee (Cmnd 8558, HMSO 1982) para 1805.

[28] DD Prentice, Creditors Interests and Directors Duties (1990) 10 Oxford Journal of Legal Studies 265, 266–67.

[29] Sofia Ellina, Scope and Challenges in Kristin van Zwieten (ed), Goode on Principles of Corporate Insolvency Law (5th edn, Sweet & Maxwell 2018) ch 15, paras 15.07–15.13.

[30] Andrew Keay, Directors Duties to Creditors, Contractarian Concerns Relating to Efficiency and Overprotection of Creditors (2003) 66 Modern Law Review 665, 672–85.

[31] Rosemary Teele Langford and Ian Ramsay, The Contours and Content of the Creditors Interests Duty (2021) 21 Journal of Corporate Law Studies 85, 88–92.

[32] Kinsela v Russell Kinsela Pty Ltd (in liq) (1986) 4 NSWLR 722, 730.

First's case should make us realize that, had there been any such provision within India's laws as that of the West Mercia provision, the board members of the airline company would be forced to take into account their creditors interests throughout the period when the cash flow was getting worse and worse prior to Section 10 filing.

C. Australia's Insolvent Trading Regime (Retrospective Liability Without a Twilight Zone Duty)

The director liability regime in Australia during times of financial distress takes a curious middle ground between the silence surrounding director liability in India and the graduated regime in the UK. Section 588G of the Corporations Act 2001 is a statutory liability to insolvency trading, but without the upstream creditor protective framework that characterises the UK framework. This structural gap exists despite the otherwise advanced regime of insolvency in Australia, whilst section 588G criminalises trading when the company is insolvent, it does not create a structured and creditor focused duty akin to that in the UK. The provision therefore has a retrospective effect, *the provision only takes effect once insolvency has been established or will be established as a consequence of the decision of the director.*[33]

This defence has been found to be critical in practice and has seriously jeopardised the efficacy of section 588G as a pre-insolvency creditor protective measure. *Mayanja's 2014 comparative analysis observes that Australian courts and practitioners have been reluctant to impose liability under section 588G, partly because the test whether the director had reasonable grounds for suspecting insolvency creates evidentiary gaps between the objective and subjective standards, and partly because the reasonable belief defence in section 588H offers directors a substantial practical escape valve.*[34]*(referring to Hall vs Poolman case).* The comparison with the UK is instructive whilst Australia's trigger operates upon "reasonable grounds for suspecting insolvency," *the UKs Sequana*[35] *standard requires only that directors know or ought to know the company is "bordering on insolvency" or that "insolvent liquidation*

[33] Corporations Act 2001, s 588G(1)(2).
[34] James Mayanja, Clarifying the Object of Directors Endeavours, What Australia Can Learn from the United Kingdom' (2014) 37 University of New South Wales Law Journal 874, 895–97; Jason Harris, Insolvent Trading The Director's Perspective (2010) 18 Insolvency Law Journal 155; Jason Harris, Anil Hargovan and Michael Adams, Australian Corporate Law (6th edn, LexisNexis Butterworths 2020) paras 22.50–22.65
[35] BTI 2014 LLC v Sequana SA (2022) UKSC 25

or administration is probable."[36] Although Australia's trigger is ostensibly earlier, the interaction of subjective belief and objective suspicion creates enforcement gaps that weaken section 588Gs protective effect. *Further, the common law twilight zone doctrine of the UK, which is expressed in West Mercia and crystallised in Sequana*[37]*, is prospectively operating, compelling directors to change their behaviour as solvency becomes more and more crystallised*. This has been demonstrated in Australian cases. In the case of *ASIC v Plymin*[38], eleven indicia were provided for insolvency with regard to the section 588G provisions, while the difficulty in using these indicia in practical situations shows how hard it is to enforce the provision as pointed out by Mayanja. The other case is that of *Hall v Poolman*[39] where the court assessed whether there was any reasonable basis of belief that the company was solvent as per the section 588H provisions.

Section 588G is essentially a retroactive, reactive response to the contrasting doctrine in the UK, where directors are required to act differently in situations of financial distress*, in Australia, directors fail to perceive or believe in insolvency after events, and is thus punished.*[40] A director in Australia who has allowed a company to slip into a worse financial position, may permissibly continue trading, but only to the extent that the director had no reasonable basis to suspect that the company is insolvent, a test which depends heavily on whether the director had actual knowledge, and the information available to the director at the material time. The subjective and objective factors interact to create enforcement issues, although there may be objective factors indicating insolvency, a director who made no attempt to obtain financial information may claim to have no knowledge of reasonable grounds to suspect insolvency. The Australian Legislature has therefore incorporated a statutory prohibition of wrongful trading under financial distress without the need to embed it in a larger frame of creditor protective duties functioning in financial distress. This is an indication of what Symes refers to as the lack of any coherent "Australian theory of insolvency law" and in which multiple and even conflicting policy objectives are left unaddressed in the statutory architecture itself.

[36] Mayanja (n 35) 901–03.
[37] West Mercia Safety wear Ltd v Dodd (1988) BCLC 250 (CA) (establishing the common law twilight zone duty), BTI 2014 LLC v Sequana SA (2022) UKSC 25 (crystallising the trigger threshold)
[38] ASIC v Plymin [2003] VSC 123.
[39] Hall v Poolman (2007) NSWSC 1330.
[40] Christopher Symes, Theory and Influences Found in Australian Insolvency Law (2024) 45 Adelaide Law Review 64, 68–70.

This gap is added by the Australian insolvency process. Part 5.3A of the Corporations Act 2001 permits directors to initiate voluntary administration when, in their opinion, the company is insolvent or likely to become insolvent.[41] EHows 2006 examination reveals a critical structural tension, the system encourages early intervention by setting a low eligibility threshold, yet simultaneously permits directors to exercise substantial discretion over timing, *creating scope for strategic delay or opportunistic acceleration depending on the controlling shareholders interests*.[42] *Eow argues the eligibility threshold is insufficient to guard against abuse and proposes an additional "value maximising test" requiring demonstration that entry into voluntary administration will extract the greatest economic value from company resources.*[43] According to the comparative analysis of wrongful trading in the UK and insolvent trading in Australia, *Keay and Murray find that the Australian regime, although apparently quite robust on the face of it, suffers as a result of enforcement limitations and lack of prospective duty framework, which considerably diminishes its protective effect compared to the UK model.*[44]

The bifurcated nature of the regime is as follows, *those who had reasonable grounds to suspect the insolvency of the company (the potential section 588G liability) and those who had no such grounds (no liability).*[45] The twilight zone, the stipulated time frame in which financial distress is discernible yet reasonable grounds to suspect insolvency are unclear or contested, is still a strategically exploitable space. *The present Australian system is an incentive to evil, a director who genuinely does not know the financial position of the company may be acquitted on the basis of the reasonable belief defence more readily than one who deliberately ignored the facts.*[46] This is especially troublesome when the controlling shareholders can sway the decisions of the directors on financial information and the deployment of assets. According to Symes, the Australian insolvency law is devoid of any clear statement of purpose to guide judicial interpretation and law reform. Australia is, therefore, a warning case study, even a statutory wrongful trading liability falls short without future facing creditor oriented obligations.

[41] Intan Eow, The Door to Reorganisation, Strategic Behaviour or Abuse of Voluntary Administration? (2006) 30 Melbourne University Law Review 300, 310–16.
[42] ibid 333–335.
[43] Corporations Act 2001, s 588H(2).
[44] Andrew Keay and Michael Murray, Making Company Directors Liable, A Comparative Analysis of Wrongful Trading in the United Kingdom and Insolvent Trading in Australia (2005) 14 International Insolvency Review 27, 30–35.
[45] Mayanja (n 35) 905–908.
[46] Symes (n 41) 75–76.

The takeaway for India is that having a statutory provision banning insolvent trading in isolation, without integrating it into a larger prospective regime of creditors duties, does not address the twilight zone issue. Such a provision, which activates itself only once insolvency has been established and can be negated by the allegation that a director did not know about the condition of the company, provides retrospective, rather than prospective, protection to creditors. India would therefore do well not to view such an isolated provision as a solution to its twilight zone issues.

D. India's Insolvency Process (Mechanics and the Strategic Timing Gap)

The corporate insolvency resolution process is laid down in Chapter II of the IBC 2016. *Section 10*[47] *is a voluntary petition* that may be filed by a corporate debtor before the NCLT initiating the corporate insolvency resolution process. The timing of voluntary Section 10 filings is largely at the discretion of the directors. The Supreme Court *in the case of Indian Overseas Bank v RCM Infrastructure Ltd*[48] had opined that once the CIRP is opened, no action can be taken to foreclose, recover or enforce any security interests. *The Bankruptcy Law Reforms Committee (BLRC) envisioned moratorium as a process of collective insolvency to maximize enterprise value and to stop the creditors from being divided up between those that default and those that make a timely payment.*[49] *An Interim Resolution Professional (IRP)*[50] takes charge of assets and operations from the beginning of the moratorium until a resolution is declared in the resolution period of 180 days. The committee of creditors thus evaluates and proposes a resolution plan proposing the sale of assets. NCLT under section 31 approves the said plan in action if it fulfils the statutory requirements. *In the case of Essar steel India vs Satish Kumar*[51]*,* Supreme Court held code places a major decision making power in hands of creditor once the process is initiated. *If no plan is approved in a time period of 180 days which at discretion can be extended to 330 days then the debtors proceed with liquidation.*[52]

The big problem with this architecture is that the decision to undertake a voluntary administration is largely in the hands of the directors. The Supreme Court *in the case of Manish*

[47] Insolvency and Bankruptcy Code 2016, s 10(1).
[48] Indian Overseas Bank v RCM Infrastructure Ltd (2022) 10 SCC 516 (24) (SC).
[49] Bankruptcy Law Reforms Committee, The Report of the Bankruptcy Law Reforms Committee Volume I, Rationale and Design (Ministry of Finance 2015) 14–18.
[50] Insolvency and Bankruptcy Code 2016, ss 16(1), 21–26.
[51] Committee of Creditors of Essar Steel India Ltd v Satish Kumar Gupta (2020) 8 SCC 531 (73)–(76) (SC).
[52] Insolvency and Bankruptcy Code 2016, s 12.

Kumar v. Union of India[53] held that the corporate debtors have the discretion to file Section 10 Petition when insolvency is likely to arise or suffer material loss. Instead, the Court acknowledged that the decision to commence CIRP is one of management's business decisions. This discretionary filing window may be termed an insolvency timing gap an opportunity for companies to file to hold the moratorium, but not to file, and thus prevent creditors from becoming part of the collective insolvency scheme. In the meantime, the creditors do not have any statutory protection against diminishing assets and directors are not legally required to keep the assets in good standing or to take creditor interests into account. *The IBC is mainly a regime for the post default phase of insolvency, rather than one with a governance focus during the approach to insolvency stage, as Umakanth Varati notes.*[54]

Go First commenced the CIRP proceedings in May 2023, when the airline was already in serious financial difficulty, fuel suppliers, aircraft lessors and operational creditors had a growing number of arrears. *The moratorium for creditor actions was in place once the Section 14 moratorium took effect on admission.*[55] None of the purchasers eventually proved to be able to purchase the airline as a going concern. By the time the Section 10 filing was made, the state of the airline's finances had worsened significantly, and the NCLT determined that rehabilitation was no longer possible. The creditors were unable to either avail themselves of the security mechanism or have a chance of negotiating for recovery from the business, even before the filing took place, when the value of the assets and relationships was more than they would be after the filing took place. *This point was reemphasized in the NCLT Order of January 2025 in the case of Shailendra Ajmera v Go Airlines (India) Ltd*[56]*,* wherein it was held that by the end of the resolution process, no viable resolution applicant had come forward and liquidation became unavoidable. The Go first case showed that before section 10 filing directors did not consider the interests of creditors during the financial distress and second, section 14 cannot reinstate assets value that may have been lost in the prefiling twilight zone.

Section 10 discretion and section 14 automaticity thus present a major structural paradox. The Code provides broad protection to creditors after the insolvency proceedings are formally

[53] Manish Kumar v Union of India (2021) 5 SCC 1 (1)–(4) (SC).
[54] Umakanth Varottil, The Evolution of Corporate Insolvency Law in India (2021) 33 National Law School of India Review 107, 118–21; M S Sahoo, Insolvency and Bankruptcy Reforms in India (2018) IBBI Working Paper 7–9.
[55] Go Airlines (India) Ltd, CP (IB) No 264/MB/2023 (NCLT Mumbai, 10 May 2023).
[56] Shailendra Ajmera v Go Airlines (India) Ltd 2025 SCC Online NCLT 3 (NCLT Mumbai, 20 January 2025).

initiated but not much protection before the proceedings are formally initiated. Directors have a significant say on the timing of a transition from ordinary corporate governance to insolvency governance. In contrast to the graduated twilight zone doctrine in the United Kingdom, which is the right for the directors to take into account the interests of creditors as their solvency becomes impaired, and section 588G in Australia, which imposes liability after the directors have reasonable grounds for suspecting their own company is insolvent, India's doctrine is binary: freedom of management until the commencement of insolvency and collective control from that moment. *The IBC was originally conceived as a creditor InControl resolution framework which was intended to focus on collective value maximisation after the resolution, rather than a system to impose pre-insolvency fiduciary duties on directors.*[57] Remarkably, there is no mention of directors duties prior to the initiation of insolvency proceedings in the BLRC Report. The discussion of corporate governance in the report is limited to the post-CIRP stage, where the management powers are delegated to the Interim Resolution Professional as well as to the Committee of Creditors. The 'grey area' which is before the submission of a petition under Section 10 is completely omitted from the discussion of the corporate governance framework proposed by the BLRC. As such, the pre-insolvency twilight zone is governed primarily by managerial discretion and the Code regulates insolvency effectively upon the initiation of formal insolvency proceedings.

E. Risk Shifting Mechanisms and The Twilight Zone

As *Jennifer Payne and Kristin van Zwieten*[58] point out, while the director continues discretionary management in the twilight zone, the insolvency risk shifts to the creditors. The risk shifting is done using three separate channels, firstly, by choosing the optimal time to trigger the insolvency process, secondly, by transferring value via preferential and undervalued deals through the Insolvency and Bankruptcy Code (IBC) 2016, thirdly, by distributing dividends or quasi-dividends using the Companies Act 2013. All three channels rely on the same vulnerability, the absence of a creditors protection obligation before the insolvency regime begins. *Section 123*[59] provides that dividends will only be paid out of distributable profits, and must be paid in cash. This rule is a capital protection rule, meaning that capital can

[57] Bankruptcy Law Reforms Committee, The Report of the Bankruptcy Law Reforms Committee Volume I: Rationale and Design (Ministry of Finance 2015) 21–25.
[58] Jennifer Payne and Kristin van Zwieten, "Insolvency and the Twilight Zone" (2020) 136 Law Quarterly Review 248, 251–56.
[59] Companies Act 2013, s 123(1).

only be returned to shareholders through the winding up process or under section 66 of the Act. However, in the grey area between proceeding with a formal insolvency and the company facing financial problems, this prohibition is open to being circumvented. *The doctrinal answer is that companies can make arrangements that effectively transfer value to controlling shareholders without the arrangement being a dividend distribution*.[60] However, in general enforcement takes place only if insolvency proceedings have been initiated, at which time the value of the enterprise may have been lost.

Preference transactions (section 43) and undervalued transactions (section 50) of the IBC 2016 are aimed at undoing asset stripping after the commencement of insolvency. However, these provisions are retrospective and reactive, *as per Section 43 of the Act which allows avoidance of preferential transactions during the lookback period and Section 50 of the Act which deals with undervalued transactions entered into prior to CIRP.* They do not have a direct effect on the directors" actions within the twilight zone. In *Anubhav Anilkumar Aggarwal v Rajendra Kumar Girdhar*[61], the NCLAT ruled that contribution orders made pursuant to Section 66 IBC would lie against directors whose acts led to the company acquiring debt from related parties on irrational commercial grounds in that the deals looked neutral on the surface, but actually drained value from the company in order to transfer value to related parties prior to the commencement of the CIRP. This was a case of conduct in which the fraudulent trading provisions would operate to make the directors personally liable for their actions. However, although this shows that Section 66 IBC may catch some twilight zone conduct, the example shows the limits of the provision. Liability under Section 66 requires proof of fraud, an elevated standard compared to the creditor-oriented duties standard discussed in Part F below. Most twilight zone activity is strategically done, but falls far short of fraud and will not be caught by Section 66 IBC.

F. Comparative Gaps, Structural Incentives, and Reform

The IBC 2016 provides an advanced creditor protection framework in the aftermath of a resolution process, but has no discernable duty framework for creditors prior to the resolution process. The directors duty is to act in the interests of shareholders, until the point of formal

[60] Indian Seamless Enterprises Ltd., In re (2015) 193 Comp Cas 25 (Bom HC).
[61] Anubhav Anilkumar Aggarwal v Rajendra Kumar Girdhar (2025) 964 NCLAT (63)–(67).

insolvency proceedings. However, Indian law does not include any duty shifting doctrine that would progressively require directors to consider creditor interests as their company's situation became more likely to become insolvent, as is the case in the UK under the common law twilight zone doctrine which was first enunciated in *West Mercia and later developed in Sequana.*[62] This has led to greater discretion on the part of Indian directors in favour of the promoters or shareholders in case of financial distress even when the creditors have become foreseeable. This is interesting as directors duties are not specifically directed at creditors" interests when the company is in financial distress.[63] The creditor related duty framework is not in place, allowing directors to carry on with high-risk strategies, related party transactions, or postponed filings at insolvency and pass the risks on to the creditors. Indian law thus maintains the shareholder primacy model even in the "twilight" at the height of creditor vulnerability.

This structural defect has been acknowledged by the Indian academia and official reports even if the legislative response has been absent thus far. Noting the development of insolvency law in India, Umakanth Varottil points out that the entire structure of creditor protection mechanisms in the IBC operates on the assumption that the insolvency is triggered, *whereas the pre-filing stage was never within the drafting purview of the BLRC.*[64] *In its Report No 212 (2008) concerning the Companies Bill 2008, the Law Commission of India proposed making directors' obligations under what later became Section 166 contingent on the state of affairs of the firm and the duty of taking creditors into consideration while the latter was experiencing financial troubles.*[65] Recently, Pratik Datta of the National Institute of Public Finance and Policy has provided evidence suggesting that value reduction happens in many cases before CIRP commences, and that the mechanisms for avoiding loss due to directors' actions prior to CIRP are fundamentally deficient in the IBC.[66]

An insolvency-focusing fiduciary duty for India's twilight zone must be crafted in the following manner. If a director of a company has knowledge or reasonable cause to suspect that the

[62] West Mercia Safety wear Ltd v Dodd (1988) BCLC 250 (CA), BTI 2014 LLC v Sequana SA (2022) UKSC 25.
[63] Companies Act 2013, s 166.
[64] Varottil (n 58) 120–21.
[65] Law Commission of India, Report No 212 on the Companies Bill 2008 (Ministry of Law and Justice 2008) para 3.7.
[66] Pratik Datta, Value Destruction and Wealth Transfer under the Insolvency and Bankruptcy Code 2016 (NIPFP Working Paper No 247, December 2018) 8–12.

company may become insolvent within a period of twelve months from that point in time, then it shall be the duty of such a director to take all measures that are reasonably feasible for minimizing losses for the creditors, which include abstaining from engaging in transactions that will decrease the availability of assets to the creditors, stopping the creation of liabilities that are not likely to be fulfilled, and deciding whether it would be in the best interests of the creditors to apply for the commencement of the corporate insolvency resolution procedure. The test – reasonable cause to believe insolvency is an objective one, based on the financial status of the company that is known to the director through the information available to him or her.

Such a duty not being provided for in India is not an omission, but stems from the realities of India's political economy of promoter-dominated corporate governance. In the vast majority of the listed companies in India, the promoter group holds majority stake in the company, effectively controlling its board composition and disclosures. Since directors nominated by promoter groups will have built-in conflicts, they are likely to defer to the interests of the promoter group by delaying the filing of a resolution process to allow for the transfer of control to the Committee of Creditors and thereby the dilution of their stake. While the IBC 2016 Act, through the provision of Section 29A on promoter bids for companies assets under the resolution process, does provide for some kind of disincentive in this twilight zone, no changes have been seen as far as the structural conflict is concerned. So far, there have not been any consultations by either the MCA or the IBBI regarding the duty of directors pre insolvency, a silence similar to that in the legislature. *The UK and Australia have a similar experience to illustrate the importance of this gap. The UK model recognises that there is no "right" or "wrong" insolvency, but rather a "falling apart" process.*[67] As a result, the decision-making focus of the directors will gradually move in the direction of bankruptcy. Australia's section 588G, by contrast, is designed to be a measure of restraint to be employed when directors have "reasonable grounds" for suspecting the company is insolvent, and in its current form is clearly limited in scope and evidence by its retrospective nature, as discussed in Section C. *The law is highly prescriptive with respect to what occurs after insolvency, and less so with respect to what occurs before.*[68]

[67] Preetha S, "The Fraudulent Trading Offence: Need for a Relook" (2011) 4 NUJS Law Review 231, 236–37.
[68] Andrew Keay and Michael Murray, "Making Company Directors Liable: A Comparative Analysis of Wrongful Trading in the United Kingdom and Insolvent Trading in Australia" (2005) 14 International Insolvency Review 27, 30–35.

The institution-based approach towards reform is important. An amendment of either the Companies Act 2013 or the IBC 2016 will have to involve parliament and hence will always be politically uncertain. Nevertheless, a focused solution to the problem can perhaps be attempted via the IBBI's regulation-making powers granted in Section 240 of the IBC 2016, where the Board is given the power to make regulations consistent with the Code. This will allow IBBI to introduce via regulations a mandate for companies solvency certification. Herein, directors would be mandated to periodically (quarterly) undertake the certification of solvency and the failure to provide such a certification or the falsification of the same shall be met with personal liability for all transactions undertaken by the company after that particular date. This solution does not need another legislative amendment and takes advantage of IBBI regulations. As it currently stands, the Company Secretary, being a statutory officer under Section 203, would be well placed for carrying out such solvency certification due to his independence, knowledge of financial affairs, and the ability to communicate to the NCLT/IBBI without fear of manipulation by the promoters.

Insofar as any reform proposals concerning the issue at hand in India have been forthcoming, these have been few and indirect in nature. For instance, the Insolvency Law Committee's reports of 2018 and 2020 were mainly concerned with streamlining the procedures concerning the CIRP timeline and the approval of resolution plans, with neither making any substantial attempt to address the problem of governance in the twilight zone. Moreover, even the IBBI's discussion papers on corporate governance in insolvency were limited in scope to matters that arise after CIRP. It is perhaps unsurprising that no reform proposal to date has dealt with pre-insolvency director responsibilities considering the arguments made above regarding political economy. *The current Indian regime creates a regulatory imbalance as directors have much discretion during the distress while the creditors have protection only after the formal insolvency proceedings are initiated.*[69]

Based on comparative literature, there is need to consider that creditor-protecting duties must be rooted in judicial standards that are more principle-based than strictly prescriptive in nature. In relation to India's NCLT adjudication process, what this implies is that there should be no implementation of a check-list of prohibited transactions as the mechanism of establishing the

[69] Kristin van Zwieten, Risk Shifting and the Twilight Zone of Directors Duties (2018) 38 Oxford Journal of Legal Studies 641.

proposed duty. *Rather, it must be determined during the process of adjudication, by the NCLT itself, if the director, in knowing or having reason to know of his/her insolvency, had taken steps that were reasonable enough in order to reduce creditor losses.*[70]

G. CONCLUSION

The Insolvency and Bankruptcy Code of 2016 marks the beginning of a transformation in the structure of Indian insolvency law. It has shortened resolution times, adopted a creditor-centric approach through the Committee of Creditors, and established a quasi-judicial regulation framework through the IBBI. These are indeed accomplishments. However, what has been highlighted in this article is the fact that while the transforming impact of the IBC functions effectively from the point of declaration of insolvency onwards, there remains a Gray area the phase preceding the Section 10 declaration. As far as the first research question goes, the structural gap that exists in India's law framework is evident. First off, the Companies Act 2013 lays down six obligations that all directors must adhere to, but they are all formulated based on the principle of going concern only. On the other hand, there are no specific director obligations under the IBC 2016 during the pre-filing stage. There is also no doctrine similar to the twilight zone concept of the UK in which the duty would require directors to take into account creditor interests to a greater extent when the possibility of insolvency becomes more likely.

As far as the second research question is concerned, the Go First case is an example that proves the practical implications of such a lack of legal measures. In that regard, the directors have remained free to decide when to file a petition for winding up while at the same time the firm was deteriorating financially, while the claims of its creditors were growing and their value was diminishing. Once the Section 14 moratorium had been introduced, the process of piecemeal collection has stopped; however, no additional protection could be provided because of the loss of asset value that occurred during the pre-insolvency period.

In response to the third research question, the reform necessary is a measured one rather than a total one. While India would do well to consider the wrongful trading legislation of the UK, or the insolvent trading regime of Australia, both such systems have drawbacks of their own, and neither can apply to the situation in India because of its promoter-based business culture.

[70] Mayanja (n 35) 905–08.

What is required in such a situation is the formulation of an obligation on the part of the directors who know of their likely insolvency, to act to minimize losses to creditors without being forced to file for insolvency prematurely. This obligation can be institutionalized using the mandatory solvency certification process, with the Company Secretary as the person in charge of doing this certification, which can easily be done under the regulation-making powers provided under Section 240 IBC without the need for any legislative changes in Parliament.